

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

**MUNICIPIO DE LARES
AUDITORÍA 2010-2011
30 DE JUNIO DE 2011**

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES**

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES
BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

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**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES
BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

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PART I - FINANCIAL SECTION

INDEPENDENT AUDITORS' REPORT

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

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

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and 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, the respective financial position of the governmental activities, each major fund and the aggregate remaining fund information of the Municipality of Lares as of June 30, 2011, and the respective changes in financial position thereof for the fiscal year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated February 21, 2012 on our consideration of the Municipality's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grants, agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis on pages 3 through 15, and the Budgetary Comparison Schedule on page 52 are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Municipality of Lare'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 basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements, and in our opinion, the information is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

San Juan, Puerto Rico
February 21, 2012

Ortiz, Rivera, Rivera & Co.

The stamp E18909 was affixed to the original of this report.



Commonwealth of Puerto Rico
MUNICIPALITY OF LARES, PUERTO RICO
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2011

The following discussion and analysis of the Municipality of Lares' 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 \$13,656,204 (net assets).
- Revenues increased by \$4,445,118 (23%) and expenses increased by \$938,884 (6%) in comparison with year 2010.
- Net change in net assets amounted to \$4,392,073, an increase of 396% 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 \$5,216,129, an increase of \$1,117,204 in comparison with the prior year.
- The General Fund reported an excess of expenditures over revenues and other financing uses of (\$313,930) and an unassigned (deficit) fund balance of (\$5,920,579). Unassigned (deficit) fund balances increased by (\$1,000,900) from prior year.

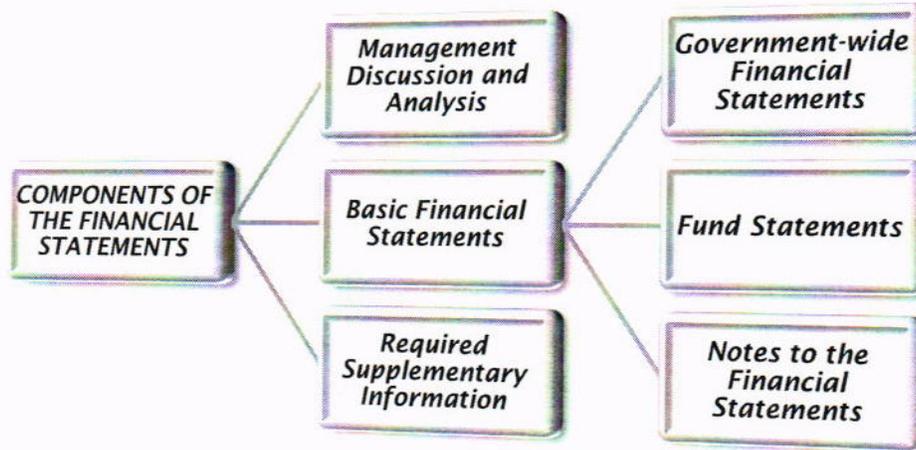
General Financial Highlights

- The investment in net capital assets as of June 30, 2011 was \$9,811,259 (net of related debt).
- Long-term debt general and special obligations bonds decreased by \$545,000, approximately 10% with respect to prior year balance.
- Other long-term debts net reductions from payments amounted to \$618,903.
- On a budgetary basis, actual expenditures exceeded actual revenues by \$576,336.
- Revenues increase was mainly due to an increase of \$343,476 in Construction Excise Taxes and \$2,069,671 in Intergovernmental revenues, also the Municipality realized economies, principally in Public Safety (\$115,859).

Commonwealth of Puerto Rico
MUNICIPALITY OF LARES, PUERTO RICO
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2011

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.

Commonwealth of Puerto Rico
MUNICIPALITY OF LARES, PUERTO RICO

MANAGEMENT'S DISCUSSION AND ANALYSIS

FOR THE FISCAL YEAR ENDED JUNE 30, 2011

- ***Fund Financial Statements***

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

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

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

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

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

- ***Required Supplementary Information***

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

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 27% with respect to prior year as restated. The most significant changes were an increase in Current and Non-Current Assets of \$3,306,041 and a decrease in Unrestricted of (\$2,289,991).

Commonwealth of Puerto Rico
MUNICIPALITY OF LARES, PUERTO RICO
MANAGEMENT'S DISCUSSION AND ANALYSIS
 FOR THE FISCAL YEAR ENDED JUNE 30, 2011

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

Table 1

Commonwealth of Puerto Rico
Municipality of Lares, Puerto Rico
Statement of Net Assets
For the Fiscal Years Ended June 30, 2011 and 2010

	2011	2010
Current and Non-Current Assets	\$ 12,333,157	\$ 10,214,914
Capital Assets	<u>12,710,259</u>	<u>11,519,461</u>
Total Assets	<u>25,043,416</u>	<u>21,734,375</u>
Current Liabilities	3,515,827	2,733,884
Deferred Revenues	585,957	590,120
Long-Term Liabilities	<u>7,285,428</u>	<u>8,537,568</u>
Total Liabilities	<u>11,387,212</u>	<u>11,861,572</u>
Net Assets:		
Investment in Capital Assets, Net of Related Debt	9,811,259	7,066,461
Restricted (as Restated)	7,251,297	8,491,633
Unrestricted	<u>(3,406,352)</u>	<u>(5,597,054)</u>
Total Net Assets	<u>\$ 13,656,204</u>	<u>\$ 9,961,040</u>

The largest portion of the Municipality's net assets reflects its investment in capital assets (e.g., land, buildings, equipment, and infrastructure) for \$9,811,259; total capital assets (\$18,257,051) less accumulated depreciation of (\$5,546,792) and less any related outstanding debt (\$2,899,000) used to acquire or construct those assets. The Municipality uses these assets to provide services to its citizens and consequently, these assets are not available for future spending. The resources needed to repay the debt related to these capital assets must be provided from other sources, because capital assets are not generally liquidated for the purposes of retiring debt.

Restricted net 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 (deficit) net assets of (\$3,406,352). This balance was affected by long term obligations such as compensated absences \$1,519,784 and other debts for the amount of \$1,886,568 for which the Municipality did not provide funding in previous budgets. Historically, such obligations have been budgeted on a pay as you go basis without providing funding for their future liquidation.

Commonwealth of Puerto Rico
MUNICIPALITY OF LARES, PUERTO RICO
MANAGEMENT'S DISCUSSION AND ANALYSIS
 FOR THE FISCAL YEAR ENDED JUNE 30, 2011

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 Lares, Puerto Rico		
Changes in Net Assets		
For the Fiscal Years Ended June 30, 2011 and 2010		
	2011	2010
Revenues:		
Program Revenues:		
Charges for Services	\$ 385,395	\$ 384,940
Operating Grants and Contributions	3,543,564	1,502,551
General Revenues:		
Property Taxes	2,720,119	2,622,113
Volumen of Business Taxes	811,823	829,703
Sales and Usage Taxes	994,827	1,018,486
Construction Taxes	540,241	196,765
Intergovernmental	10,101,325	8,031,654
Other General Revenues	390,969	456,933
Total Revenues	<u>19,488,263</u>	<u>15,043,145</u>
Expenses:		
General Administration	6,891,783	5,759,502
Public Safety	830,104	945,963
Public Works	2,983,070	3,085,735
Culture and Recreation	729,424	685,479
Health and Sanitation	1,131,480	1,199,729
Solid Waste Disposal	422,960	475,184
Public Instruction	26,182	50,462
Human Services and Welfare	841,733	852,774
Urban Development	1,006,526	855,033
Interest Costs	232,928	247,445
Total Expenses	<u>15,096,190</u>	<u>14,157,306</u>
Changes in Net Assets	4,392,073	885,839
Net Assets-Beginning, as Restated	9,264,131	9,075,201
Net Assets-Ending	<u>\$ 13,656,204</u>	<u>\$ 9,961,040</u>

Commonwealth of Puerto Rico
MUNICIPALITY OF LARES, PUERTO RICO
MANAGEMENT'S DISCUSSION AND ANALYSIS
 FOR THE FISCAL YEAR ENDED JUNE 30, 2011

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

FIGURE 1

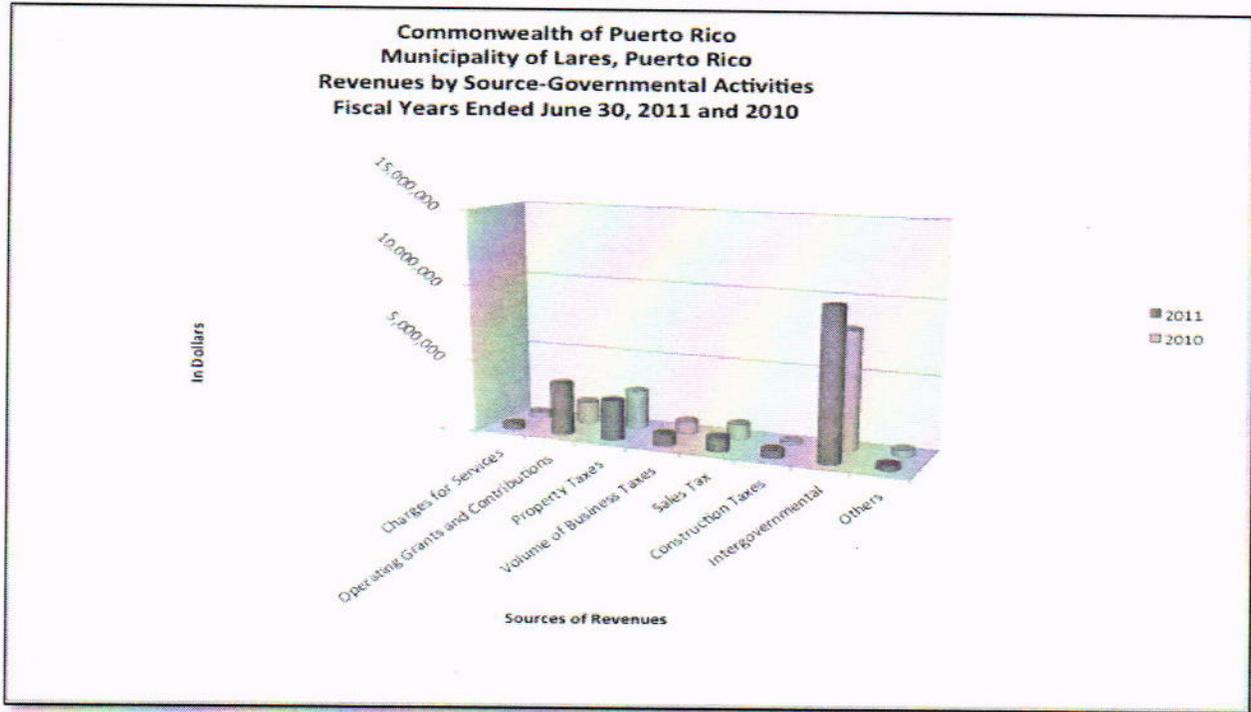
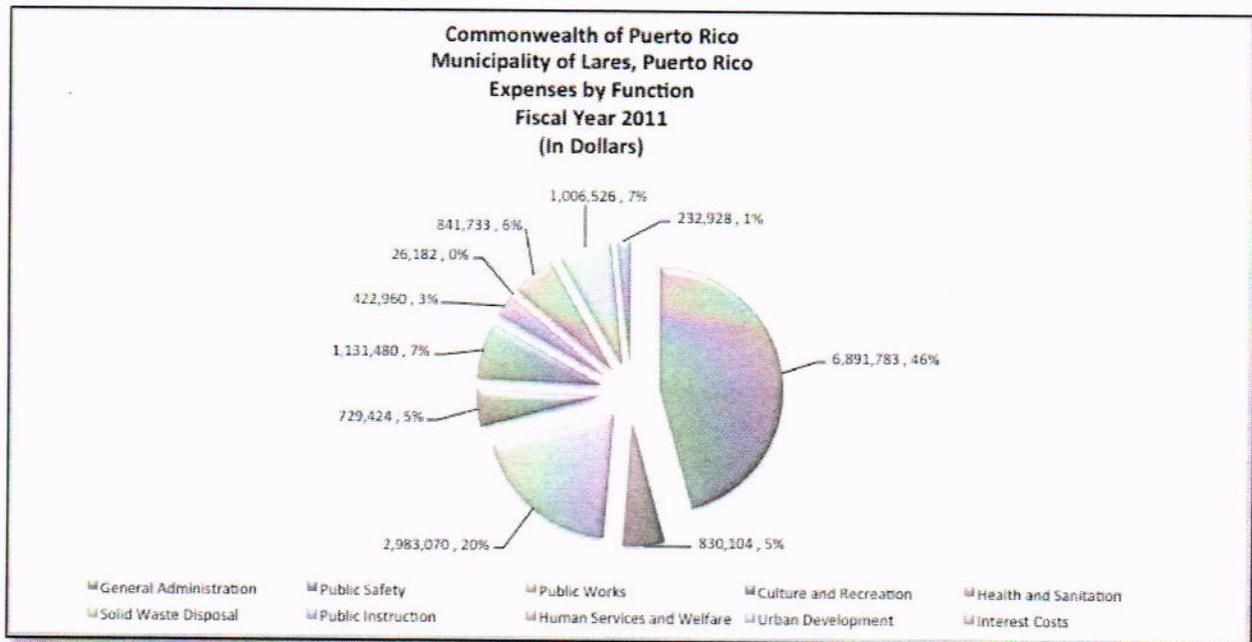


Figure 2 presents expenses by function of the governmental activities during the fiscal year 2011-2010:

FIGURE 2



**Commonwealth of Puerto Rico
MUNICIPALITY OF LARES, PUERTO RICO**

MANAGEMENT'S DISCUSSION AND ANALYSIS

FOR THE FISCAL YEAR ENDED JUNE 30, 2011

Approximately 52% of the Municipality's revenues came from intergovernmental, 18% from grants and contributions, 14% from property taxes, and 16% from other sources. The Municipality's expenses cover a range of services. The largest expenses are general administration with 46%, public works with 20%, health and sanitation with 7%, public safety with 5%, urban development with 7% and human services and welfare with 6%. Program revenues of the Municipality covered 20% of total expenses.

With respect to prior year, revenues increased by approximately \$4,445,118, principally on Intergovernmental.

Expenses increased 6.22% or \$938,884 in comparison with 2010 year. Significant decreases were registered on public safety, public works and health and sanitation services incurred for the benefit of the community.

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 Lares, Puerto Rico
Net Cost of Municipality's Governmental Activities
For the Fiscal Years Ended June 30, 2011 and 2010**

Functions/Programs	Total Cost of Services		Net Cost of Services	
	2011	2010	2011	2010
General Administration	\$ 6,891,783	\$ 5,759,502	\$ 6,506,388	\$ 5,374,562
Public Safety	830,104	945,963	830,104	945,963
Public Works	2,983,070	3,085,735	2,983,070	3,085,735
Culture And Recreation	729,424	685,479	729,424	685,479
Health and Sanitation	1,131,480	1,199,729	1,131,480	1,199,729
Human Services and Welfare	841,733	852,774	(566,173)	373,562
Urban Development	1,006,526	855,033	(1,129,132)	(168,306)
Others	682,070	773,091	682,070	773,091
Total	\$ 15,096,190	\$ 14,157,306	\$ 11,167,231	\$ 12,269,815

Some of the cost of governmental activities in 2011 was paid by those who directly benefited from the programs (\$385,395) and other governments and organizations that subsidized certain programs with grants and contributions (\$3,543,564). The \$11,167,231 net cost of services was substantially covered by other general revenues including property, volume of business license taxes, the sales and usage taxes and intergovernmental.

Commonwealth of Puerto Rico
MUNICIPALITY OF LARES, PUERTO RICO

MANAGEMENT'S DISCUSSION AND ANALYSIS

FOR THE FISCAL YEAR ENDED JUNE 30, 2011

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.

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 \$5.2 million. Approximately (\$5.8) million of this amount isn't 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. For the fiscal year ended June 30, 2010, the governmental funds reported combined ending fund balances of \$4.1 million, with a net increase of approximately \$1,117,204 in comparison with the current year. This increase was due primarily to funds assigned by the State Legislature.

Table 4

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

	2011	2010
Fund Balances:		
Nonexpendable	\$ -	\$ -
Restricted	10,889,112	8,810,655
Committed	64,641	187,678
Assigned	115,620	70,050
Unassigned	(5,853,244)	(4,969,458)
Total	\$ 5,216,129	\$ 4,098,925

Table 5

**Commonwealth of Puerto Rico
Municipality of Lares, Puerto Rico
General Fund
As of June 30,**

Description	2011	2010
Revenues:		
Property Taxes	\$ 1,877,704	\$ 2,055,240
Volume of Business Taxes	811,823	829,703
Intergovernmental	6,301,691	6,043,702
Construction Excise Taxes	540,241	196,765
Sales and Usage Taxes	689,033	696,469
Rent	136,976	206,495
Miscellaneous	614,036	607,132
Total Revenues	10,971,504	10,635,506
Expenditures:		
General Government	4,832,615	4,472,868
Public Safety	816,194	922,444
Public Work	2,721,560	2,398,135
Culture and Recreation	711,023	617,333
Health and Sanitation	1,108,478	1,177,348
Solid Waste Disposal	422,960	475,184
Human Services and Welfare	583,089	591,182
Urban Development	38,167	49,858
Capital Outlay	51,348	36,599
Total Expenditures	11,285,434	10,740,951
Net Transfer In (Out)	(262,406)	700,094
Other Financing Sources	-	-
Net Increase in Fund Balance	\$ (576,336)	\$ 594,649

**Commonwealth of Puerto Rico
MUNICIPALITY OF LARES, PUERTO RICO**

MANAGEMENT'S DISCUSSION AND ANALYSIS

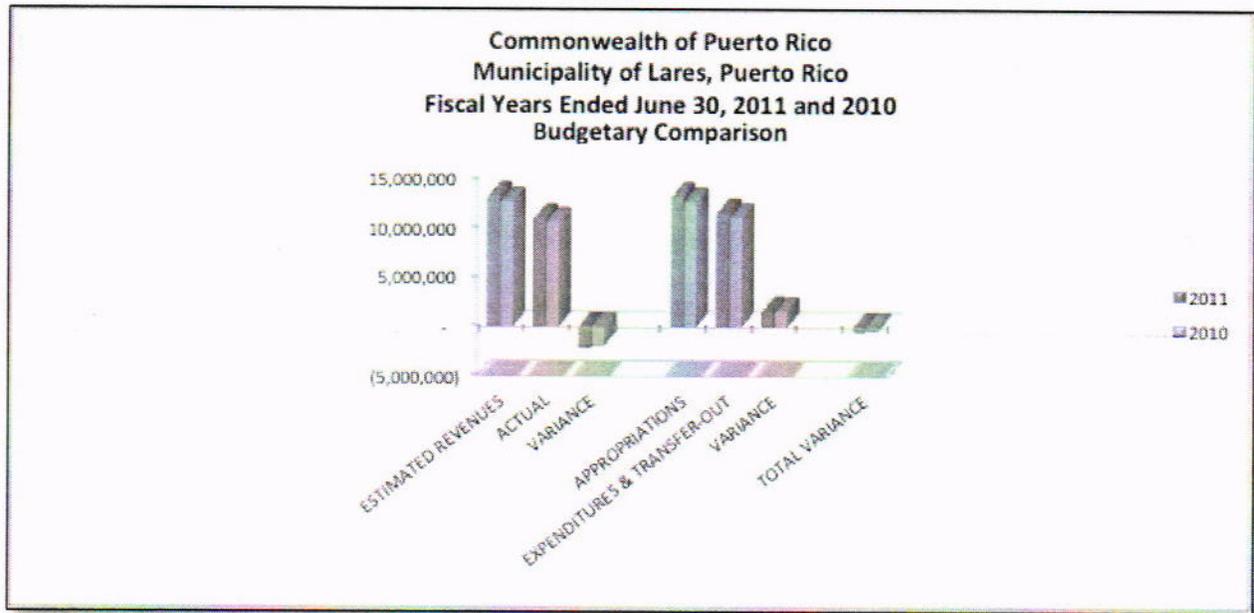
FOR THE FISCAL YEAR ENDED JUNE 30, 2011

The general fund is the operating fund of the **Municipality**. Unassigned Fund Balance of the General Fund represents approximately 192.6% of total fund balances and 103.4% of total ending General Fund Balance, which is not in compliance with Fund Balances Policies. For the year ended June 30, 2011, the fund balance of the general fund decreased by (\$576,336) when compared with the prior year.

GENERAL FUND BUDGETARY HIGHLIGHTS

The general fund original budget for the fiscal period 2010-2011 presented an increase of 4% with respect to prior year budget. During the fiscal year the Municipality did not revise the total budget revenues or appropriation, but the appropriation were revised at department level. The Municipality does not amend the budget for the reduction on projected revenues in property taxes, volume of business taxes, construction excise taxes and miscellaneous revenues, nor for the sales and usage taxes.

FIGURE 3



The negative variance of \$573,729 between revised budget and actual expenditures was due mainly to reduction in revenues as explained in the preceding paragraph in excess of economies in some functions. The Municipality reported less expenditure than appropriations in those functions for payments to purchase of supplies, professional and nonprofessional services.

Commonwealth of Puerto Rico
MUNICIPALITY OF LARES, PUERTO RICO
MANAGEMENT'S DISCUSSION AND ANALYSIS
 FOR THE FISCAL YEAR ENDED JUNE 30, 2011

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

At the end of the fiscal year, the Municipality has invested \$12,710,259 (net of accumulated depreciation) in a broad range of capital assets, including buildings, land, construction in progress and equipment. This amount represents a net increase of \$1,190,798 or 9% from the prior year, as restated.

Table 6

Commonwealth of Puerto Rico
Municipality of Lares, Puerto Rico
Capital Assets (Net)
For the Fiscal Years Ended June 30, 2011 and 2010

	Governmental Activities	
	2011	2010
Non-depreciable assets:		
Land	\$ 3,619,954	\$ 3,210,794
Construction in Progress	1,148,431	2,258,051
Depreciable assets:		
Buildings	6,321,715	4,798,518
Equipment and Vehicles	256,985	404,365
Furniture and Fixtures	36,447	43,843
Heavy Equipment	507,987	558,773
Infrastructure	818,740	245,117
Total	\$ 12,710,259	\$ 11,519,461

The Municipality acquired a total of \$506,164 of capital assets during the fiscal year 2010-2011 as follows:

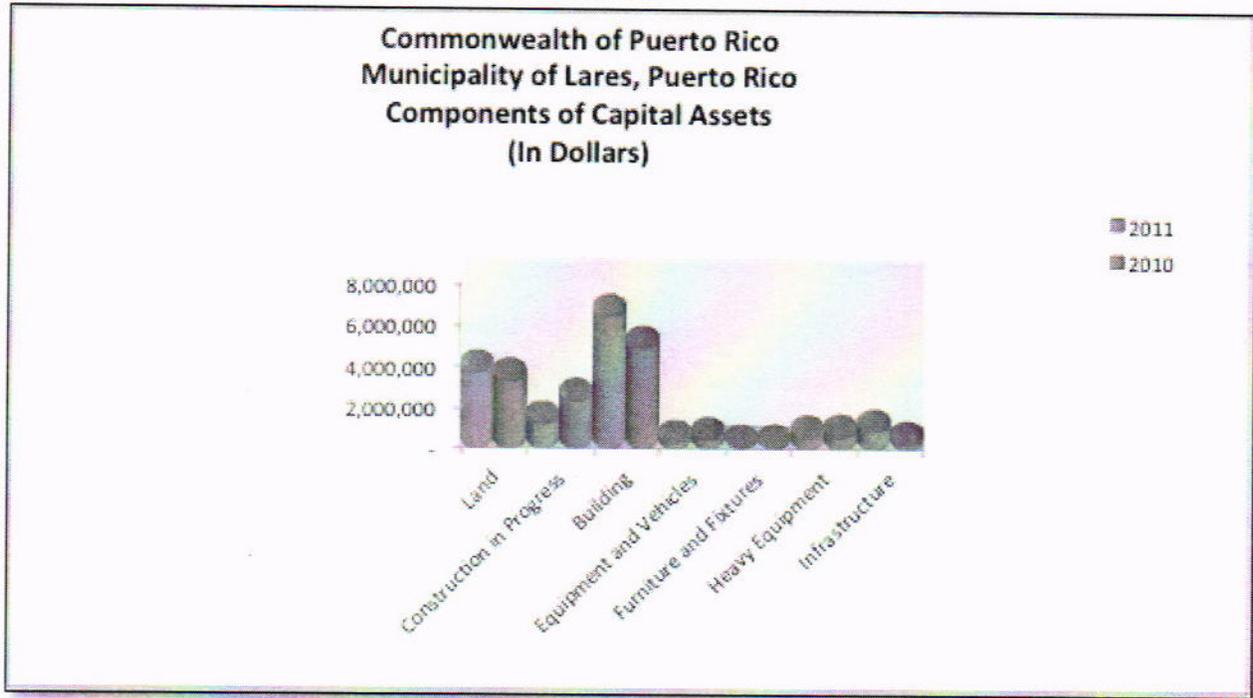
- Land – \$409,160
- Acquisition of Equipment and Vehicles – \$57,666
- Acquisition of Furniture and Fixtures - \$2,800
- Construction in Progress - \$1,152,899

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

Commonwealth of Puerto Rico
MUNICIPALITY OF LARES, PUERTO RICO
MANAGEMENT'S DISCUSSION AND ANALYSIS
 FOR THE FISCAL YEAR ENDED JUNE 30, 2011

Figures 4 below present the components of capital assets during the fiscal years 2011 and 2010:

FIGURE 4



Long-Term Debts

At year-end, the Municipality had \$4,708,000 in general and special obligation bonds, a decrease of 10% with respect to prior year. The following is a summary of the Municipality's outstanding debt as of June 30, 2011 and 2010:

Table 7

**Commonwealth of Puerto Rico
 Municipality of Lares, Puerto Rico
 Outstanding Long-term Debt
 For the Fiscal Years Ended June 30, 2011 and 2010**

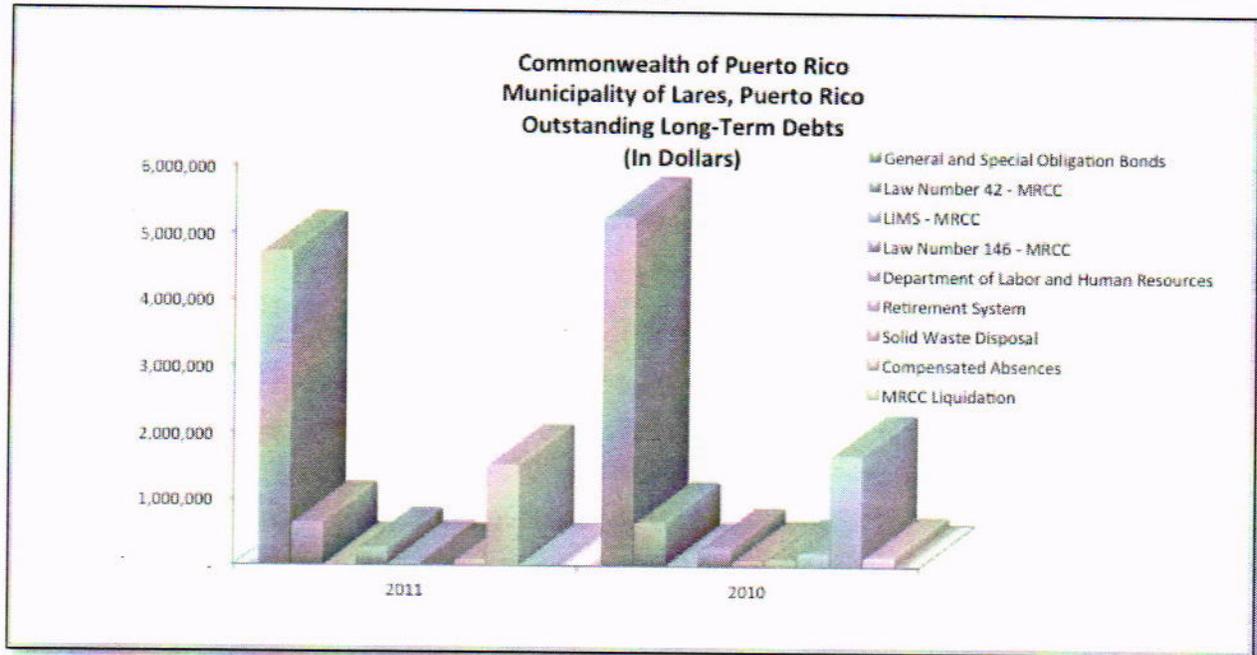
	2011	2010
General and Special Obligation Bonds	\$ 4,708,000	\$ 5,253,000
Law Number 42 - MRCC	645,395	659,497
LIMS - MRCC	14,777	42,189
Law Number 146 - MRCC	256,362	268,570
MRCC Liquidation	-	144,986
Department of Labor and Human Resources	49,410	84,285
Retirement System	-	107,662
Solid Waste Disposal	92,000	212,000
Compensated Absences	1,519,784	1,677,142
Total	\$ 7,285,728	\$ 8,449,331

More detailed information about the Municipality's long-term liabilities is presented in Note 9 to the financial statements.

Commonwealth of Puerto Rico
MUNICIPALITY OF LARES, PUERTO RICO
MANAGEMENT'S DISCUSSION AND ANALYSIS
 FOR THE FISCAL YEAR ENDED JUNE 30, 2011

Figure 5 present the components of long-term debts during the fiscal year 2011 and 2010:

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 18.9%, which compares with the Commonwealth rate of 16%.

The Municipality applied an aggressive approach in development budget estimates. Amounts available for appropriations in the General Fund for the fiscal year 2011-2012 are \$13.8 million, approximately \$680,000 more than the fiscal year 2011. The Municipality expects an increase in revenues for the next year due to new construction projects. Budgeted expenditures are expected to stabilize accordingly to the projected revenues. Among planned projects, this budget may be adjusted in accordance with economic injection projected when the construction project promoted by the Municipality and others private projects were develop during the year.

Commonwealth of Puerto Rico
MUNICIPALITY OF LARES, PUERTO RICO
MANAGEMENT'S DISCUSSION AND ANALYSIS
 FOR THE FISCAL YEAR ENDED JUNE 30, 2011

AMERICAN RECOVERY AND REINVESTMENT ACT

The Municipality expended the following federal awards from the American Recovery and Reinvestment Act during fiscal year 2010-2011. These awards corresponded to fiscal year 2009-2010 that were carry forward during current year:

Federal Program	CFDA Number	Total Award	Total Expended
Federal Transit – Bus and Other Motor Vehicle Transit Systems (0.73 jobs)]	20.500	\$1,208,942	\$ 898,625
Department of Housing and Urban Development – Puerto Rico State Homeless Prevention and Rapid Rehousing Program	14.262	452,355	138,460
Department of Justice – Justice Assistance Grant Program	16.803	178,373	89,186
Department of Energy - Energy Efficiency and Conservation Block Grant Program [To change lights in Félix Méndez Sport Complex (0.93) job]	81.128	<u>156,900</u>	<u>17,500</u>
Total		<u>\$1,996,570</u>	<u>\$1,143,771</u>

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) 897-2300] or P.O. Box 395, Lares, Puerto Rico 00669.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES, PUERTO RICO

STATEMENT OF NET ASSETS

JUNE 30, 2011

	GOVERNMENTAL ACTIVITIES
ASSETS:	
Cash and Investments (Note 3)	\$ 6,901,769
Cash with Fiscal Agent (Note 3)	2,050,831
Receivables (net):	
Property Taxes	9,613
Sales and Usage Taxes	57,542
Federal Grants	3,117,584
Others	5,102
Due from Local Government (Note 4)	<u>164,540</u>
Deferred Charges	<u>26,176</u>
Capital Assets:	
Land, Improvement and Construction in Progress (Note 8)	4,768,385
Other Capital Assets [Net of Depreciation] (Note 8)	<u>7,941,874</u>
Total Capital Assets	<u>12,710,259</u>
TOTAL ASSETS	<u>25,043,416</u>
LIABILITIES:	
Accounts Payable and Accrued Expenses	3,029,906
Accrued Interest	75,449
Due to Governmental Units (Note 7)	410,472
Deferred Revenues (Note 5)	585,957
Long-Term Liabilities:	
Due Within One Year (Note 9)	1,582,151
Due in More than One Year (Note 9)	<u>5,703,277</u>
TOTAL LIABILITIES	<u>11,387,212</u>
NET ASSETS:	
Investment in Capital Assets, Net of Related Debt	9,811,259
Restricted for:	
Capital Projects	2,969
Debt Services	1,954,034
Community Development Projects	2,700,022
Other Purposes	2,594,272
Unrestricted (Deficit)	<u>(3,406,352)</u>
TOTAL NET ASSETS	<u>\$ 13,656,204</u>

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES, PUERTO RICO

STATEMENT OF ACTIVITIES

FOR THE FISCAL YEAR ENDED JUNE 30, 2011

Functions/Programs	Expenses	Program Revenues			Net (Expense) Revenues
		Charges For Services	Operating Grants and Contributions	Capital Grants and Contributions	
Governmental Activities:					
Mayor and Municipal Legislature	\$ 569,518	\$ -	\$ -	\$ -	\$ (569,518)
General Government	6,322,265	385,395	-	-	(5,936,870)
Public Safety	830,104	-	-	-	(830,104)
Public Works	2,983,070	-	-	-	(2,983,070)
Culture and Recreation	729,424	-	-	-	(729,424)
Health and Sanitation	1,131,480	-	-	-	(1,131,480)
Solid Waste Disposal	422,960	-	-	-	(422,960)
Public Instruction	26,182	-	-	-	(26,182)
Human Services and Welfare	841,733	-	1,407,906	-	566,173
Urban Development	1,006,526	-	2,135,658	-	1,129,132
Interest on Long-Term Debt	232,928	-	-	-	(232,928)
Total Governmental Activities	\$ 15,096,190	\$ 385,395	\$ 3,543,564	\$ -	(11,167,231)
General Revenues:					
Taxes:					
Property Taxes, levied for General Purposes (Note 11)					1,877,704
Property Taxes, levied for Debt Service (Note 11)					842,415
Sales and Usage Taxes (Note 13)					994,827
Volume of Business Taxes (Note 12)					811,823
Construction Excise Taxes (Note 14)					540,241
Intergovernmental (Note 15)					10,101,325
Rent					136,976
Miscellaneous					253,993
Total General Revenues					<u>15,559,304</u>
CHANGES IN NET ASSETS					
					4,392,073
Net Assets – At Restated, at Beginning of Year (Note 19)					<u>9,264,131</u>
NET ASSETS – ENDING OF YEAR					<u>\$ 13,656,204</u>

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES, PUERTO RICO
BALANCE SHEET - GOVERNMENTAL FUNDS

JUNE 30, 2011

	GENERAL FUND	SBGP FUND	STATE ASSIGNMENTS FUND	DEBT SERVICE FUND	OTHER GOVERNMENTAL FUNDS	TOTAL GOVERNMENTAL FUNDS
ASSETS:						
Cash and Investment (Note 3)	\$ -	\$ 57	\$ 4,915,658	\$ -	\$ 1,986,054	\$ 6,901,769
Cash with Fiscal Agent (Note 3)	15,251	-	-	2,019,870	15,710	2,050,831
Receivables:						
Property Taxes	-	-	-	9,613	-	9,613
Sales and Usage Taxes	57,542	-	-	-	-	57,542
Federal Grants	-	3,117,584	-	-	-	3,117,584
Due from Other Funds (Note 6)	-	-	2,962,281	-	-	2,962,281
Due from Governmental Units (Note 4)	-	-	-	-	164,540	164,540
Other Receivables	-	-	-	-	5,102	5,102
Total Assets	\$ 72,793	\$ 3,117,641	\$ 7,877,939	\$ 2,029,483	\$ 2,171,406	\$ 15,269,262
LIABILITIES AND FUND BALANCES:						
Liabilities:						
Account Payable	\$ 1,940,470	\$ 394,373	\$ 318,296	\$ 455,000	\$ 376,767	\$ 3,484,906
Account Interest	-	-	-	75,449	-	75,449
Due to Governmental Units (Note 7)	410,472	-	-	-	-	410,472
Due to Other Funds (Note 6)	2,932,273	23,246	-	-	6,762	2,962,281
Deferred Revenues:						
Volume of Business Taxes (Note 5)	585,957	-	-	-	-	585,957
Federal Grants (Note 5)	-	2,534,068	-	-	-	2,534,068
Total Liabilities	5,869,172	2,951,687	318,296	530,449	383,529	10,053,133
Fund Balances:						
Restricted	-	165,954	7,559,643	1,499,034	1,664,481	10,889,112
Committed	64,641	-	-	-	-	64,641
Assigned	115,620	-	-	-	-	115,620
Unassigned (Deficit)	(5,976,640)	-	-	-	123,396	(5,853,244)
Total Fund Balances (Deficit)	(5,796,379)	165,954	7,559,643	1,499,034	1,787,877	5,216,129
Total Liabilities and Fund Balances	\$ 72,793	\$ 3,117,641	\$ 7,877,939	\$ 2,029,483	\$ 2,171,406	\$ 15,269,262

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES, PUERTO RICO

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

JUNE 30, 2011

Total Fund Balances – Government Funds	\$ 5,216,129
Amount reported for Governmental Activities in the Statement of Net Assets 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	\$ 4,768,385
Depreciable Capital Assets	12,636,148
Infrastructure Assets	852,518
Accumulated Depreciation	<u>(5,546,792)</u>
Total Capital Assets	12,710,259
Other Assets used in governmental activities are not financial resources and therefore are not reported in the funds:	
Deferred Charges	26,176
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:	
SBGP	2,534,068
Some liabilities are not due and payable in the current period and therefore are not reported in the funds. Those liabilities consist of:	
General Bonds and Special Bonds	4,253,000
PR Department of Labor and Human Resources	49,410
LIMS – MRCC	14,477
Solid Waste Disposal	92,000
Compensated Absences	1,519,784
Law Number 146 - MRCC	256,362
Law Number 42 - MRCC	<u>645,395</u>
Total Long-Term Liabilities	<u>(6,830,428)</u>
Total Net Assets of Governmental Activities	\$ <u>13,656,204</u>

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES, PUERTO RICO

STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE - GOVERNMENTAL FUNDS

FOR THE FISCAL YEAR ENDED JUNE 30, 2011

	GENERAL FUND	SBCP FUND	STATE ASSIGNMENTS FUND	DEBT SERVICE FUND	OTHER GOVERNMENTAL FUNDS	TOTAL GOVERNMENTAL FUNDS
REVENUES:						
Property Taxes (Note 11)	\$ 1,877,704	\$ -	\$ -	\$ 842,415	\$ -	\$ 2,720,119
Volume of Business Taxes (Note 12)	811,823	-	-	-	-	811,823
Sales and Usage Taxes (Note 13)	689,033	-	-	305,794	-	994,827
Federal Grants	-	1,902,682	-	-	-	1,902,682
Intergovernmental (Note 15)	6,301,691	-	2,565,166	-	1,407,906	10,274,753
Construction Excise Taxes (Note 14)	540,241	-	-	-	1,234,468	1,774,709
Rent	136,976	-	-	-	-	136,976
Miscellaneous	614,036	-	-	-	25,352	639,388
Total Revenues	10,971,504	1,902,682	2,565,166	1,148,209	2,667,726	19,255,287
EXPENDITURES:						
Current:						
Mayor and Municipal Legislature	564,918	-	-	-	-	564,918
General Government	4,267,697	740,706	223,421	-	2,010,760	7,242,584
Public Safety	816,194	-	-	-	109	816,303
Public Works	2,721,560	-	1,257	-	25,638	2,748,455
Culture and Recreation	711,023	-	-	-	-	711,023
Health and Sanitation	1,108,478	-	-	-	-	1,108,478
Public Instruction	-	-	8,571	-	17,611	26,182
Solid Waste Disposal	422,960	-	-	-	-	422,960
Human Services and Welfare	583,089	-	253	-	-	583,342
Urban Development	38,167	1,177,137	348,026	-	258,391	1,921,721
Capital Outlays	51,348	1,395	275,482	-	49,289	1,612,619
Debt Service:						
Principal	-	-	-	-	161,562	161,562
Interest and Other Charges	-	-	-	762,022	-	762,022
Total Expenditures	11,285,434	1,919,238	857,010	994,950	2,523,360	17,579,992
Excess of Revenues Over (Under) Expenditures	(313,930)	(16,556)	1,708,156	153,259	144,366	1,675,295
OTHER FINANCING SOURCES (USES):						
Transfers - In (Note 6B)	-	-	-	-	-	-
Transfers - Out (Note 6B)	(262,406)	-	-	113,423	148,983	(62,000)
Total Other Financing Sources and Uses	(262,406)	-	-	113,423	148,983	(62,000)
Net Change in Fund Balances	(576,336)	(16,556)	1,708,156	266,682	293,349	1,675,295
Fund Balances (Deficit) - As Restated, Beginning (Note 19)	(5,220,043)	182,510	5,851,487	1,232,352	1,494,528	3,540,834
FUND BALANCES (DEFICIT) - ENDING	(5,796,379)	165,954	7,559,643	1,499,034	1,787,877	5,216,129

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES, 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	\$ 1,675,295
Amount reported for Governmental Activities in the Statement of Activities are different because:	
Governmental funds report capital outlays as expenditures. However, in the Statement of Activities the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense. In the current period, these amounts are:	
Capital Assets	\$ 1,622,525
Depreciation Expense	(460,030)
Loss on Disposition of Capital Asset	(255)
Excess of Depreciation Expense over Capital Assets	1,162,240
Revenues in the Statement of Activities that do not provide current financial resources are reported as revenues in the funds and vice versa.:	
SBGP	232,976
Repayment of long-term principal is expenditure in the governmental funds, but issuing debt reduced Long-Term Liabilities in the Statement of Net Assets. In the current period repayments were	
	762,022
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 Compensated Absences	157,358
Bond Issue Costs Amortization	(5,341)
MRCC Liquidation	144,986
Retirement System	107,662
Solid Waste Disposal	120,000
Department of Labor and Human Resources	34,875
Total Additional Expenses	559,540
Change in Net Assets of Governmental Activities	\$ 4,392,073

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

1. FINANCIAL REPORTING ENTITY

The accompanying financial statements present information on the financial activities of the Municipality of Lares, 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 (GAAP). 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 of Lares, Puerto Rico (Municipality) was founded in the year 1827, and operates as a governmental unit of the Commonwealth of Puerto Rico, under Law Number 81 of August 30, 1991, known as "Autonomous Municipalities Law of the Commonwealth of Puerto Rico". The governmental system of the Municipality is composed of the executive and legislative bodies. The Mayor is the Chief Executive Officer and is elected every four years in the general elections of the Commonwealth of Puerto Rico. The legislative body consists of 14 Legislators also elected in the general elections of Puerto Rico for a four-year period.

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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.

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 (GAAP). 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*.

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.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

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.

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

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 GASB Accounting Standards Codification Section N50, *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.

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

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.

SBGP Fund – This is the fund used to account for all the transactions of the State Block Grant Program. The primary objectives of this program is the development of viable communities by providing decent housing, a suitable living environment and expanded economic opportunities, principally for persons of low and moderate income.

State Assignments Fund – This is the fund used to account for all the transactions of the State Assignments by Legislature Resolutions. The primary objectives of these assignments is the development of projects on communities, not-for-profit organizations, purchase of equipment and indirect assignment to persons of low and moderate income.

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.

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. 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. Unexpended appropriations at the end of the fiscal year generally lapse. However, they may be re-appropriated for expenditures in the following fiscal year.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

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 GAAP reporting purposes, encumbrances outstanding at year-end are reported as reservations of fund balances and do not constitute expenditures or liabilities because the commitments will be honored during the subsequent year. 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)

- 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 Multiuse 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) 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."

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

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.

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.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

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

CAPITAL ASSETS	YEARS
Buildings and Improvements	50
Infrastructure	60
Heavy	10
Furniture and Fixtures	5
Equipment and Vehicles	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 is prevented legally from entering into obligations extending beyond one fiscal year, and most lease agreements entered by the Municipality contain fiscal funding clauses or cancellation clauses that make the continuation of the agreements subject to future appropriations. The Municipality's lease agreements do not include contingent rental payments no escalation clauses. Accordingly, lease payments are recorded in the GWFS as expense when incurred.

In the accompanying GFFS, the lease payments are recorded as expenditures in the governmental fund.

6) *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).

7) *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, and landfill post closure care costs). 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.

8) *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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

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.

9) *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.

10) *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.

11) *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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

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 Activities</u>
Capital Assets, Net of Accumulated Depreciation.....	\$12,710,259
Outstanding Balance on Related Debt.....	<u>(2,899,000)</u>
Total Invested in Capital Assets, Net of Related Debt	<u>\$ 9,811,259</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.
- *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 the collection of property taxes and other main income. The purpose of this policy is to specify the size and composition of the Municipality’s financial reserves and to identify certain requirements for replenishing any fund balance reserves utilized.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

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.

- *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.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

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.

Policy on Unassigned General Fund Balance

It is the goal of the Municipality to achieve and maintain an Unassigned General Fund Balance equal to 4% of budgeted expenditures. The Municipality considers a balance of less than 3% to be a cause for concern, barring unusual or deliberate circumstances, and a balance of more than 5% as excessive. An amount in excess of 6% 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.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

C) Components of Fund Balance

	GENERAL FUND	SBGP FUND	STATE ASSIGNMENTS FUND	DEBT SERVICE FUND	OTHER GOVERNMENTAL FUNDS	TOTAL GOVERNMENTAL FUNDS
Nonspendable	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Restricted For:						
Improvement and Construction of Facilities	-	-	7,559,643	-	912,592	8,472,235
Debt Services	-	-	-	1,499,034	-	1,499,034
Improvement of Streets and Sidewalks	-	-	-	-	628,351	628,351
Traffic Enforcement Program	-	-	-	-	23,923	23,923
Welfare	-	-	-	-	63,351	63,351
Capital Outlay - Purchase of Equipment	-	-	-	-	36,264	36,264
Housing Assistance Programs	-	165,954	-	-	-	165,954
Total Restricted	-	165,954	7,559,643	1,499,034	1,664,481	10,889,112
Committed To:						
Solid Waste Disposal	15,040	-	-	-	-	15,040
Professional Services	38,608	-	-	-	-	38,608
Welfare and Donations	7,043	-	-	-	-	7,043
Improvement and Construction of Facilities	3,950	-	-	-	-	3,950
Total Committed	64,641	-	-	-	-	64,641
Assigned To:						
General Government	115,620	-	-	-	-	115,620
Total Assigned	115,620	-	-	-	-	115,620
Unassigned:	(5,976,640)	-	-	-	123,396	(5,853,244)
Total Fund Balances (Deficits)	\$ (5,796,379)	\$ 165,954	\$ 7,559,643	\$ 1,499,034	\$ 1,787,877	\$ 5,216,129

E. 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.

F. 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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

the gross property tax collections by the MRCC for the year ended June 30, 2011 amounted to approximately \$204,179. The current insurance policies have not been cancelled or terminated. In addition, MRCC deducted approximately \$215,308 for workers compensation insurance covering all municipal employees for the same period.

G. 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.

H. 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.

I. 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.

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.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

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.

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.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

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 this statement.

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, and (2) demand deposits in the Government Development Bank of Puerto Rico (GDB, fiscal agent).

Puerto Rico laws authorize governmental entities to invest in direct obligations or obligations guaranteed by the federal government or the 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 Government laws.

The Municipality follows the practice of pooling cash. At June 30, 2011, the cash are maintained in commercial banks with a balance of \$6,901,769 of which \$57 in the SBGP Fund, \$4,915,658 in State Assignments Fund, and \$1,986,054 in Other Governmental Funds. The balance in cash account is available to meet current operating requirements and any unrestricted excess, if any, is generally invested in certificates of deposit with commercial banks. Any deficiency in the 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 \$2,019,870 that are restricted for the payment of the Municipality's debt service, as required by law. Cash with Fiscal Agent of \$15,251 in the General Fund and \$15,710 in other governmental funds consist principally of unspent proceeds of bonds 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:

3. CASH AND INVESTMENTS (continuation)

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 in banks of \$5.9 million 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 or 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 \$5.9 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 \$2.0 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.

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 and certificates of deposit 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. DUE FROM GOVERNMENTAL UNITS

The due from governmental units for the fiscal year ended June 30, 2011 corresponds to various government departments for the amount of \$164,540.

5. DEFERRED AND UNEARNED REVENUES

Governmental funds report *deferred revenue* in connection with receivables for revenues that are not considered to be available to liquidate liabilities of the current period. 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 revenue* and *unearned revenue* reported in the governmental funds were as follows:

Governmental Funds:	UNAVAILABLE	UNEARNED
Volume of Business Taxes	\$ -	\$ 585,957
SBGP Revenues	<u>2,534,068</u>	<u>-</u>
Total Deferred/ Unearned Revenues	<u>\$ 2,534,068</u>	<u>\$ 585,957</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
State Assignments	General Fund	\$ 2,932,273
State Assignments	Other Funds	6,762
State Assignments	SBGP	<u>23,246</u>
TOTAL		<u>\$ 2,962,281</u>

B. INTERFUND TRANSFERS

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

INTERFUND TRANSFERS WITHIN THE GOVERNMENTAL FUNDS			
Sources	Transfer to	Amount	Purpose
General Fund	Debt Service Fund	\$ 113,423	Debt Repayment
General Fund	Other Governmental Funds	<u>148,983</u>	Transfer for Operational Purposes
		<u>\$ 262,406</u>	

7. DUE TO OTHER GOVERNMENTAL UNITS

As of June 30, 2011, balance due to other governmental units of the General Fund for services rendered to the Municipality, consists of the following:

	AMOUNT
Water and Sewer Authority	\$ 82,576
Retirement System Administration	86,152
Federal Insurance Contributions Act Tax	774
Unemployment Payable	1,932
Health Insurance	2,516
Retirement System Employee Loan	23,861
State Insurance Fund	14,115
General Service Administration	<u>198,546</u>
Total Due to Governmental Units	<u>\$ 410,472</u>

8. CAPITAL ASSETS

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

DESCRIPTION	BALANCE JULY 1, 2010	ADJUSTMENT	INCREASES	DECREASES	BALANCE JUNE 30, 2011
Non-Depreciable Capital Assets:					
Land	\$ 3,210,794	\$ -	\$ 409,160	\$ -	\$ 3,619,954
Construction in Progress	2,258,051	(2,262,519)	1,152,899	-	1,148,431
Total Non-Depreciable Capital Assets	5,468,845	(2,262,519)	1,562,059	-	4,768,385
Depreciable Capital Assets:					
Buildings and Buildings Improvements	6,371,965	1,684,323	-	-	8,056,288
Equipment and Vehicles	3,299,371	(3,325)	57,666	(138,266)	3,215,446
Furniture and Fixtures	137,301	7,332	2,800	-	147,433
Heavy Equipment	1,122,466	94,515	-	-	1,216,981
Infrastructure	274,322	578,196	-	-	852,518
Total Depreciable Capital Assets	11,205,425	2,361,041	60,466	(138,266)	13,488,666
Less Accumulated Depreciation:					
Buildings and Buildings Improvements	1,573,447	-	161,126	-	1,734,573
Equipment and Vehicles	2,895,006	8,338	193,128	138,011	2,958,461
Furniture and Fixtures	93,458	9,967	7,561	-	110,986
Heavy Equipment	563,693	51,659	93,642	-	708,994
Infrastructure	29,205	-	4,573	-	33,778
Total Accumulated Depreciation	5,154,809	69,964	460,030	138,011	5,546,792
Total Depreciable Capital Assets (Net)	6,050,616	2,291,077	(399,564)	(255)	7,941,874
CAPITAL ASSETS, NET	\$ 11,519,461	\$ 28,558	\$ 1,162,495	\$ (255)	\$ 12,710,259

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

	AMOUNT
General Government	\$ 105,807
Mayor and Municipal Legislature	4,600
Public Safety	13,801
Public Works and Transportation	234,615
Culture and Recreation	18,401
Health and Sanitation	23,002
Urban Development	59,804
Total Depreciation Expenses	\$ 460,030

9. GENERAL LONG-TERM DEBTS

A. General Obligations Bonds and Special Obligations Bonds

The principal long-term obligations of the Municipality are general obligations bonds and special notes issued to finance the construction and improvements of public facilities and purchase of equipment. The Municipality's obligations long-term debt retirements are appropriated and paid from resources accumulated in the Debt Service Fund (See Note 10).

9. GENERAL LONG-TERM DEBTS (continuation)

General and special obligations bonds as of June 30, 2011, are comprised of the following individual issues:

Type of Obligation and Purpose	Maturity Date	Interest Rate	Amount
General Obligation Bonds - Property Taxes:			
\$1,634,000, Series 2005 - Purchase of Equipment*	2012	4.13%	\$ 264,000
\$937,000, Series 2008 - Operational Purpose	2017	7.50%	723,000
\$665,000, Series 2000 - Purchase of Land and Building	2031	7.00%	620,000
\$900,000, Series 2009 - Operational Purpose	2015	7.50%	690,000
\$464,000, Series 2009 - Operational Purpose	2018	7.50%	396,000
Total General Obligation Bonds			<u>2,693,000</u>
Special Obligation Bonds - Operational Revenues:			
\$750,000, Series 2002 - Purchase of Land	2026	8.00%	625,000
\$1,045,000, Series 2000 - General Construction	2022	6.00 to 8.00%	760,000
\$880,000, Series 2008 - Purchase of Equipment	2014	7.50%	630,000
Total Special Obligation Bonds			<u>2,015,000</u>
Total General and Special Obligation Bonds			<u>\$ 4,708,000</u>

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.

B. Legal Debt Limit and Legal Debt Margin

As of June 30, 2009 (the last year available), the Municipality debt limit (10% of valuation of property subject to taxation) was \$41,937,121, 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. The total amount of debt applicable to the debt limit was \$41,461,738, net of certain assets in the Debt Service Fund. 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, 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 amount of debt is \$741,794 to be paid during 25 years plus annual interest of 6.1875%.

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 amount of debt is \$305,194 to be paid during 25 years plus annual interest of 6.22%.

9. GENERAL LONG-TERM DEBTS (continuation)

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 \$222,307 to be paid during 10 years plus annual interest of 5.95%.

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 JULY 1, 2010	NEW ISSUES	RETIREMENTS AND ADJUSTMENTS	BALANCE JUNE 30, 2011	AMOUNTS DUE WITHIN ONE YEAR	AMOUNTS DUE AFTER NEXT YEAR
Law Number 42 - MRCC	\$ 659,497	\$ -	\$ (14,102)	\$ 645,395	\$ 14,982	\$ 630,413
LIMS - MRCC	42,489	-	(27,712)	14,777	14,477	300
Law Number 146 - MRCC	268,570	-	(12,208)	256,362	12,208	244,154
PR Department of Labor and Human Resources	84,285	-	(34,875)	49,410	34,875	14,535
MRCC Liquidation	144,986	-	(144,986)	-	-	-
Retirement System	107,662	-	(107,662)	-	-	-
Solid Waste Disposal	212,000	-	(120,000)	92,000	92,000	-
Compensated Absences	1,677,142	-	(157,358)	1,519,784	694,609	825,175
TOTAL	\$ 3,196,631	\$ -	\$ (618,903)	\$ 2,577,728	\$ 863,151	\$ 1,714,577

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 JULY 1, 2010	NEW ISSUES	RETIREMENTS AND ADJUSTMENTS	BALANCE JUNE 30, 2011	AMOUNTS DUE WITHIN ONE YEAR	AMOUNTS DUE AFTER NEXT YEAR
General	\$ 3,183,000	\$ -	\$ (490,000)	\$ 2,693,000	\$ 519,000	\$ 2,174,000
Special	2,070,000	-	(55,000)	2,015,000	200,000	1,815,000
Other Debts	3,196,331	-	(618,903)	2,577,428	863,151	1,714,277
TOTAL	\$ 8,449,331	\$ -	\$ (1,163,903)	\$ 7,285,428	\$ 1,582,151	\$ 5,703,277

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.

9. GENERAL LONG-TERM DEBTS (continuation)

The annual requirements to amortize the general long-term debts outstanding as of June 30, 2011 are as follows:

YEAR ENDING JUNE 30,	General Obligation Bonds		Special Obligation Bonds		Other Long-Term Obligations		TOTAL	
	PRINCIPAL PAYMENT	INTEREST PAYMENT	PRINCIPAL PAYMENT	INTEREST PAYMENT	PRINCIPAL PAYMENT	INTEREST PAYMENT	PRINCIPAL	INTEREST
Governmental Funds:								
2012	\$ 519,000	\$ 80,754	\$ 200,000	\$ 92,574	\$ 863,151	\$ 56,083	\$ 1,582,151	\$ 229,411
2013	269,000	149,975	215,000	107,417	42,666	53,951	526,666	311,343
2014	289,000	128,750	230,000	92,032	29,132	50,368	548,132	271,150
2015	309,000	106,775	255,000	75,102	30,196	50,368	594,196	232,245
2016	346,000	82,300	85,000	63,853	31,325	48,479	462,325	194,632
2017-2021	531,000	209,988	530,000	232,673	176,225	211,407	1,237,225	654,068
2022-2026	155,000	125,125	435,000	68,149	217,258	151,393	807,258	344,667
2027-2031	220,000	59,500	65,000	1,820	272,898	76,316	557,898	137,636
2032-2036	55,000	1,925	-	-	89,402	5,587	144,402	7,512
Unmatured	-	-	-	-	825,175	-	825,175	-
TOTAL	\$ 2,693,000	\$ 945,092	\$ 2,015,000	\$ 733,620	\$ 2,577,428	\$ 703,952	\$ 7,285,428	\$ 2,382,664

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 1st 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

11. PROPERTY TAXES (continuation)

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. Due to the fact that collections of property tax are applied to the advances of property tax paid by the Municipality Revenue Collection Center, the amortization of the advance at end of year was not available due to that is in process of verification by external auditors.

The tax rate for fiscal year 2011 is 10.28% for real property and 8.28% for personal property of which 1.03% of both are for the redemption of public debt issued by the Commonwealth of Puerto Rico and 9.25% and 7.25%, 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 3.25% 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 10). The Municipality has reached the maximum statutory tax rate limit for the basic tax while there is no limitation for the ad-valorem tax rate.

The Commonwealth of Puerto Rico grants complete real property tax exoneration on the first \$15,000 has assessed valuation on residential units occupied by their owners. For such exempted amounts, the Puerto Rico Treasury Department assumes payment of the basic tax to the Municipality, except for residential units assessed at less than \$3,500 on which a complete exemption is granted. As part of Law No. 83 of August 30, 1991, as amended, the exempt amount to be paid by the Puerto Rico Treasury Department to the Municipality was frozen as of January 1, 1992.

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.

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 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. All other organizations as per the following scale:
 - i. \$0.01 – \$5,000 – Exempt
 - ii. \$5,001 – \$8,334 – \$25.00
 - iii. \$8,335 – \$100,000 – .3%
 - iv. \$100,000 – \$200,000 – .4%
 - v. In excess of \$200,000 – .5%

12. VOLUME OF BUSINESS TAXES (continuation)

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 10th 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 and Usage Taxes Receivable represents filed sales and usage taxes returns that were collected subsequent to June 30, 2011, but pertaining to the current year period.

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, cable TV, commercial antennas 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. Breaking of streets, roads and/or sidewalk (including asphalt – \$20.00 per occurrence.
- b. All residential construction projects made by homeowners – \$5.00 per each \$1,000 or fraction in excess of \$10,000. Residential construction projects for rent - \$10.00 per each \$1,000 and \$5.00 per fraction of \$1,000.
- c. All construction projects carried out by Non-for-Profit Organization have full exemption to the construction excise taxes. If the constructed projects are sold during the first 5-years the original organization would pay 4% of the total construction costs.
- d. Cable line (TV, telephone, etc.) – \$0.10 per line feet.

14. CONSTRUCTION EXCISE TAXES (continuation)

- e. Fences and scaffolding – \$3.00 per line meter up to 10 meter for the first 4 months. Each additional meter would pay \$1.50. For period exceeding 4 months would pay the same taxes.

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.

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.

16. PENSION PLAN (continuation)

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

Annual Contribution

Total employee contributions to the above-mentioned plans during the year ended June 30, 2011, 2009 and 2008 amounted to approximately \$983,575. 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	\$ 186,412	\$ 169,237
2010	198,765	161,896
2009	213,238	163,366

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. Any liability for reimbursement which may arise as the result of these audits is not believed to be material.

18. COMMITMENTS

A. 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:

	Encumbered For	Amount	Reported within Fund Balance Classification
State Assignment Fund	Improvement of Streets	\$ 124,916	Restricted to Improvement of Streets and Sidewalks
	Improvement of Facilities	247,063	Restricted to Improvement and Construction of Facilities
Non Major Funds	Resurfacing of Streets	364,059	Restricted to Improvement of Streets and Sidewalks

B. Other Commitments

At June 30, 2011, the general fund had a deficit of \$5,197,532 which will be covered with future budgetary appropriations of the general fund.

19. NET ASSETS/FUND BALANCES RESTATEMENTS

A. *Net Assets Restatements*

During the year, the Municipality adjusted the governmental net assets for unrecognized revenues and expenses, and capital assets. 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.

	NET ASSETS	
Net Assets, as Previously Reported, At June 30, 2010	\$	9,961,040
To Adjust Accounts Receivable		(223,436)
To Adjust Accounts Payable		(502,031)
To Correct Capital Assets		28,558
Beginning Net Assets, as Restated, At July 1, 2010	\$	<u>9,264,131</u>

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 various funds:

	FUND BALANCE RESTATED	
	General Fund	Other Governmental Funds
Fund Balance (Deficit), as Previously Reported, At June 30, 2010	\$ (4,907,054)	\$ 1,907,007
To Adjust Accounts Receivable	(56,061.00)	(167,375.00)
To Adjust Accounts Payable	(502,032.00)	-
Reclassification of Major Fund	245,104.00	(245,104.00)
Beginning Fund Balance, as Restated, At July 1, 2010	<u>\$ (5,220,043)</u>	<u>\$ 1,494,528</u>

PART II – REQUIRED SUPPLEMENTARY INFORMATION

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

	Budget Amounts		Actual Amounts (Budgetary Basis) (See Notes 1, 2 and 3)	Variance with Final Budget
	Original	Final		
BUDGETARY FUND BALANCE, AS RESTATED, JULY 1, 2010	\$ (5,220,043)	\$ (5,220,043)	\$ (5,220,043)	\$ -
Resources (Inflows):				
Property Taxes	2,368,965	2,368,965	1,877,704	(491,261)
Volume of Business Taxes	1,105,001	1,105,001	811,823	(293,178)
Intergovernmental Revenues	6,763,831	6,763,831	6,301,691	(462,140)
Sales and Usage Taxes	1,050,000	1,050,000	689,033	(360,967)
Construction Excise Taxes	875,513	875,513	540,241	(335,272)
Rent	215,346	215,346	136,976	(78,370)
Miscellaneous	823,000	823,000	614,036	(208,964)
Total Resources (Inflows)	<u>13,201,656</u>	<u>13,201,656</u>	<u>10,971,504</u>	<u>(2,230,152)</u>
Amounts Available for Appropriation	<u>7,981,613</u>	<u>7,981,613</u>	<u>5,751,461</u>	<u>(2,230,152)</u>
Charges to Appropriations (Outflows):				
Mayor and Municipal Legislature	694,705	676,167	582,395	93,772
General Government	4,928,435	5,114,680	4,130,546	984,134
Public Safety	1,255,323	969,039	816,194	152,845
Public Works	2,539,520	2,967,263	2,798,106	169,157
Culture and Recreation	826,604	839,148	724,225	114,923
Health and Sanitation	1,442,649	1,237,338	1,109,303	128,035
Human Services and Welfare	842,887	683,148	584,919	98,229
Solid Wasted Disposal	438,000	438,000	438,000	-
Urban Development	30,000	48,000	47,791	209
Capital Outlays	57,400	79,890	51,348	28,542
Transfer to Other Funds	146,133	148,983	262,406	(113,423)
Total Charges to Appropriations	<u>13,201,656</u>	<u>13,201,656</u>	<u>11,545,233</u>	<u>1,656,423</u>
BUDGETARY FUND BALANCE, JUNE 30, 2011	\$ (5,220,043)	\$ (5,220,043)	\$ (5,793,772)	\$ (573,729)

See the accompanying notes to Budgetary Comparison Schedule
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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES, 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 GASB Accounting Standards Codification Section 1700, *The Budget and Budgetary Accounting*. Formal and legal budgetary control is based upon major classes of expenditures known as functions. The Municipality's Transfer to Other Funds functions exceeded the budgetary amount by \$113,423, due to transfers to other funds for special projects. Economies was realized in the other functions due to a decrease in estimated revenues. Budgetary Fund Balance was restated at beginning of the year, to conformed GASB Number 54 Fund Balances.

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

	<u>General Fund</u>
Sources/Inflows of Resources:	
Actual Amounts (Budgetary Basis) "Available for Appropriation" from the Budgetary Comparison Schedule	\$ 5,751,461
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	5,220,043
Total Revenues as Reported on the Statement of Governmental Funds Revenues, Expenditures and Changes in Fund Balance	\$ 10,971,504
Uses/Outflows of Resources:	
Actual Amounts (Budgetary Basis) "Total Charges to Appropriation" from the Budgetary Comparison Schedule	\$ 11,545,233
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	(180,261)
Payments of encumbrances of prior year that are expenditures for financial reporting purposes but are not outflows for budgetary purposes	182,868
Transfers to other funds are outflows of budgetary resources but are not expenditures for financial reporting purposes	(262,406)
Total Expenditures as Reported on the Statement of Governmental Funds Revenues, Expenditures and Changes in Fund Balance	\$ 11,285,434

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

Budgetary Fund Balance (Deficit), June 30, 2011	\$ (5,793,772)
Timing Differences:	
Change in Encumbrances	(2,607)
Fund Balance (Deficit), June 30, 2011	\$ (5,796,379)

PART III – SINGLE AUDIT SECTION

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES, PUERTO RICO

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

FOR THE FISCAL YEAR ENDED JUNE 30, 2011

FEDERAL GRANTOR / PASS-THROUGH GRANTOR / PROGRAM OR CLUSTER TITLE	FEDERAL CFDA NUMBER	PASS-THROUGH ENTITY IDENTIFYING NUMBER	FEDERAL EXPENDITURES
U.S. Department of Housing and Urban Development:			
Direct Programs:			
Section 8 Housing Choice Vouchers.....	14.871		\$ 233,261
Indirect Programs:			
Pass-Through State – Office of the Commissioner of Municipal Affairs:			
State Block Grant Program (SBGP).....	14.228		1,674,238
ARRA – State Block Grant Program (SBGP)	14.253		<u>245,000</u>
ARRA – Homelessness Prevention and Rapid Re-Housing Program	14.257		138,460
Total U.S. Department of Housing and Urban Development			<u>2,290,959</u>
U. S. Department of Energy:			
ARRA – Energy Efficiency and Conservation Block Grant	81.128		<u>12,500</u>
U.S. Department of Transportation:			
Pass-Through Puerto Rico Traffic Safety Commission:			
State and Community Highway Safety.....	20.600	10-708	<u>43,660</u>
U.S. Federal Transit Administration:			
Federal Transit Administration	20.500		8,267
ARRA – Federal Transit Administration.....	20.507		<u>898,625</u>
Total U.S. Federal Transit Administration.....			<u>906,892</u>
Pass Through Puerto Rico State Emergency Management Agency:			
Homeland Security Grant Program	97.067		<u>17,411</u>
Pass Through Puerto Rico Department of Justice:			
ARRA – Edward Byrne Memorial Justice Assistance Grant Program Recovery Act Funded.....	16.803		<u>89,186</u>
TOTAL EXPENDITURES OF FEDERAL AWARDS			<u>\$3,360,608</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LARES, PUERTO RICO

NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

FOR THE FISCAL YEAR ENDED JUNE 30, 2011

1. BASIS OF PRESENTATION

The accompanying Schedule of Expenditures of Federal Awards (the Schedule) includes the federal grant activities of the **Municipality of Lares, 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: SBGP - \$1,919,238 and Other Governmental Funds \$1,441,370.

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

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

We have audited the financial statements of the governmental activities, each major fund and the aggregate remaining fund information of the Municipality of Lares, as of and for the year ended June 30, 2011, which collectively comprise the Municipality's basic financial statements and have issued our report thereon dated February 21, 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

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

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

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

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Municipality of Lares'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 test disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

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

San Juan, Puerto Rico
February 21, 2012

Ortiz, Rivera, Rivera & Co

The stamp E18910 was affixed
to the original of this report.



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

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

Compliance

We have audited Municipality of Lares'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 Municipality of Lares's major federal programs for the year ended June 30, 2011. Municipality of Lares'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 Lares's management. Our responsibility is to express an opinion on Municipality of Lares'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 Lares'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 on Municipality of Lares's compliance with those requirements.

In our opinion, the Municipality of Lares's, complied in all material respects, with the requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2011.

Internal Control over Compliance

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

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.

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

San Juan, Puerto Rico
February 21, 2012

Ortiz, Rivera, Rivera & Co.

The stamp E18911 was affixed
to the original of this report.



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

1. SUMMARY OF AUDIT RESULTS

Financial Statements

Type of auditor's report issued: Unqualified opinion

Internal control over financial reporting:

Material weakness (es) identified? X Yes No

Significant deficiency (ies) identified? X Yes No

Noncompliance material to financial statements noted? Yes X No

Federal Awards

Internal control over major programs:

Material weakness (es) identified? Yes X No

Significant deficiency (ies) identified? Yes X No

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

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

Identification of major programs:

<u>CFDA Numbers</u>	<u>Name of federal programs or Cluster</u>
14.228	State Block Grant Program
14.253	State Block Grant Program (ARRA)
20.507	Federal Transit Administration (ARRA)

Dollar threshold used to distinguish between type A and Type B programs: \$300,000

Audited qualified as low-risk auditee? Yes X No

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

II. FINANCIAL STATEMENTS FINDINGS

• **11-A: General Fund Deficit**

Condition

As of June 31, 2011, the Municipality closed with an accumulated deficit of \$5,796,379 seven consecutive year that The Municipality closed its operations reporting a deficit.

Criteria

Article 7.011(a) of Autonomous Municipal Act (Law 81 of August 30, 1991), as amended, establishes that municipalities with deficits at their closing dates must provide for sufficient resources during the next fiscal year period in order to cover such deficit.

Section 3 of the Revised Regulation over Basic Standards for Municipalities of Puerto Rico (The Regulation) states that special care must be provided for the estimation of future revenues in order to avoid budget appropriations in excess of available resources.

Cause

The deficit is caused by the overestimation of budgeted revenues and by the incurrence of obligations without the proper consideration of current and future available resources. The mayor and the Finance Director did not follow adequate budgeting procedures.

Recommendation

The continuing deficit reported by the Municipality of Lares may harm the basic governmental services provided to its citizens. We strongly recommend that the necessary measures are taken in order to stop this trend. The Municipality must work on increasing actual revenues and/or substantially reducing expenditures.

• **11-B: Estimated Revenue Shortfall**

Condition

As of June 30, 2011, the Municipality did not meet certain projected revenues by significant amounts, causing an increase in its General Fund deficit (see Finding 11-A). The following deficiencies were noted based on our comparison of budgeted revenues versus final operating results:

- For construction excise taxes, the Municipality failed to meet its expectations by \$335,272 a 38% budget shortfall.

- For Miscellaneous revenues, the Municipality failed to meet its expectations by \$208,964 a 25% budget shortfall.
- For sales and usage taxes, the Municipality failed to meet its expectations by 360,967, a 34% budget shortfall.
- For volume of business taxes, the Municipality failed to meet its expectations by 293,178, a 27% budget shortfall.
- For property taxes, the Municipality failed to meet its expectations by \$491,261, a 21% budget shortfall.

Criteria

Section 3 of the Revised Regulation over Basic Standards for Municipalities of Puerto Rico (The Regulation) states that special care must be provided for the estimation of future revenues in order to avoid budget appropriations in excess of available resources.

Cause

The mayor and the Finance Director did not follow adequate budgeting procedures for establishing reasonable estimates.

Recommendation

The Municipality should revise and amend the budget as current information related to collections of budgeted revenues became available.

III. FEDERAL AWARDS FINDINGS AND QUESTIONED COSTS

None

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

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

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

<u>Program</u>	<u>Finding/Noncompliance</u>	<u>Status</u>
State Block Grant Program CFDA No. 14.228	Condition 10-01 The Municipality' internal control over compliance with the cash management requirements of the federal program is not effective since it is not minimizing the time elapsed between the receipt and final disbursements of funds.	Condition was corrected.