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

# MUNICIPIO DE LUQUILLO
# AUDITORÍA 2009-2010

30 DE JUNIO DE 2010

# COMMONWEALTH OF PUERTO RICO

# MUNICIPALITY OF LUQUILLO

## BASIC FINANCIAL STATEMENTS
## WITH THE ADDITIONAL REPORTS AND INFORMATION
## REQUIRED BY THE SINGLE AUDIT ACT

## YEAR ENDED JUNE 30, 2010

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

BASIC FINANCIAL STATEMENTS
WITH THE ADDITIONAL REPORTS AND INFORMATION
REQUIRED BY THE SINGLE AUDIT ACT

YEAR ENDED JUNE 30, 2010

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

BASIC FINANCIAL STATEMENTS
WITH THE ADDITIONAL REPORTS AND INFORMATION
REQUIRED BY THE SINGLE AUDIT ACT

YEAR ENDED JUNE 30, 2010

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López-Vega, CPA, PSC
Certified Public Accountants / Management Advisors

Member of:
- American Institute of Certified Public Accountants
- Puerto Rico Society of Certified Public Accountants

## INDEPENDENT AUDITORS' REPORT

**To the Honorable Mayor and**
**the Municipal Legislature**
**Municipality of Luquillo**
**Luquillo, 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 Luquillo, Puerto Rico (Municipality)** as of and for the year ended June 30, 2010, 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 the 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 respective financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the respective financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statements 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 Luquillo, Puerto Rico**, as of June 30, 2010, and the respective changes in financial position, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with Government Auditing Standards, we have also issued our report dated March 25, 2011, on our consideration of the **Municipality's** internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.



Calle Paraná #1686, El Cerezal, San Juan, P.R. 00926-3144 – Tel. (787) 777-8044 / Fax (787) 764-9377

## INDEPENDENT AUDITORS' REPORT (CONTINUED)

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and budgetary comparison information on pages 3 through 12 and 43 be presented to supplement the basic financial statements. Such information, although not part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with the auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the **Municipality of Luquillo'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 also not a required part of the financial statements.

The schedule of expenditures of federal awards are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

López-Vega CPA, PSC

LÓPEZ-VEGA, CPA, PSC

San Juan, Puerto Rico
December 15, 2010

Stamp No. 2575448 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.

This discussion and analysis of the **Municipality of Luquillo** (the Municipality) financial performance provides an overview of the Municipality's financial activities for the fiscal year ended on June 30, 2010. The Management Discussion and Analysis (MD&A) should be read in conjunction with the accompanying basic financial statements and the accompanying notes to those financial statements. The discussion and analysis includes comparative data for prior year as this information is available for the fiscal year ended on June 30, 2009, second year of implementation of Governmental Accounting Standards Board (GASB) Statement No. 34, *"Basic Financial Statements – and Management's Discussion and Analysis- for State and Local Governments."* This MD & A is prepared in order to comply with such pronouncement and, among other purposes, to provide the financial statements users with the following major information:

1. a broader basis in focusing important issues;
2. acknowledgement of an overview of the Municipality's financial activities;
3. provide for an evaluation of its financial condition as of the end of the fiscal year 2009-2010, compared with prior year results;
4. identification of uses of funds in the financing of the Municipality's variety of activities and;
5. assess management's ability to handle budgetary functions.

## FINANCIAL HIGHLIGHTS

The financial condition and results of operations as reflected in the financial statements prepared for fiscal year 2010 constitute factual evidence of the Municipality's economic strength by the end of such year. The following comments deserve special mention:

1. At the end of fiscal year 2010, total liabilities amounted to $16,074,722. Out of said amount, $13,786,711 corresponded to long-term liabilities of which $11,342,000 represented the outstanding balance of bonds and notes issued. The Municipality continued to meet all debt service requirements, most of which was paid from self generated revenues;
2. Total net assets of the Municipality amounted to $31,498,074 which represents an increase of 13% compared to prior fiscal year;
3. Total revenues available for the financing of activities as reflected in the Statement of Activities amounted to $16,365,486, derived from the following sources: $83,626 charges for services; $2,754,624 from operating grants and contributions; $2,291,370 from capital grants and contributions obtained from other sources, and $11,235,866 from general revenues available;

## FINANCIAL HIGHLIGHTS (CONTINUED)

4. Total expenses incurred to afford the cost of all functions and programs as reflected in the Statement of Activities amounted to $12,862,714;

5. As reflected in the Statement of Activities, the current fiscal year operations contributed to an increase in the Net Assets figure by $3,502,772;

6. As of the close of the current fiscal, the Municipality's Governmental Funds reported combined ending fund balances of $11,965,784;

7. At the end of the fiscal year, the Municipality's General Fund balance amounted to $1,996,855. It is pertinent to note that it is the municipal administration's contention that the importance of such figure should not be overestimated since it has adopted the policy to use internal generated resources to increase services to Municipality's community rather than let them unused in the accounted records;

8. The actual General Fund budgetary activities resulted in a favorable balance of $108,730 which is indicative of full compliance with the balanced budget principle applicable to all municipalities of the Commonwealth Government of Puerto Rico as required by the Municipal Autonomous Act enacted in August 1991.

## FUNDAMENTALS OF FINANCIAL STATEMENTS PRESENTATION

The new approach used in the presentation of the financial statements of the Municipality is based on a government-wide view of such statements as well as a presentation of individual funds behavior during fiscal year 2010. The combination of these two perspectives provide the user the opportunity to address significant questions concerning the content of said financial statements, and provide the basis for a comparable analysis of future years performance. The comparative analysis is a meaningful and useful management tool for municipal management in the decision making process.

Under the aforementioned approach, assets and liabilities are recognized using the accrual basis of accounting which is similar to the method used by most private enterprises. This means that current year's revenues and expenses are accounted for regardless of when cash is received or paid.

## FINANCIAL STATEMENTS COMPONENTS

The basic financial statements consist of the government wide financial statements, the major funds financial statements and the notes to the financial statements which provide details, disclosure and description of the most important items included in said statements.

The Statement of Net Assets reflects information of the Municipality as a whole on a consolidated basis and provides relevant information about its financial strength as reflected at the end of the fiscal year. Such financial level is measured as the difference between total assets and liabilities, with the difference between both items reported as net assets. It is important to note that although municipalities as governmental public entities were not created to operate under a profit motive framework, the return on assets performance plays an important role in their financial operations. The higher the increments achieved in net revenues, the higher the capacity to increase the net assets figure either thru additional borrowings or thru internally generated funds. This in turn will benefit the welfare of the constituents.

The Statement of Activities is focused on both gross and net cost of the various activities of the Municipality. It presents information which shows the changes in the Municipality's net assets at the most recent fiscal year. Based on the use of the accrual basis of accounting, changes are reported as soon as the underlying event occurs, regardless of the timing of the related cash flows. Under said approach, revenues and expenses are reported in the Statement of Activities based on the theory that it will result in cash flows to be realized in future periods.

A brief review of the Statement of Activities of the Municipality at June 30, 2010, shows total expenses incurred to afford the cost of all functions and programs amounted to $12,862,714. Upon examining the sources of revenues for the financing of said programs, the Statement reflects that $5,129,620 was derived from the following sources: $83,626 charges for services; $2,754,624 from operating grants and contributions; and $2,291,370 from capital grants and contributions obtained from other sources. General revenues for the year amounted to $11,235,866. When such figure is added to the $5,129,620 previously mentioned, total revenues available for the financing of activities amounted to $16,365,486. There was an excess of revenues over expenses in the amount of $3,502,772 which contributed to an increase in the figure of net assets attained at the end of the fiscal year.

## FINANCIAL STATEMENTS COMPONENTS (CONTINUED)

The Fund Financial Statement is another important component of the Municipality's financial statements. A fund is a grouping of related accounts that are used to maintain accountability and controls over economic resources of the Municipality that have been segregated for specific activities. The Municipal fund type of accounting is used to demonstrate compliance with related legal requirements. Information offered thru this Statement is limited to the Municipality most significant funds and is particularly related to the local government only, instead of the government as a whole. Government funds are used to account for essentially the same functions as those reported as governmental activities. The funds are reported using an accounting method known as modified accrual accounting which measures cash and all other financial assets that can be readily converted into cash.

The fund statement approach gives the user a short term view of the Municipality's government operations and the basic services it provides. Since the focus of government funds is narrower than that of the financial statements as a whole, it also helps the user with comparable information presented in the governmental activities report. By doing so, readers of the basic financial statements may understand better the long-term effect of the Municipality's short-term financial decisions.

## INFRASTRUCTURE ASSETS

Historically, a significant group of infrastructure assets such as roads, bridges, traffic signals, underground pipes not associated with utilities, have not been recognized nor depreciated in the accounting records of the Municipality. GASB 34 requires that such type of assets be inventoried, valued and reported under the governmental column of the Government-Wide Statement. As explained in the Capital Assets and Debt Administration Section of this MD&A, on July 1, 2002, the Municipality commenced partially the prospective reporting of infrastructure assets. The Municipality implemented the capitalization of infrastructure since July 1, 2006.

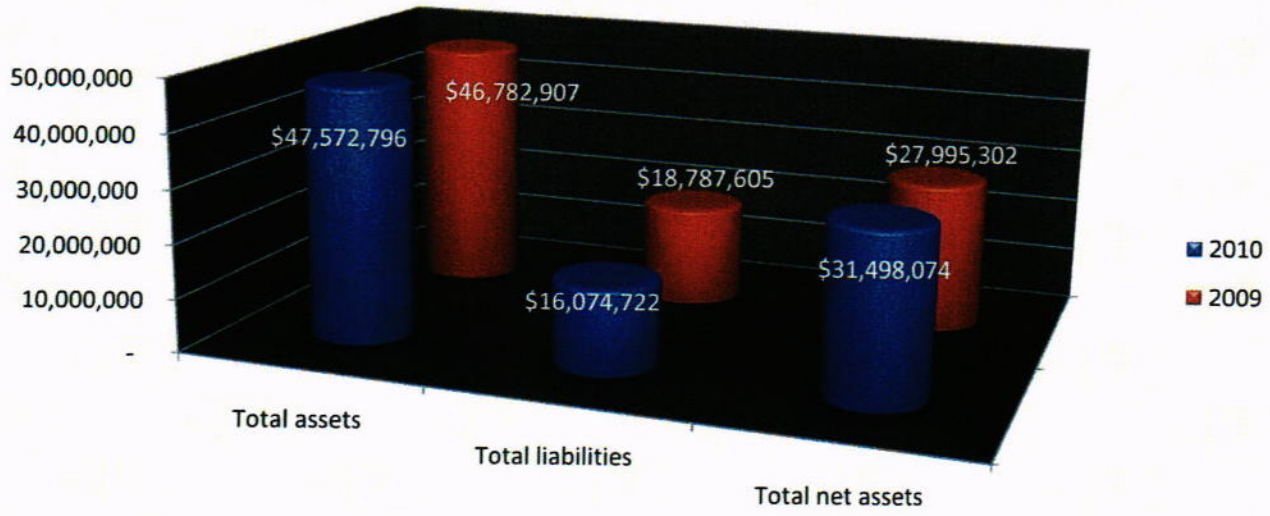
According to the requirements of GASB 34, the government must elect to either (a) depreciate the aforementioned assets over their estimated useful life or (b) develop a system of asset management designed to maintain the service delivery to near perpetuity. If the government develops the asset management system, (the modified approach) which periodically (at least every three years), by category, measures and demonstrate its maintenance of locally established levels of service standards, the government may record its cost of maintenance in lieu of depreciation. In this particular respect, the Municipality has elected the use of recognizing depreciation under the useful life method and it contemplates to continue this treatment on said basis.

## FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE

### Net Assets

The Statement of Net Assets serves as an indicator of the Municipality's financial position at the end of the fiscal year. In the case of the **Municipality of Luquillo**, primary government assets exceeded total liabilities by $31,498,074 at the end of 2010, compared to $27,995,302 at the end of the previous year, as showed in the following condensed Statement of Net Assets of the Primary Government.

| Condensed Statement of Net Assets | 2010 | 2009 | Change | % |
|---|---|---|---|---|
| Current and other assets | 13,070,092 | 14,301,452 | (1,231,360) | (9%) |
| Capital assets | 34,502,704 | 32,481,455 | 2,021,249 | 6% |
| Total assets | 47,572,796 | 46,782,907 | 789,889 | 2% |
| Current and other liabilities | 2,288,011 | 4,050,760 | (1,762,749) | (44%) |
| Long-term liabilities | 13,786,711 | 14,736,845 | (950,134) | (6%) |
| Total liabilities | 16,074,722 | 18,787,605 | (2,712,883) | (14%) |
| Investment in capital assets, net of related debt | 23,058,704 | 21,037,455 | 2,021,249 | 10% |
| Restricted | 9,866,784 | 9,303,526 | 563,258 | 6% |
| Unrestricted deficit | (1,427,414) | (2,345,679) | 918,265 | (39%) |
| Total net assets | 31,498,074 | 27,995,302 | 3,502,772 | 13% |



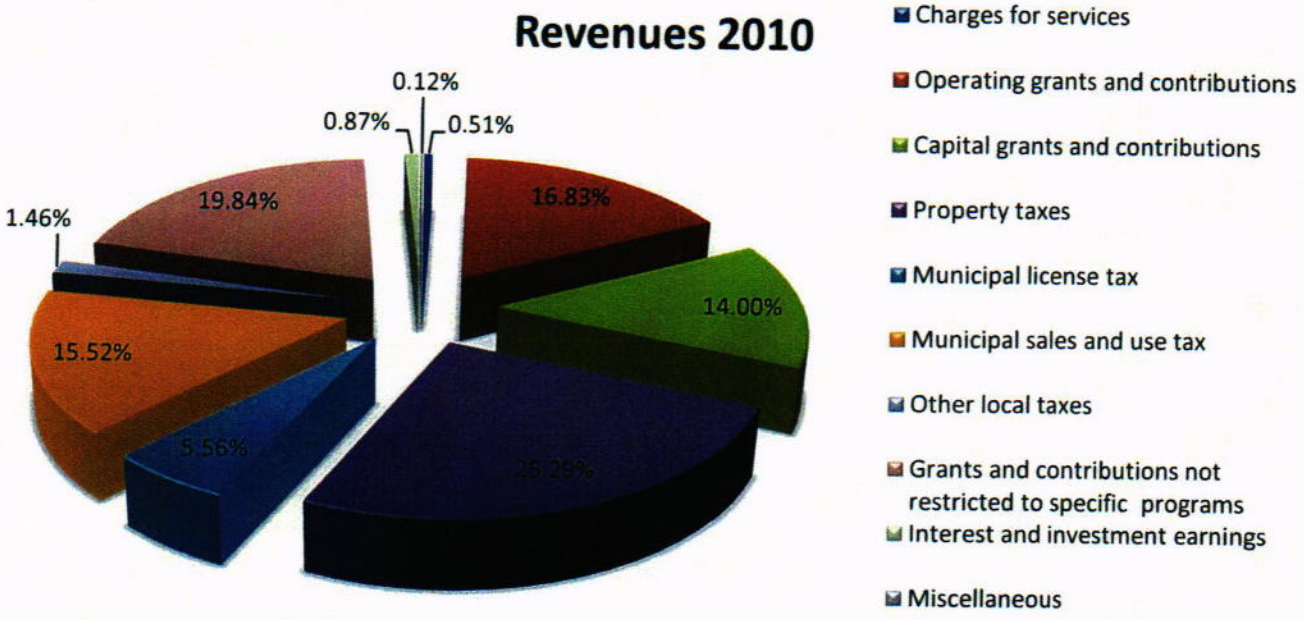
## FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE (CONTINUED)

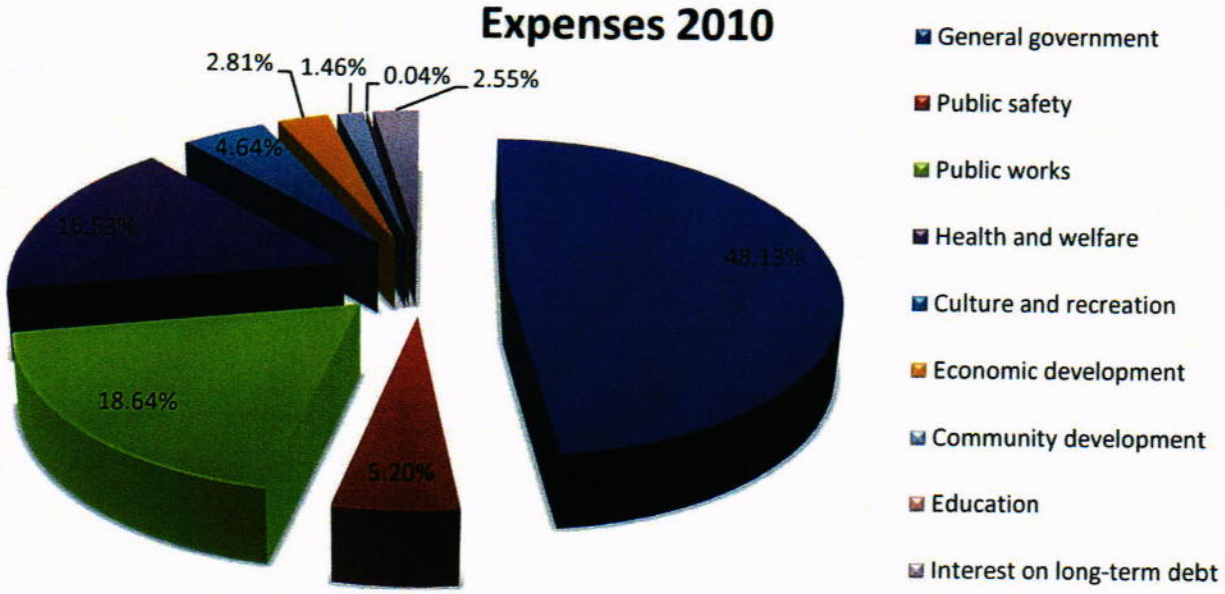
### Changes in Net Assets

The Statement of Activities reflects that for fiscal year 2010, the net effect of the revenues derived from several programs plus current operating revenues compared to the total expense, amounted to an increase of $3,502,772 Approximately 51 percent of the Municipality's total revenues resulted from grants and contributions, including federal aid, while 48 percent came from taxes. The largest expenses were for general government, public works, culture and recreation and health and welfare. As follow, is presented a comparative analysis of governmental-wide data. With this analysis, the readers have comparative information with the percentage of change in revenues and expenses from prior year to current year.

| **Condensed Statement of Activities** | **2010** | **2009** | **Change** | **%** |
|---|---|---|---|---|
| Program revenues: | | | | |
| Charges for services | $ 83,626 | $ 100,855 | $ (17,229) | (17%) |
| Operating grants and contributions | 2,754,624 | 3,549,940 | (795,316) | (22%) |
| Capital grants and contributions | 2,291,370 | 2,521,910 | (230,540) | (9%) |
| General revenues: | | | | |
| Property taxes | 4,138,704 | 3,807,965 | 330,739 | 9% |
| Municipal license tax | 909,548 | 1,058,019 | (148,471) | (14%) |
| Municipal sales and use tax | 2,539,131 | 1,440,253 | 1,098,878 | 76% |
| Other local taxes | 239,564 | 335,764 | (96,200) | (29%) |
| Grants and contributions not restricted to specific programs | 3,246,197 | 3,409,329 | (163,132) | (5%) |
| Interest and investment earnings | 142,285 | 155,568 | (13,283) | (9%) |
| Miscellaneous | 20,437 | 51,856 | (31,419) | (61%) |
| Total revenues | 16,365,486 | 16,431,459 | (65,973) | - |
| Expenses: | | | | |
| General government | 6,191,122 | 5,858,303 | 332,819 | 6% |
| Public safety | 668,390 | 486,377 | 182,013 | 37% |
| Public works | 2,397,144 | 3,468,484 | (1,071,340) | (31%) |
| Culture and recreation | 597,185 | 502,389 | 94,796 | 19% |
| Health and welfare | 2,125,803 | 2,434,673 | (308,870) | (13%) |
| Economic development | 361,646 | 281,114 | 80,532 | 29% |
| Community development | 188,185 | 545,230 | (357,045) | (65%) |
| Education | 5,041 | - | 5,041 | 100% |
| Urban Development | - | 3,600 | (3,600) | (100%) |
| Interest on long-term debt | 328,198 | 469,930 | (141,732) | (30%) |
| Total expenses | 12,862,714 | 14,050,100 | (1,187,386) | (8%) |
| Change in net assets | 3,502,772 | 2,381,359 | 1,121,413 | (47%) |
| Net assets, beginning of year, as restated | 27,995,302 | 25,613,943 | 2,381,359 | (9%) |
| Net assets, end of year | $31,498,074 | $27,995,302 | $ 3,502,772 | 13% |

## FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE (CONTINUED)



## FINANCIAL ANALYSIS OF THE MUNICIPALITY'S INDIVIDUAL FUNDS

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

### Governmental Funds

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

As of the end of the current fiscal year, the Municipality's governmental funds reported combined ending fund balances of $11,965,784, a decrease of ($21,779) in comparison with the prior year, as restated. There are reservations of fund balance amounting to $11,192,561. This is the fund balance that is not available for new spending because it has already been committed 1) to liquidate contracts and purchase orders of the prior fiscal year $1,192,523, 2) to pay debt service $2,740,284, 3) to pay for capital projects $7,342,973, 4) to pay other purpose a deficit of $(83,219).

Within the governmental funds, it is included the general fund which is the chief operating fund of the Municipality. As of June 30, 2010, the general fund has an undesignated fund balance of $773,223.

## GENERAL FUND BUDGETARY HIGHLIGHTS

Over the course of the year, the Municipality Council revised the Municipality's budget in order to include increases in revenues that were identified during the course of the fiscal year based on current developments that positively affected the Municipality's finances. Increases in budgeted expenditures were also made since the law mandates a balanced budget.

## CAPITAL ASSETS AND DEBT ADMINISTRATION

### Capital Assets

The Municipality's investment in capital assets as of June 30, 2010, amounts to $47,586,749, with an accumulated depreciation of $13,084,045 (including $1,146,581 of current year depreciation expense), leaving a net book value of $34,502,704. This investment in capital assets includes land, construction in progress, buildings, improvements, equipment, infrastructure, furnishing, computers and vehicles. Infrastructure assets are items that are normally immovable and of value only to the state, such as roads, bridges, streets and sidewalks, drainage systems, lighting systems, and similar items.

## CAPITAL ASSETS AND DEBT ADMINISTRATION (CONTINUED)

The Municipality finances a significant portion of its construction activities through bond or notes issuances. The proceeds from bond and notes issuances designated for construction activities are committed in its entirety for such purposes and cannot be used for any other purposes. As of June 30, 2010, the Municipality has $5,417,776 of unexpended proceeds from bond and notes issuances that are committed to future construction activities.

### Debt Administration

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

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

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

## ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

The Municipality relies primarily on property and municipal taxes as well as federal and state grants to carry out the governmental activities. Historically, property and municipal taxes have been very predictable with increases of approximately five percent. Federal and State grant revenues may very if new grants are available but the revenue also is very predictable. Those factors were considered when preparing the Municipality's budget for the fiscal year 2010-2011.

## FINAL COMMENTS

The Municipality is an autonomous governmental entity whose powers and authority vested on its Executive and Legislative Branches are specifically established in the Municipal Autonomous Act approved in August 1991. By virtue of such powers, it provides a wide range of services to its constituents which includes, among others, public works, education, public safety, public housing, health, community development, recreation, waste disposal, welfare and others. The Municipality's principal sources of revenues are derived from property taxes, municipal license taxes, subsidies from the Commonwealth of Puerto Rico's General Fund and contributions from the Traditional and Electronic Lottery sponsored by said Government.

The Municipality's management is committed to a continued improvement in the confection of a budget that will response to the needs of the public and private sectors in accordance with its permissible revenues levels. Such has been the case of the financial operation corresponding to fiscal year 2010. It further contemplates to improve its current figure of net assets, which has been identified as one of the main short and long-term objectives of the Municipality.

## FINANCIAL CONTACT

The Municipality's financial statements are designed to present users (citizens, taxpayer, customers, investors and creditors) with a general overview of the Municipality's finances and to demonstrate the Municipality's accountability. If you have questions about the report or need additional financial information, contact the Municipality's Chief Financial Officer at PO Box 1012, Luquillo, Puerto Rico 00773-1012, or call (787) 889-2068.

Commonwealth of Puerto Rico
Municipality of Luquillo
Statement of Net Assets
June 30, 2010

| | Governmental Activities |
|---|---|
| **Assets** | |
| Cash and cash equivalents | $ 4,668,421 |
| Cash with fiscal agent | 8,218,534 |
| Accounts receivable: | |
| Municipal license tax | 5,708 |
| Municipal sales and use tax | 33,366 |
| Construction excise tax | 8,180 |
| Intergovernmental | 20,334 |
| Interest | 45,228 |
| Federal grants | 51,725 |
| Others | 18,596 |
| Capital assets | |
| Land, improvements, and construction in progress | 16,137,292 |
| Other capital assets, net of depreciation | 18,365,412 |
| Total capital assets | 34,502,704 |
| **Total assets** | 47,572,796 |
| Liabilities | |
| Accounts payable and accrued liabilities | 1,475,864 |
| Due to other governmental entities | 46,566 |
| Deferred revenues: | |
| Municipal license tax | 554,451 |
| Federal grant revenues | 77,876 |
| Interest payable | 133,254 |
| Noncurrent liabilities: | |
| Due within one year | 943,944 |
| Due in more than one year | 12,842,767 |
| **Total liabilities** | 16,074,722 |
| **Net Assets** | |
| Invested in capital assets, net of related debt | $ 23,058,704 |
| Restricted for: | |
| Capital projects | 7,342,973 |
| Debt service | 2,607,030 |
| Other purposes | (83,219) |
| Unrestricted (deficit) | (1,427,414) |
| **Total net assets** | $ 31,498,074 |

The notes to the financial statements are an integral part of this statement.

# Commonwealth of Puerto Rico
# Municipality of Luquillo
# Statement of Activities
# For the Year Ended June 30, 2010

| Functions/Programs | Expenses | Program Revenues: Charges for Services | Program Revenues: Operating Grants and Contributions | Program Revenues: Capital Grants and Contributions | Net (Expense) Revenue and Changes in Net Assets: Governmental Activities |
|---|---|---|---|---|---|
| General government | $ 6,191,122 | $ - | $ 113,119 | $ - | $ (6,078,003) |
| Public safety | 668,390 | 43,039 | 603,999 | | (21,352) |
| Public works | 2,397,144 | 8,527 | 100,002 | 2,291,300 | 2,685 |
| Health and welfare | 2,125,803 | | 1,086,304 | | (1,039,499) |
| Culture and recreation | 597,185 | 22,105 | 23,506 | 70 | (551,504) |
| Economic development | 361,646 | 9,955 | 205,015 | | (146,676) |
| Community development | 188,185 | | 572,679 | | 384,494 |
| Education | 5,041 | | 50,000 | | 44,959 |
| Interest on long-term debt | 328,198 | | | | (328,198) |
| Total governmental activities | $12,862,714 | $ 83,626 | $ 2,754,624 | $ 2,291,370 | (7,733,094) |

| | |
|---|---|
| General revenues: | |
| Property taxes | 4,138,704 |
| Municipal license tax | 909,548 |
| Municipal sales and use tax | 2,539,131 |
| Other local taxes | 239,564 |
| Grants and contributions not restricted to specific programs | 3,246,197 |
| Interest and investment earnings | 142,285 |
| Miscellaneous | 20,437 |
| Total general revenues | 11,235,866 |
| Change in net assets | 3,502,772 |
| Net assets - beginning, as restated | 27,995,302 |
| Net assets - ending | $ 31,498,074 |

The notes to the financial statements are an integral part of this statement.

## Commonwealth of Puerto Rico
## Municipality of Luquillo
## Balance Sheet
## Governmental Funds
## June 30, 2010

| | General Fund | Special Revenue Fund - State & Local Grants | Special Revenue Fund Other Federal Grants | Capital Projects Fund - State & Local Grants | Debt Service Fund | Other Governmental Funds | Total Governmental Funds |
|---|---|---|---|---|---|---|---|
| **Assets** | | | | | | | |
| Cash and cash equivalents | $ 1,200,932 | $ 375,915 | $ 358,204 | $ 2,533,771 | $ - | $ 199,599 | $ 4,668,421 |
| Cash with fiscal agent | | 46,823 | 33,985 | 5,417,776 | 2,719,950 | | 8,218,534 |
| Accounts receivable: | | | | | | | |
| Municipal license tax | 5,708 | | | | | | 5,708 |
| Municipal sales and use tax | 33,366 | | | | | | 33,366 |
| Construction excise tax | 8,180 | | | | | | 8,180 |
| Intergovernmental | | | | | 20,334 | | 20,334 |
| Interest | 45,228 | | | | | | 45,228 |
| Federal grants | | | 51,725 | | | | 51,725 |
| Others | 18,596 | | | | | | 18,596 |
| Due from other funds | 1,682,517 | | | | | | 1,682,517 |
| Total assets | $ 2,994,527 | $ 422,738 | $ 443,914 | $ 7,951,547 | $ 2,740,284 | $ 199,599 | $ 14,752,609 |
| **Liabilities and Fund Balances** | | | | | | | |
| Liabilities : | | | | | | | |
| Accounts payable and accrued liabilities | $ 396,655 | $ 2,312 | $ 18,070 | $ 8,378 | $ - | $ - | $ 425,415 |
| Due to other governmental entities | 46,566 | | | | | | 46,566 |
| Due to other funds | | 704,246 | 347,968 | 600,196 | | 30,107 | 1,682,517 |
| Deferred revenues: | | | | | | | |
| Municipal license tax | 554,451 | | | | | | 554,451 |
| Federal grant revenues | | | 77,876 | | | | 77,876 |
| Total liabilities | 997,672 | 706,558 | 443,914 | 608,574 | - | 30,107 | 2,786,825 |
| Fund balances: | | | | | | | |
| Reserved for: | | | | | | | |
| Encumbrances | 1,192,523 | | | | | | 1,192,523 |
| Capital projects | | | | 7,342,973 | | | 7,342,973 |
| Debt service fund | | | | | 2,740,284 | | 2,740,284 |
| Other purposes | 31,109 | (283,820) | | | | | (252,711) |
| Reserved reported in nonmajor funds: | | | | | | | |
| Other purposes | | | | | | 169,492 | 169,492 |
| Unreserved: | | | | | | | |
| Undesignated | 773,223 | | | | | | 773,223 |
| Total fund balances | 1,996,855 | (283,820) | - | 7,342,973 | 2,740,284 | 169,492 | 11,965,784 |
| Total liabilities and fund balances | $ 2,994,527 | $ 422,738 | $ 443,914 | $ 7,951,547 | $ 2,740,284 | $ 199,599 | $ 14,752,609 |

The notes to the financial statements are an integral part of this statement.

## Commonwealth of Puerto Rico
## Municipality of Luquillo
## Statement of Revenues, Expenditures and Changes in Fund Balances
## Governmental Funds
## For the Year Ended June 30, 2010

| | General Fund | Special Revenue Fund - State & Local Grants | Special Revenue Fund Other Federal Grants | Capital Projects Fund - State & Local Grants | Debt Service Fund | Other Governmental Funds | Total Governmental Funds |
|---|---|---|---|---|---|---|---|
| **Revenues** | | | | | | | |
| Property taxes | $ 3,135,949 | $ - | $ - | $ - | $ 1,002,755 | $ - | $ 4,138,704 |
| Municipal license taxes | 909,548 | | | | | | 909,548 |
| Municipal sales and use tax | 2,146,363 | | | | 392,768 | | 2,539,131 |
| Licenses,permits and other local taxes | 239,564 | | | | | | 239,564 |
| Charges for services | 25,342 | | | | | | 25,342 |
| Intergovernmental | 3,359,317 | 791,483 | | 2,391,370 | | | 6,542,170 |
| Fines and forfeitures | 43,039 | | | | | | 43,039 |
| Rent of property | 15,245 | | | | | | 15,245 |
| Interest | 142,285 | | | | | | 142,285 |
| Federal grants | | | 1,250,556 | | | 455,179 | 1,705,735 |
| Miscellaneous | 20,437 | | | | | 44,286 | 64,723 |
| Total revenues | 10,037,089 | 791,483 | 1,250,556 | 2,391,370 | 1,395,523 | 499,465 | 16,365,486 |
| **Expenditures** | | | | | | | |
| Current: | | | | | | | |
| General government | 6,383,746 | 32,123 | | | | | 6,415,869 |
| Public safety | 320,035 | 201,861 | 91,038 | | | | 612,934 |
| Public works | 2,159,527 | 224,009 | | 2,247,184 | | | 4,630,720 |
| Health and welfare | 1,036,902 | | 586,839 | | | 473,071 | 2,096,812 |
| Culture and recreation | 442,407 | 23,506 | | 51,553 | | | 517,466 |
| Economic development | | 361,482 | | | | | 361,482 |
| Community development | | | 572,679 | | | | 572,679 |
| Debt service: | | | | | | | |
| Principal | | | | | 782,000 | | 782,000 |
| Interest | | | | | 397,303 | | 397,303 |
| Total expenditures | 10,342,617 | 842,981 | 1,250,556 | 2,298,737 | 1,179,303 | 473,071 | 16,387,265 |
| Excess (deficiency) of revenues over (under) expenditures | (305,528) | (51,498) | | 92,633 | 216,220 | 26,394 | (21,779) |
| **Other financing sources (uses)** | | | | | | | |
| Transfers in | 9,008 | 12,621 | | 10,369 | | | 31,998 |
| Transfers out | | (14,902) | | (17,096) | | | (31,998) |
| Total other financing sources (uses) | 9,008 | (2,281) | | (6,727) | | | - |
| Net change in fund balances | (296,520) | (53,779) | | 85,906 | 216,220 | 26,394 | (21,779) |
| Fund balance, beginning as restated | 2,293,375 | (230,041) | | 7,257,067 | 2,524,064 | 143,098 | 11,987,563 |
| Fund balance, ending | $ 1,996,855 | $ (283,820) | $ - | $ 7,342,973 | $ 2,740,284 | $ 169,492 | $ 11,965,784 |

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The notes to the financial statements are an integral part of this statement.

**Commonwealth of Puerto Rico**
**Municipality of Luquillo**
**Reconciliation of the Balance Sheet - Governmental Funds**
**to the Statement of Net Assets**
**For the Year Ended June 30, 2010**

| | | |
|---|---|---|
| **Total Fund Balances - Governmental Funds** | | $ 11,965,784 |
| Amounts 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 | $ 16,137,292 | |
| Depreciable Capital Assets | 31,449,457 | |
| Accumulated Depreciation | (13,084,045) | |
| Total Capital Assets | | 34,502,704 |
| Accounts payable accumulated according to the accrual basis of accounting. In the current period, those amounts are: | | (1,050,449) |
| 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 Notes Payable | 11,342,000 | |
| LIMS Repayment Plan | 78,478 | |
| Property Taxes Debt | 1,258,227 | |
| Interest Payable of Noncurrent liabilities | 133,254 | |
| Compensated Absences | 1,108,006 | |
| Total Long-Term Liabilities | | (13,919,965) |
| **Total Net Assets of Governmental Activities** | | $ 31,498,074 |

The notes to the financial statements are an integral part of this statement.

## Commonwealth of Puerto Rico
## Municipality of Luquillo
## Reconciliation of the Statement of Revenues, Expenditures, and Changes in Fund Balances of Governmental Funds to the Statement of Activities
## For the Year Ended June 30, 2010

| | | |
|---|---|---|
| **Net Change in Fund Balances - Total Governmental Funds** | $ | (21,779) |
| Amounts reported for governmental activities in the Statement of Activities are different because: | | |
| Governmental Funds report capital outlays as expenditures. However, in the Government-Wide Statement of Activities and Changes in Net Assets, the cost of those assets is allocated over their estimated useful lives as depreciation expense. This is the amount of capital assets recorded in the current period. | | 3,209,977 |
| Depreciation expense on capital assets is reported in the Government-Wide Statements of Activities and Changes in Net Assets, but they do not require the use of current financial resources. Therefore, depreciation expense is not reported as expenditures in Governmental Funds. | | (1,146,581) |
| Disposal of capital assets require removal of cost of the capital assets from the capital asset account on the Government-Wide Statement of Net Assets, resulting in a loss on disposal of capital assets on the Government-Wide Statement of Activities and Changes in Net Assets. | | (42,147) |
| Interest Payable on long-term debt was reported in the Government-Wide Statement of Activities and Changes in Net Assets, but it did not require the use of current financial resources. Therefore, Interest Payable was not reported as expenditures in Governmental Funds. The following amount represents the change in accrued interest from prior year. | | 69,103 |
| Accounts Payable reported in the Government-Wide Statement of Activities and Changes in Net Assets but not reported as in the Governmental Funds because they do not require the use of current financial resources. The following amount represents the change in this accounts payable from prior year. | | 484,065 |
| Repayment of bonds and notes principal is an expenditure in Governmental Funds, but the repayment reduces long -term liabilties in the Government-Wide Statement of Net Assets. This is the amount by which the debt proceeds service principal payments exceed debt. | | 782,000 |
| Repayment of long-term property tax advance debt is an expenditure in Governmental Funds, but the repayment reduces long -term property tax advance debt in the Government-Wide Statement of Net Assets. This is the change in the property tax advance debt in the current period. | | 29,516 |
| Repayment of long term Land Information Management System (LIMS) debt is an expenditure in Governmental Funds, but the repayment reduces long term LIMS debt in the Government-Wide Statement of Net Assets. This is the amount paid in the current period. | | 48,613 |
| Long-term compensated absences are reported in the Government-Wide Statement of Activities and Changes in Net Assets, but they do not require the use of current financial resources. Therefore, long-term compensated absences were not reported as expenditures in Govermental Funds. The following amount represented the change in long-term compensated absences from prior year. | | 90,005 |
| **Change in Net Assets of Governmental Activities** | $ | 3,502,772 |

The notes to the financial statements are an integral part of this statement.

## 1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The **Municipality of Luquillo** (the Municipality) was founded on the year 1797. The Municipality's governmental system consists of an executive and legislature body. It is governed by a Mayor and a twelve member Municipal Legislature who are elected for a four-year term.

The Municipality provides a full range of services for its citizens. These services include public safety, public works, culture and recreation, health and welfare, community development, education, and other miscellaneous services.

The accounting policies and financial reporting practices of the Municipality conform to accounting principles generally accepted in the United States of America ("USGAAP") as applicable to governmental units.

In June 1999, the Governmental Accounting Standards Board (GASB) issued Statement No. 34, "Basic Financial Statements and Management's and Discussion and Analysis for State and Local Governments." This Statement, known as the Reporting Model, provides for the most significant change in financial reporting for state and local governments in over 20 years and affects the way the Municipality prepares and presents financial information. The Statement was adopted as of July 1, 2002 In addition to this Statement, GASB Statement No. 37, "Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments: Omnibus" and GASB Statement No. 38, "Certain Financial Statement Note Disclosures" have been adopted and are reflected in these financial statements.

As part of this Statement, there is a new reporting requirement regarding the capitalization of local government infrastructure (roads, bridges, traffic signals, etc.). This requirement permits an optional four-year delay for implementation to fiscal year ended on June 30, 2007. The Municipality implemented the capitalization of infrastructure since July 1, 2006.

The following is a summary of the significant accounting policies of the Municipality:

### A. Component Units

In evaluating how to define the Municipality for financial reporting purposes, management has considered all potential component units. The decision to include a potential component unit in the reporting entity was made by applying the provisions of Statement No. 14, The Financial Reporting Entity, of the GASB, as amended by GASB Statement No. 39. The basic, but not the only criterion for including a potential component unit within the reporting entity is if elected officials of a primary government are financially accountable for the entity. Financial accountability exists if the primary governmental appoints a voting majority of the entity's governing body, and if either one of the following conditions exist: the primary government can impose its will on the other entity or the potential exists for the

## 1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

other entity to (1) provide specific financial benefits to or (2) impose specific financial burdens on the primary government. A second criterion used in evaluating potential component units is if the nature and significance of the relationship between the entity and a primary government are such that to exclude the entity from the financial reporting entity would render the financial statements misleading or incomplete. Based on the above criteria, the Municipality does not have component units to include within its reporting entity.

### B. Government-wide and fund financial statements

Financial information of the Municipality is presented in this report as follow:

1. Management's discussion and analysis introduces the basic financial statements and provides an analytical overview of the Municipality's financial activities.

2. The government-wide financial statements (i.e. the statement of net assets and the statement of activities) report information on all the activities of the Municipality and its component units, if any. Governmental activities, which normally are supported by taxes and intergovernmental revenues, are reported separately from business-type activities, if any, which rely to a significant extent on fees and charges for support. Interfund activity has been removed from these statements to minimize the duplicating effect on assets and liabilities within the governmental activities. The statement of activities demonstrates the degree to which the direct expenses of a given function or segment is offset by program revenue. Direct expenses are those that are 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 not properly included among program revenues are reported instead as general revenues.

3. Fund financial statements focus on information about the Municipality's major governmental funds. Major individual governmental funds are reported as separate columns in the fund financial statements. The Municipality reports the following major governmental funds:

## 1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

***General Fund*** – is the accounting entity in which all governmental activity, except that which is required to be accounted for in another fund, is accounted for. Its revenues consist mainly of taxes, licenses and permits, intergovernmental revenue, charges for services and other.

***Special Revenue Fund – State and Local Grants*** – is the accounting entity in which revenues derived from local funds, state or other restricted revenue source is accounted for the uses and limitations specified by Municipality ordinances or state statutes.

***Special Revenue Fund –Other Federal Grants*** – is the accounting entity in which revenues derived from federal grants, is accounted for. The uses and limitations of each special revenue fund are specified by Municipality ordinances or federal and state statutes.

***Capital Projects Fund – State and Local Grants*** – is the accounting entity in which revenues derived from local funds and state grants or other restricted revenue sources related to capital projects, is accounted for. The uses and limitations of each capital project fund are specified by Municipality ordinances and state statutes.

***Debt Service Fund*** – is the accounting entity used to account for the resources accumulated and payments made for principal and interest on long-term general obligation bonds of governmental funds.

The other governmental funds of the Municipality account for grants and other resources whose use is restricted to a particular purpose.

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

5. Required supplementary information such as the budgetary comparison schedule-general fund and other types of data required by GASB.

6. Notes to the budgetary comparison schedule-general fund.

### C. Financial reporting presentation

The accounts of the Municipality are organized on the basis of funds, each of which is considered a separate accounting entity. The operations of each fund are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues, and expenditures. Fund types are as follows:

## 1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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

***Special Revenue Fund – Local and State Grants*** – Special Revenue Funds are used to account for revenues derived from local funds, state grants or other restricted revenue sources. The uses and limitations of each special revenue fund are specified by Municipality ordinances or federal and state statutes.

***Special Revenue Fund – Section 8*** – Special Revenue Funds are used to account for revenues derived from Section 8 Housing Choice Voucher Program. The uses and limitations of each special revenue fund are specified by Municipality ordinances or federal and state statutes.

***Special Revenue Fund –Other Federal Grants*** – Special Revenue Funds are used to account for revenues derived from federal grants. The uses and limitations of each special revenue fund are specified by Municipality ordinances or federal and state statutes.

***Capital Projects Fund – Local and State Grants*** – Capital Project Funds are used to account for financial resources used for the acquisition or construction of major capital facilities.

***Debt Service Funds*** – Debt Service Funds are used to account for the accumulation of resources for and the payment of, general long-term debt principal, interest, and related costs.

### D. Measurement focus, basis of accounting and financial presentation

Except for budgetary purposes, the basis of accounting used by the Municipality conform to accounting principles generally accepted in the United States of America ("USGAAP") as applicable to governmental units. The accounting and financial reporting treatment applied to a fund is determined by its measurement focus.

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenues in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

The Municipality has elected not to apply all Statements and Interpretations issued by the Financial Accounting Standard Board after November 30, 1989, in accordance with GASB Statement No. 20.

## 1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period.

For this purpose, the government considers revenues to be available if they are collected within the current period or soon enough thereafter. Expenditures are recorded when the related fund liability is incurred, except for principal and interest on general long-term debt, claims and judgments, and compensated absences, which are recognized as expenditures when payment is due. General capital asset acquisitions are reported as expenditure in governmental funds. Proceeds from issuance of general long-term debt reported as other financing sources.

Property taxes, other taxes, licenses, rent, 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 the government receives cash.

Private-sector standards of accounting and financial reporting issue prior to December 1, 1989, generally are followed in the government-wide financial statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. Governments also have the option of following subsequent private-sector guidance for their business-type activities and enterprise funds, subject to this same limitation. The Municipality has elected not to follow subsequent private-sector guidance.

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

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

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

## 1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### E. Assets, liabilities and net assets

1. **Cash, cash equivalents, and cash with fiscal agent** – The Municipality's cash and cash equivalents are considered to be cash on hand, demand deposits, and short-term investments with original maturities of three months or less from the date of acquisition.

   Cash with fiscal agent in the debt service fund represents special additional property tax collections retained by the Commonwealth of Puerto Rico and restricted for the payment of the Municipality's debt service, as established by law. Also, cash with fiscal agent consists of unused proceeds of bonds and notes issued for the acquisition of equipment and construction of major capital improvements.

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."

   Advances 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 are stated net of estimated allowance for uncollectible accounts, which are determined, based upon past collections experience and current economic conditions. Intergovernmental receivables in the General Fund represent mostly charge for services rendered to other governmental entities. Intergovernmental receivable in the special revenue or capital project funds represent amounts owed to the Municipality for reimbursement of expenditures incurred pursuant to federally funded or state funded programs.

3. **Inventories** – Inventories in the general fund is recorded as expenditure and, consequently, the inventory is not recorded in the statement of net assets.

4. **Capital assets** – Capital assets, which include property, equipment and infrastructure assets (e.g., roads, bridges, sidewalks and similar items), are reported in the governmental activities column in the governmental-wide financial statements. The Municipality defines capital asset as assets with an initial, individual cost of more than $25 and an estimated useful life in excess of one year. Such assets are reported at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation.

## 1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The cost of normal maintenance and repairs that do not add to the value of the asset or materially extend assets lives are not capitalized.

Major outlays for capital assets and improvements are capitalized as projects are constructed.

Capital assets of the Municipality are depreciated using the straight-line method over the following estimated useful lives:

| Description | Useful Life | Capitalization threshold |
|---|---|---|
| Buildings and site improvements | 40 years | $1 |
| Infrastructure | 40 years | $1 |
| Works of art | 10 years | $1 |
| Vehicles | 5 years | $1 |
| Furniture and fixtures | 5 years | $25 |
| Machinery and equipment | 3 to 5 years | $25 |

5. **Long-term obligations** – The liabilities reported in the government-wide financial statements included general and special obligation bonds and notes, and other long-term liabilities, such as vacation, sick leave, litigation, long-term liabilities to other governmental entities.

   In the fund financial statements, governmental fund types recognize bond issuances cost, during the current period. The face amount of debt issued is reported as other financing sources, while bond issuance costs, whether or not withheld from the actual debt proceeds received, are reported as expenditures.

6. **Compensated absences** – Employees accumulate vacation leave at a rate of 2.5 days per month up to a maximum of 60 days. Unpaid vacation time accumulated is fully vested to the employees from the first day of work. All vacation pay is accrued when incurred in the government-wide financial statements.

   Employees accumulate sick leave at a rate of 1.5 days per month up to a maximum of 90 days. Upon retirement, an employee receives compensation for all accumulated and unpaid sick leave at the current rate, if the employee has at least 10 years of service with the Municipality. All sick leave pay and salary related benefits are accrued when incurred in the governmental-wide financial statements when the employee meets such criteria.

7. **Claims and judgments** – The estimated amount of the liability for claims and judgments, which is due on demand, such as from adjudicated or settled claims, is recorded in the general fund when the liability is incurred.

## 1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

8. **Reservations of fund balance** – Reservations of fund balance in the fund financial statements, represent portions of fund balances that are legally segregated for specific future use or are not appropriated for expenditure. The Municipality has the following reservations of fund balance:

   a. ***Capital Projects*** – Represent the reservation of amounts to be used for future expenditures for capital projects under contacts and other commitments. These committed amounts generally will become liabilities in future periods as the projects are completed.

   b. ***Encumbrances*** – Represent future expenditures under purchase orders, contracts and other commitments. These committed amounts generally will become liabilities in future periods as the goods or services are received.

   c. ***Other Purposes*** – Represents net assets available for specific use and/or legally segregated for other specific future use.

   d. ***Debt Service Fund*** – Represents net assets available to finance future debt service payments.

9. **Interfund and intra-entity transactions** – The Municipality has the following types of transactions among funds:

   a. Operating Transfers – Legally required transfers that are reported when incurred as "Operating transfer-in" by the recipient fund and as "Operating transfers-out" by the disbursing fund.

   b. Intra-Entity Transactions – Transfers between the funds of the primary government are reported as interfund transfers with receivables and payables presented as amounts due to and due from other funds.

10. **Net Assets** - In the government-wide statements, net assets are segregated into three categories:

   a. Invested in capital assets, net of related debt: Consist of capital asset balances net of accumulated depreciation and outstanding balances of any bonds, notes and other borrowings that are attributable to the acquisition, construction, or improvement of those assets. This category should not include cash that is restricted to capital assets acquisition or construction (unspent bond proceeds) and any unamortized debt issue costs.

## 1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

b. Restricted net assets: Represent net assets that are subject to restrictions beyond the Municipal's control. These include restrictions that are externally imposed (by creditors, grantors, contributors, or laws and regulations of other governments) or restrictions imposed by the law through constitutional provisions or enabling legislation (including enabling legislation passed by the government itself).

c. Unrestricted net assets: Represent net assets that do not meet the definition of net assets invested in capital assets, net of related debt or restricted. Unrestricted assets are often designated to indicate that management does not consider them to be available for general operations. These types of constraints are internal and management can remove or modify them. Designations are not reported on the face statement of net assets.

**11. Accounting for Pension Costs**- For the purpose of applying the requirements of GASB Statements No. 27, *Accounting for Pensions by State and Local Government Employers* (GASB No. 27), the state government of the Commonwealth of Puerto Rico is considered to be the sponsor of the Employee's Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS) and System 2000, a multi-employer cost-sharing defined benefit 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 Commonwealth of Puerto Rico. Accordingly, no portion of the net pension obligation (NPO) related to ERS has been allocated to the Municipality in the accompanying basic financial statements. The basic financial statements of the Commonwealth of Puerto Rico report the total amount of the net pension obligation of ERS, including any amount that may correspond to the Municipality.

**12. Risk financing** – The Municipality carries commercial insurance to cover casualty, theft, tort claims and other losses. Insurance policies are negotiated by the Puerto Rico Treasury Department and costs are allocated among all the Municipalities of Puerto Rico.

Cost of insurance allocated to the Municipality and deducted from the gross property tax collections by the Municipal Revenue Collection Center (CRIM) for the year ended June 30, 2010 amounted to approximately $181,225. The current insurance policies have not been cancelled or terminated. The CRIM also deducted approximately $146,412 for workers compensation insurance covering all municipal employees.

## 2. CASH AND CASH EQUIVALENTS

The Municipality maintains its deposits in various commercial banks located in Puerto Rico and Government Development Bank for Puerto Rico (GDB). Proceeds from bonds and funds related to certain grant awards are required by law to be held with GDB.

The Municipality adopted the provisions of GASB Statement No. 40 (GASB No. 40), *Deposit and Investment Risk Disclosure, an Amendment to GASB Statement No. 3*. This statement requires that state and local governments disclose essential risk information about deposits and investments. The disclosure requirements cover four main areas: (1) credit risk, (2) interest rate risk, (3) custodial credit risk, (4) foreign exchange exposure.

**Credit risk** – This is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. In compliance with the laws and regulations of the Commonwealth, the Municipality has adopted, as it's custodial and credit risk policy, the *Statement of Investment Guidelines for the Government of the Commonwealth of Puerto Rico*. Accordingly the Municipality invests only in obligations of the Commonwealth, obligations of the United States of America, certificates of deposits, commercial paper, bankers' acceptances, or in pools of obligations of the municipalities of Puerto Rico, which are managed by GDB. According to the aforementioned investment guidelines, the Municipality does not invest in marketable securities or any types of investments for which credit risk exposure may be significant. Therefore, the Municipality's management has concluded that the risk related to any possible loss related to defaults by commercial banks on the Municipality's deposits is considered low at June 30, 2010.

**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 investments in its investment portfolio at June 30, 2010, (2) limiting the weighted average maturity of its investments to three months or less, and (3) keeping most of its bank deposits in interests bearing accounts generating interests at prevailing market rates. At June 30, 2010, the Municipality's investments in certificates of deposits are recorded at cost, which approximates their fair value. Therefore, the Municipality's management has concluded that at June 30, 2010, the interest rate risk associated with the Municipality's cash and cash equivalents is considered low.

**Custodial credit risk** – In the case of deposits, this is the risk that in the event of a bank failure, the Municipality's deposits may not be recovered. Pursuant to the *Statement of Investment Guidelines for the Government of the Commonwealth of Puerto Rico* the balances deposited in commercial banks by the Municipality are insured by the Federal Deposit Insurance Corporation (FDIC) generally up to a maximum of $250,000 per depositor.

## 2.CASH AND CASH EQUIVALENTS (CONTINUED)

**Custodial credit risk** –In addition, public funds deposited in commercial banks by the Municipality are fully securities pledged as collateral are held, in the Municipality's name, by the agents of the Commonwealth's Secretary of Treasury. Deposits with GDB are uninsured and uncollateralized. However, no losses related to defaults by GDB on deposit transactions have been incurred by the Municipality through June 30, 2010. Therefore, the Municipality's management has concluded that at June 30, 2010 the custodial credit risk associated with the Municipality's cash and cash equivalents is considered low.

**Foreign exchange risk** – The risk that changes in exchange rates will adversely affect the value of an investment or a deposit. According to the aforementioned investment guidelines, the Municipality is prevented from investing in foreign securities or any other types of investments in 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, 2010.

Under Commonwealth of Puerto Rico statutes public funds deposited in commercial banks must be fully collateralized for the amount deposited in excess of federal depository insurance. All securities pledged as collateral are held by the Secretary of the Treasury of Puerto Rico. In addition, the Municipality maintains deposits with the Government Development Bank for Puerto Rico (GDB).

The Municipality's bank balances in commercial banks of $1,200,932 in the General Fund, the $358,204 in the Special Revenue Fund Other Federal Grants, the $2,533,771 in the Capital Projects Fund – State and Local Grants and the $375,915 in the Special Revenue Fund – State & Local Grants were fully collateralized at June 30, 2010. In the Other Governmental Funds there were deposits with commercial banks of $199,599 that were fully collateralized.

The deposits at GDB of $46,823 in the Special Revenue Fund – State & Local Grants, the $5,417,776 in the Capital Projects Fund – State and Local Grants, the $2,719,950 that is restricted for Debt Service Fund and the $33,985 in the Special Revenue Fund Other Federal Grants are unsecured and uncollateralized, as no collateral is required to be carried by governmental banks.

## 3. RECEIVABLES

***A. Municipal Sales and Use Tax*** – On July 29, 2007, an amendment to Act No. 117 of July 4, 2006, Known as the "The Fairness Act of 2006", was enacted with the purpose of establishing a mandatory sales and use tax of 1.5% at the municipal level. The municipalities of Puerto Rico are responsible to collect 1% of the corresponding tax with the same exemptions and limitations that the portion collected by the Treasury Department. The Act provides an optional surtax on the un-process food. This surtax must be approved by the Municipal Legislature. The Treasury Department is responsible to create the Municipal Development Fund (.2%), the Municipal Redemption Fund (.2%) and the Municipal Improvements Fund (.1%) with the remaining 0.5%. Municipal sales and use tax receivable of $33,366 represents filed municipal sales and tax returns that where uncollected as of June 30, 2010, net of allowance for uncollectible accounts.

***B. Municipal License Tax*** - The Municipality imposes a municipal license tax on all businesses that operate within the Municipality, which are not totally or partially exempt from the tax pursuant to 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 on April 15 of each year. Entities with sales volume of $1,000,000 or more must include audited financial statements together with the tax return. This tax is due in two equal installments on July 1 and January 1 of each fiscal year. A discount of 5% is allowed when full payment is made on or before April 15. Municipal license tax receivable of $5,708 represents filed municipal license tax returns that were uncollected as of June 30, 2010, net of allowance for uncollectible accounts.

***C. Construction excise tax***- Construction excise tax receivables amounting to $8,180 in the general fund represent a payment agreement formalized by the Municipality during the fiscal year 2009-10 and collected on August 19, 2010.

***D. Intergovernmental***- Intergovernmental receivable in the Debt Service Fund represents property tax receivable at June 30, 2010. Following is a detail of the intergovernmental receivable:

| Governmental Entity | Amount |
|---|---|
| Municipal Revenue Collection Center (CRIM) | $ 20,334 |
| **Total** | $ 20,334 |

***E. Federal Grants*** –Intergovernmental receivables in the Special Revenue Fund – Other Federal Grants represent expenditures incurred not yet reimbursed by the federal government or the pass-through grantor. Following is a detail of the intergovernmental receivables:

## 3. RECEIVABLES (CONTINUED)

| Program Description | Amount |
|---|---|
| Child Care and Development Block Grant | $ 17,326 |
| Community Development Block Grants-State's Program | 12,452 |
| State and Community Highway Safety Program | 10,299 |
| Special Program, for Aging Title III | 9,568 |
| Nutrition Program for the Elderly | 2,080 |
| **Total** | $ 51,725 |

## 4. INTERFUND TRANSACTIONS

Interfund receivables and payables at June 30, 2010 are summarized as follows:

### a. Due from/to other fund:

| Receivable Fund | Payable Fund | Purpose | Amount |
|---|---|---|---|
| General Fund | Special Revenue Fund – Local and State Grants | Payrolls, accruals, and other expenditures not reimbursed | $ 704,246 |
| General Fund | Special Revenue Fund – Other Federal Grants | Payrolls, accruals, and other expenditures not reimbursed | 347,968 |
| General Fund | Capital Projects Fund – Local and State Grants | Capital Projects | 600,196 |
| General Fund | Other Governmental Funds | Payrolls, accruals, and other expenditures not reimbursed | 30,107 |
| **Total** | | | $ 1,682,517 |

### b. Transfer in/out to other fund

| Transfer out | Transfer in | Purpose | Amount |
|---|---|---|---|
| Capital Projects Funds – State & Local Grants | Special Revenue Funds-State & Local Grants | Transfer of funds for special purpose | $ 12,621 |
| Capital Projects Funds – State & Local Grants | General Fund | Transfer of funds for general purpose | 4,475 |
| Special Revenue Funds-State & Local Grants | General Fund | Transfer of funds for general purpose | 4,533 |
| Special Revenue Funds-State & Local Grants | Capital Projects Funds – State & Local Grants | Transfer of funds for special purpose | 10,369 |
| **Total** | | | $ 31,998 |

## 5. CAPITAL ASSETS

Capital assets; those with an estimated useful live of one year or more from the time of acquisition by the Municipality and a cost of $25 or more, are primarily funded through the issuance of long-term bonds and loans. A summary of capital assets and changes occurring in 2010, including those changes pursuant to the implementation of GASB Statement No. 34, follows. Land and construction in progress are not subject to depreciation:

| Governmental Activities: | Balance June 30, 2009 | Additions | Retirements | Balance June 30, 2010 |
|---|---|---|---|---|
| **Capital asset, not being depreciated:** | | | | |
| Land | $ 10,462,413 | $ - | $ - | $ 10,462,413 |
| Construction in progress | 3,548,049 | 2,376,482 | (249,652) | 5,674,879 |
| **Total capital assets not being depreciated** | 14,010,462 | 2,376,482 | (249,652) | 16,137,292 |
| **Capital assets, being depreciated:** | | | | |
| Buildings | 11,921,957 | 24,995 | - | 11,946,952 |
| Buildings improvements | 3,775,179 | 359,970 | - | 4,135,149 |
| Infrastructure | 4,662,306 | 588,951 | - | 5,251,257 |
| Infrastructure improvements | 4,292,715 | | - | 4,292,715 |
| Equipment | 2,559,955 | 82,363 | (83,105) | 2,559,213 |
| Furnishing | 603,437 | 3,417 | | 606,854 |
| Work of art | 1,960 | | - | 1,960 |
| Computers | 385,109 | 23,451 | (2,340) | 406,220 |
| Vehicles | 2,249,237 | - | (100) | 2,249,137 |
| **Total capital assets being depreciated** | 30,451,855 | 1,083,147 | (85,545) | 31,449,457 |
| **Less accumulated depreciation for:** | | | | |
| Buildings | (3,674,535) | (298,361) | - | (3,972,896) |
| Buildings improvements | (322,046) | (101,555) | - | (423,601) |
| Infrastructure | (2,337,710) | (126,380) | - | (2,464,090) |
| Infrastructure improvements | (794,330) | (286,181) | - | (1,080,511) |
| Equipment | (1,961,355) | (194,860) | 41,099 | (2,115,116) |
| Furnishing | (549,094) | (18,927) | | (568,021) |
| Works of art | (409) | (196) | - | (605) |
| Computers | (300,727) | (52,894) | 2,262 | (351,359) |
| Vehicles | (2,040,656) | (67,227) | 37 | (2,107,846) |
| **Total accumulated depreciation** | (11,980,862) | (1,146,581) | 43,398 | (13,084,045) |
| **Total capital assets being depreciated, net** | 18,470,993 | (63,434) | (42,147) | 18,365,412 |
| **Governmental activities capital assets, net** | $ 32,481,455 | $ 2,313,048 | $ (291,799) | $ 34,502,704 |

## 5. CAPITAL ASSETS (CONTINUED)

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

| Governmental activities: | Amount |
|---|---|
| General government | $ 364,534 |
| Public works | 353,033 |
| Culture and recreation | 147,829 |
| Community development | 212,168 |
| Health and welfare | 30,022 |
| Public safety | 33,791 |
| Education | 5,040 |
| Economic development | 164 |
| **Total depreciation expense-governmental activities** | $ 1,146,581 |

## 6. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities at June 30, 2010 are summarized as follows:

| Description | General Fund | Special Revenue Fund-State & Local Grants | Special Revenue Fund Section Other Federal Grants | Capital Projects Fund - State & Local Grants | Debt Service Fund | Other Governmental Funds | Total |
|---|---|---|---|---|---|---|---|
| Accounts payable | $ 179,970 | $ 2,312 | $ 18,070 | $ 8,378 | $ - | $ - | $ 208,730 |
| Accrued liabilities | 216,685 | - | - | - | - | - | 216,685 |
| **Total** | $ 396,655 | $ 2,312 | $ 18,070 | $ 8,378 | $ - | $ - | $ 425,415 |

## 7. PROPERTY TAXES

The personal property tax is self assessed by the taxpayer on a return which is to be filed by May 15 of each year with the Municipal Revenue Collection Center (CRIM), a governmental entity created by the government of Puerto Rico as part of the Municipal Governmental Autonomous Law of August 1991. Real property tax is assessed by the CRIM on each piece of real estate and on each building.

The assessment is made as of January 1 of each year and is based on current values for personal property and on estimated values as of 1957 for real property tax. The tax on personal property must be paid in full together with the return by May 15. The tax on real property may be paid in two installments by July 1 and January 1. The CRIM is responsible for the billing and collections of real and personal property taxes on behalf of all the municipalities of Puerto Rico. Prior to the beginning of each fiscal year, the CRIM informs the Municipality of the estimated amount of property tax expected to be collect for the ensuing fiscal year. Throughout the year, the CRIM advances funds to the Municipality based on the initial estimated collections. The CRIM is required by law to prepare a settlement statement

## 7. PROPERTY TAXES (CONTINUED)

on a fiscal year basis, whereby a comparison is made between the amounts advanced to the Municipality and amounts actually collected from taxpayers. This settlement has to be completed on a preliminary basis not later than three months after fiscal year-end, and a final settlement made not later than six months after year-end. If the CRIM remits to the Municipality property tax advances, which are less than the tax actually collected, a receivable from the CRIM is recorded at June 30. However, if advances exceed the amount actually collected by the CRIM, a payable to the CRIM is recorded at June 30. The CRIM issued the preliminary liquidation noting that the advances exceeded collections by $3,980. In the governmental funds, the entire receivable has been offset by deferred revenue since the excess was not available to pay liabilities of the current period. In the government-wide financial statements, the entire receivable is recognized as revenue.

The governmental-wide statement of net assets includes an outstanding debt balance of $86,256 corresponding to the prior year's CRIM final liquidation.

On January 26, 2000, Public Law No. 42 was enacted, which authorized the CRIM to obtain a loan up to $200,000,000, and for a term not to exceeding 10 years, to allow for the financing of the debt that the Municipalities of Puerto Rico have with the CRIM arising from final settlements of property tax advances versus actual collections through fiscal year ended June 30, 2000. The amounts that the Municipalities will collect from additional property taxes resulting from increases in the subsidy from the Commonwealth of Puerto Rico to the Municipalities are assigned through this law to repay such loan. The increase in this subsidy was the result of the Public Law No. 238, enacted on August 15, 1999. On October 11, 2001, Public Law No. 146 was enacted to amend Public Law No. 42, to extend the loan amortization period up to 30 years. Also, on October 11, 2003, Public Law No, 172 was enacted, to provide as an option for the Municipalities to include the debt that the Municipalities of Puerto Rico have with the CRIM arising from final settlements of property tax advances versus actual collections for the fiscal year ended June 30, 2001 with the loan authorized through Public Law No. 42 enacted on January 26, 2000.

On June 26, 1997, Public Law No. 21 was enacted authorizing the CRIM, among other things, to sell the property tax receivables related to taxpayers who owned property taxes from 1974 to 1996. Such property tax receivables were purchased by the Public Financing Corporation, a subsidiary of the Government Development Bank of Puerto Rico (GDB) using the proceeds of a bond issuance executed for such purposes. Said Law imposed the CRIM the obligation to replace uncollectible property tax receivables with any valid property tax receivable or

## 7. PROPERTY TAXES (CONTINUED)

equivalent in money. Subsequent to the approval of the Law and to the sale transaction, it was detected that a substantial percentage of the receivables sold were uncollectible. In order to protect the economic damage to the financial structure of municipalities caused by the substitution of uncollectible tax receivables with sound collectible receivables, on October 11, 2001, Public Law No. 146 was approved and enacted. Through this Law, the CRIM was authorized to obtain a loan from any qualified financial institution and pay in advance the outstanding balance of the bonds issued and any related cost incurred for the purchase by the Public Financing Corporation (a GDB subsidiary) of the tax receivables. The loan is being paid by the municipalities thru a 30 year long term financing negotiated by the CRIM with GDB on behalf of such municipalities as authorized by the indicated Law.

The government-wide Statement of Net Assets includes an outstanding balance of $655,874 and $512,117 related to Law No. 146 and the Law No. 42, respectively.

Residential real property occupied by its owner is exempt by law from the payment of property taxes on the first $15,000 of the assessed value. For such exempted amounts, the Puerto Rico Treasury Department assumes payment of the basic tax to the Municipalities, except for property assessed at less than $3,500 for which no payment is made. As part of the Municipal Autonomous Law of 1991, the exempt amount to be paid by the Puerto Rico Treasury department to the Municipalities was frozen as of January 1, 1992. In addition, the law grants a tax exemption from the payment of personal property taxes of up to $50,000 of the assessed value to retailers having annual net sales of less than $150,000.

The annual tax rate is 8.83% for real property and 6.83% for personal property of which 1.03% of both tax rates are for the redemption of public debt issued by the Commonwealth of Puerto Rico. The remaining percentage is distributed as follows: (a) 5.8% and 3.8%, respectively, represents the Municipality's basic property tax rate which is appropriated for basics and accounted for in 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. From such fund, a distribution is made to all municipalities; (b) 2.00% represents the ad valorem tax restricted for debt service and accounted for in the debt service fund.

## 8. DUE TO OTHER GOVERNMENTAL ENTITIES

The amounts due to other governmental entities in the general fund include the following:

| Governmental Entity | Amount |
|---|---|
| Puerto Rico Aqueduct and Sewer Authority ("AAA") | $ 45,425 |
| General Services Administration | 1,141 |
| **Total** | $ 46,566 |

## 9. DEFERRED REVENUES

**A. Municipal License Tax** –The Municipality imposes a municipal license tax on all businesses that operate within the Municipality, which are not totally or partially exempt from the tax pursuant to the Industrial Incentives Act 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 on April 15 of each year. Entities with sales volume of $1,000,000 or more must include audited financial statements together with the tax return. During the fiscal year ended June 30, 2010, the tax rates were as follows:

1. Financial business – 1.50% of gross revenues.
2. Other organizations – 0.50% of gross revenues.

This tax is due in two equal installments on July 1 and January 1 of each fiscal year. A discount of 5% is allowed when full payment is made on or before April 15. Municipal license tax receivable represents filed municipal license tax returns that were uncollected as of June 30, 2010, net of allowance for uncollectible account. Municipal license taxes collected prior to June 30 but pertaining to the next fiscal year are recorded as deferred revenues.

The deferred revenues of $554,451 in the General Fund relates to municipal license tax collected in fiscal year 2009-10 that will be earned in fiscal year 2010-11.

**B. Federal Grants** – The deferred revenues presented in the Special Revenue Fund – Other Federal Grants represents the portion of federal grants received for which qualifying expenditures have not been incurred. Deferred revenues from the federal government are as follows:

| Program Description | Amount |
|---|---|
| ARRA-Homelessness Prevention and Rapid Re-Housing Program | $ 27,642 |
| Disaster Grants-Public Assistance | 33,985 |
| Emergency Management Performance Grant | 12,322 |
| Others | 3,927 |
| **Total** | $ 77,876 |

## 10. LONG-TERM LIABILITIES

Long-term liability activity for the year ended June 30, 2010, was as follows:

| Description | Beginning Balance | Borrowings or Additions | Payments or Deductions | Ending Balance | Due Within One Year |
|---|---|---|---|---|---|
| Bonds Payable | $ 7,440,000 | - | $ (335,000) | $ 7,105,000 | $ 360,000 |
| Notes Payable | 4,684,000 | - | (447,000) | 4,237,000 | 354,000 |
| Property Taxes Advances | 1,287,743 | 3,981 | (33,497) | 1,258,227 | 82,854 |
| Compensated Absences | 1,198,011 | 32,225 | (122,230) | 1,108,006 | 95,542 |
| LIMS Repayment Plan | 127,091 | - | (48,613) | 78,478 | 51,548 |
| **Total** | $14,736,845 | $ 36,206 | $ (986,340) | $13,786,711 | $ 943,944 |

1. **Legal debt margin** – The Municipality is subject to a legal debt margin requirement, which is equal to 10% of the total assessment of property located within the Municipality plus balance of the ad valorem taxes in the debt service fund, for bonds payable to be repaid with the proceeds of property taxes restricted for debt service. 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. Long-term debt, except for the bonds and notes payable, is paid with unrestricted funds.

2. **Bonds Payable** – The Municipality issues general and special obligation bonds to provide funds for the acquisition and construction of major capital facilities. Bonds payable outstanding at June 30, 2010 are as follows:

| Type of bonds | Maturity Date | Original Amount | Range of Interest Rates | Balance at June 30, 2010 |
|---|---|---|---|---|
| 1993 Series | 7-1-12 | $ 2,015,000 | 5.00% to 8.00% | $ 530,000 |
| 2000 Series | 7-1-14 | 460,000 | 2.70% to 7.81% | 215,000 |
| 2003 Series | 7-1-27 | 4,430,000 | 5.00% to 5.31% | 3,790,000 |
| 2008 Series | 7-1-33 | 2,645,000 | 3.93% to 7.50% | 2,570,000 |
| **Total general obligation bonds** | | | | $ 7,105,000 |

These bonds are payable from the special ad valorem property tax of 2.00% which is restricted for debt service and retained by the Government Development Bank for Puerto Rico for such purposes.

## 10. LONG-TERM LIABILITIES (CONTINUED)

Annual debt service requirements to maturity for bonds payable are as follows:

| Year Ending June 30, | Principal | Interest |
|---|---|---|
| 2011 | $ 360,000 | $ 262,633 |
| 2012 | 390,000 | 393,502 |
| 2013 | 420,000 | 367,179 |
| 2014 | 240,000 | 347,346 |
| 2015 | 260,000 | 334,425 |
| 2016-2020 | 1,285,000 | 1,471,749 |
| 2021-2025 | 1,790,000 | 1,044,141 |
| 2026-2030 | 1,745,000 | 460,484 |
| 2031-2035 | 615,000 | 71,437 |
| Total | $ 7,105,000 | $ 4,752,896 |

3. **Notes Payable** – The proceeds of the issuance of notes payables were used principally to pay debt incurred in prior years and to cover the expenditures of a special event. Notes payable outstanding at June 30, 2010 are as follows:

| Type of notes | Maturity Date | Original Amount | Range of Interest rates | Balance at June 30, 2010 |
|---|---|---|---|---|
| 2004 Series | 1-1-13 | 228,000 | 4.25% | $ 107,000 |
| 2006 Series | 7-1-12 | 685,000 | 4.23% to 5.33% | 335,000 |
| 2007 Series | 7-1-14 | 1,125,000 | 6.48% to 7.50% | 715,000 |
| 2007 Series | 7-1-32 | 3,165,000 | 2.42% to 7.50% | 3,080,000 |
| Total notes payable | | | | $ 4,237,000 |

The notes are payable from the ad valorem property tax of 2.00% which is restricted for debt service and retained by the Government Development Bank for Puerto Rico for such purposes.

Annual debt service requirements to maturity for notes payable are as follows:

| Year Ending June 30, | Principal | Interest |
|---|---|---|
| 2011 | $ 354,000 | $ 261,419 |
| 2012 | 375,000 | 271,152 |
| 2013 | 403,000 | 246,473 |
| 2014 | 265,000 | 222,938 |
| 2015 | 80,000 | 210,000 |
| 2016-2020 | 535,000 | 940,312 |
| 2021-2025 | 700,000 | 710,625 |
| 2026-2030 | 1,005,000 | 393,938 |
| 2031-2035 | 520,000 | 39,750 |
| Total | $ 4,237,000 | $ 3,296,607 |

## 10. LONG-TERM LIABILITIES (CONTINUED)

4. **Advances from CRIM** – This amount represents the balance owed to the CRIM at June 30, 2010, as described in Note 7.

5. **Compensated Absences** – The government-wide statement of net assets includes approximately $604,158 of accrued sick leave benefits, and approximately $503,848 of accrued vacation benefits, representing the Municipality's commitment to fund such costs from future operations.

6. **LIMS Repayment Plan** – During the fiscal year 2001-2002, the Municipality authorized the CRIM to retain the corresponding portion for the financing project of Land Information Management System – LIMS, contracted by the CRIM. A total of $413,522 is to be retained in a ten years period at an interest rate of 5.95%, until November 28, 2011. At June 30, 2010 the outstanding debt balance is $78,478. This amount will be presented in the government wide Statement of Net Assets.

## 11. PENSION PLAN

The Employee's Retirement System of the Commonwealth and its Instrumentalities (the Retirement System) is a cost-sharing multiple defined benefit pension plan sponsored by, and reported as a component unit of the Commonwealth of Puerto Rico. All regular employees of the Municipality under 55 years of age at the date of employment become members of the Retirement System as a condition to their employment.

The Retirement System provides retirement, death and disability benefits pursuant to legislation enacted by the Commonwealth's legislature. Disability retirement benefits are available to members for occupational and non-occupational disabilities. Retirement benefits depend upon age at retirement and the number of years of creditable service. Benefits vest after ten years of plan participation.

Members who have attained 55 years of age and have completed at least 25 years of creditable service or members who have attained 58 years of age and have completed ten years of creditable service are entitled to an annual benefit payable monthly for life.

The amount of the annuity shall be one and one-half percent of the average compensation, as defined, multiplied by the number of years of creditable service up to twenty years, plus two percent of the average compensation, 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.

## 11. PENSION PLAN (CONTINUED)

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 65 percent of the average compensation, as defined; otherwise they will receive 75 percent of the average compensation, as defined. No benefits are payable if the participant receives a refund of his/her accumulated contributions.

Commonwealth legislation requires employees to contribute 5.775% for the first $550 of their monthly gross salary and 8.275% for the excess over $ 550 of monthly gross salary. The Municipality is required by the same statute to contribute 9.275% of the participant's gross salary. Total Municipality contributions to the above-mentioned plans during the year ended June 30, 2010 recorded as pension expenditures were $ 297,131. This amount represented 100% of the required contribution.

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

System 2000 is a hybrid defined contribution plan, also known as a cash balance plan. Under this new plan, there will be a pool of pension assets, which will be invested by ERS together with those of the current defined benefit plan. The Commonwealth of Puerto Rico will not guarantee benefits at retirement age. The annuity will be based on a formula which assumes that each year the employee's contribution (with a minimum of 8.275% to the employee's salary up to a maximum of 10%) will be invested in an account which will either: (1) earn a fixed rate based on the two-year Constant Maturity Treasury Note or, (2) earn a rate equal to 75% of the return of the ERS's investment portfolio (net of management fees), or (3) earn a combination of both alternatives. Participants will receive periodic account statements similar to those of defined contribution plans showing their accrued balances. Disability pensions will not be granted under System 2000. The employer's contribution (9.275% of the employee's salary) will be used to fund the current plan.

Additional information on the Retirement System is provided in its financial statements for the year ended June 30, 2010, a copy of which can be obtained from the Retirement System, Minillas Station, PO Box 42004, San Juan, PR 00940.

## 12. RISK MANAGEMENT

The Property Division of the Municipality is responsible of assuring that the Municipality's property is properly insured. Annually, the Property Division compiles the information of all property owned and its respective market value. After evaluating this information, the Property Division submits the data regarding the Municipality's properties to the area of Public Insurance Department at the Department of the Treasury of the Commonwealth of Puerto Rico who is responsible for purchasing all property and casualty insurance policies of all municipalities. Settled claims have not exceeded commercial coverage in any of the past three fiscal years.

## 13. CONTINGENCIES

The Municipality is a defendant in a number of lawsuits arising principally from claims against the Municipality for alleged improper actions, and other legal matters that arise in the ordinary course of the Municipality's activities.

It is management's opinion, based on the advice of the legal counsel, that the potential claims against the Municipality not covered by insurance will not materially affect the financial resources for its payment.

The Municipality participates in a number of federal financial assistance programs funded by the Federal Government. Expenditures financed by these programs are subject to financial and compliance audits by the appropriate grantor. The amount, if any, of expenditures which may be disallowed by such audits cannot be determined at this time, although the Municipality management expects such amounts, if any, will not be material.

## 14. FUTURE ADOPTION OF ACCOUNTING PRONOUNCEMENTS

The GASB has issued the following statements that have effective dates after June 30, 2010:

a. GASB Statement No.54, Fund Balance Reporting and Governmental Fund Type Definitions, which is effective for periods beginning after June 15, 2010, with early implementation encouraged.

b. GASB Concepts Statement No. 5, Service Efforts and Accomplishments- an Amendment of GASB Concepts Statements No. 2. This Statement provides a framework to be used by the GASB in considering guidance for reporting SEA by state and local governmental entities and amends terminology and other information in GASB: CS-2

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

## 15. PRIOR PERIOD ADJUSTMENTS

### A. GOVERNMENTAL FUND FINANCIAL STATEMENTS

The following restatements have been made in the governmental fund financial statements, which are reported as an adjustment to the beginning fund balances:

| Description | General Fund | Special Revenue Fund – State & Local Grants | Special Revenue Fund – Other Federal Grants | Capital Projects Fund – State & Local Grants | Debt Service Fund | Other Governmental Fund | Total |
|---|---|---|---|---|---|---|---|
| Fund balance, beginning | $ 2,293,375 | $ (230,041) | $ - | $ 7,037,654 | $ 2,524,064 | $ 143,098 | $11,768,150 |
| To adjust prior year accounts payable | - | - | - | 219,413 | - | - | 219,413 |
| Fund balance, beginning as restated | $ 2,293,375 | $ (230,041) | $ - | $ 7,257,067 | $ 2,524,064 | $ 143,098 | $11,987,563 |

### B. GOVERNMENTAL WIDE FINANCIAL STATEMENTS

The following restatements have been made in the governmental wide financial statements, which are reported as an adjustment to the beginning net assets:

| Description | Total |
|---|---|
| Net assets, beginning | $ 27,775,889 |
| To adjust prior year accounts payable | 219,413 |
| Net assets, beginning as restated | $ 27,995,302 |

# COMMONWEALTH OF PUERTO RICO
# MUNICIPALITY OF LUQUILLO

## BUDGETARY COMPARISON SCHEDULE – GENERAL FUND
## (SEE NOTES TO BUDGETARY COMPARISON SCHEDULE)

## YEAR ENDED JUNE 30, 2010

| | Budgeted Amounts Original | Budgeted Amounts Final | Actual Amounts (Budgetary Basis) (See Note 1) | Variance with Final Budget Positive (Negative) |
|---|---|---|---|---|
| **REVENUES:** | | | | |
| Property taxes | $ 3,135,949 | $ 3,135,949 | $ 3,135,949 | - |
| Municipal license tax | 783,535 | 898,840 | 910,256 | 11,416 |
| Licenses, permits and other local taxes | 337,000 | 231,384 | 244,250 | 12,866 |
| Charges for services | 23,250 | 25,342 | 25,342 | - |
| Intergovernmental | 2,550,427 | 2,424,271 | 3,359,317 | 935,046 |
| Rent of property | 24,300 | 15,245 | 15,245 | - |
| Fines and forfeitures | 30,000 | 46,042 | 60,301 | 14,259 |
| Interest | 248,000 | 118,646 | 208,959 | 90,313 |
| Miscellaneous | 86,000 | 19,104 | 20,437 | 1,333 |
| Municipal sales and use tax | 620,000 | 1,235,600 | 2,154,078 | 918,478 |
| **Total revenues** | 7,838,461 | 8,150,423 | 10,134,134 | 1,983,711 |
| **Budget carryover (1)** | - | 490,964 | 490,964 | - |
| **Total revenues after carryover** | 7,838,461 | 8,641,387 | 10,625,098 | 1,983,711 |
| **EXPENDITURES, ENCUMBRANCES AND OTHER FINANCING USES:** | | | | |
| Current: | | | | |
| General government | 4,581,228 | 5,020,244 | 6,518,210 | (1,497,966) |
| Public safety | 288,349 | 322,304 | 325,508 | (3,204) |
| Public works | 1,651,023 | 1,996,924 | 2,167,139 | (170,215) |
| Health and welfare | 1,097,117 | 1,032,696 | 1,059,556 | (26,860) |
| Culture and recreation | 220,744 | 269,219 | 445,955 | (176,736) |
| **Total expenditures, encumbrances and other financing uses** | 7,838,461 | 8,641,387 | 10,516,368 | (1,874,981) |
| **EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES, ENCUMBRANCES AND OTHER FINANCING SOURCES (USES)** | | | $ 108,730 | $ 108,730 |

**Explanation of Differences:**

| | |
|---|---|
| **Sources/inflows of resources:** | |
| Actual amounts (budgetary basis)"available for appropriation" from the budgetary comparison schedule | $ 10,625,098 |
| Differences-budget to USGAAP: | |
| Budgeted carryover | (490,964) |
| USGAAP adjustments to revenues | (97,045) |
| Non-budgeted transfer in | 9,008 |
| **Total revenues as reported on the statement of revenues, expenditures, and changes in fund balances** | $ 10,046,097 |
| **Uses/outflows of resources:** | |
| Actual amounts (budgetary basis) "total charges to appropriations" from the budgetary comparison schedule | $ 10,516,368 |
| Differences-budget to USGAAP: | |
| Prior year encumbrances recorded as current year expenditures for USGAAP basis | 101,597 |
| Current year encumbrances recorded as expenditures for budgetary purposes | (275,348) |
| **Total expenditures as reported on the statement of revenues, expenditures, and changes in fund balances** | $ 10,342,617 |

**(1) Represents fund balance carried over from prior year**

## 1. STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY

### a. Budgetary Control

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

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

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

The annual budget as presented in the Budgetary Comparison Schedule-General Fund is the budget ordinance at June 30, 2010 representing the original budget. There were no supplemental appropriations for the year ended June 30, 2010.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

YEAR ENDED JUNE 30, 2010

| Federal Grantor/Pass-through Grantor/Program or Cluster Title | Federal CFDA Number | Pass-through Entity Identifying Number | Expenditures |
|---|---|---|---|
| **U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT:** | | | |
| Direct Program: | | | |
| ARRA-Homeless Prevention and Rapid Re-Housing (Recovery Act Funded) | 14.257 | | $ 380 |
| Direct Program: | | | |
| Section 8 Housing Choice Vouchers | 14.871 | | 447,229 |
| Pass-through the Commonwealth of Puerto Rico – Office of the Commissioner of Municipal Affairs: | | | |
| Community Development Block Grants – State's Program | 14.228 | 09-AB, FC-41<br>08-AB, FC-41<br>07-AB, FC-41<br>06-AB, FC-41<br>05-AB<br>04-AB, FC-41<br>03-AB, FC-41 | 572,298 |
| **Total U.S. Department of Housing and Urban Development** | | | **1,019,907** |
| **U.S. DEPARTMENT OF JUSTICE:** | | | |
| Pass-through the Commonwealth of Puerto Rico – Department of Justice | | | |
| Edward Byrne Memorial Justice Assistance Grant Program | 16.738 | 2006-DJ-DMFPL-01 | 30,695 |
| **Total U.S. Department of Justice** | | | **30,695** |
| **U.S. DEPARTMENT OF TRANSPORTATION:** | | | |
| Pass-through the Commonwealth of Puerto Rico – Traffic Safety Commission | | | |
| State and Community Highway Safety | 20.600 | Not Available | 91,038 |
| **Total U.S. Department of Transportation** | | | **91,038** |

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (CONTINUED)

YEAR ENDED JUNE 30, 2010

| Federal Grantor/Pass-through Grantor/Program or Cluster Title | Federal CFDA Number | Pass-through Entity Identifying Number | Expenditures |
|---|---|---|---|
| **U.S DEPARTMENT OF HEALTH AND HUMAN SERVICES:** | | | |
| Pass-through the Commonwealth of Puerto Rico – Governor's Office (Elderly Office): | | | |
| Special Programs for the Aging - Title III, Part B, Grants for Supportive Services and Senior Centers | 93.044 | Not Available | 169,958 |
| Nutrition Services Incentive Program | 93.053 | Not Available | 40,762 |
| Child Care and Development Block Grant | 93.575 | Not Available | 345,425 |
| **Total U.S. Department of Health and Human Services** | | | **556,145** |
| **TOTAL EXPENDITURES OF FEDERAL AWARDS** | | | **$ 1,697,785** |

The accompanying notes are an integral part of this schedule.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

YEAR ENDED JUNE 30, 2010

## 1. BASIS OF PRESENTATION:

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of the **Municipality of Luquillo** and is presented on the modified accrual basis of accounting. The basis of accounting is the same used to prepare the fund financial statements. The information in this Schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

## 2. RELATIONSHIP TO FEDERAL FINANCIAL REPORTS:

Amounts reported in the accompanying Schedule are included in the Special Revenue Fund – Other Federal Grants and in the Other Governmental Funds in the Municipality's fund financial statements. The reconciliation between the expenditures in the fund financial statements and the expenditures in the Schedule of Expenditures of Federal Awards is as follows:

| Description | Special Revenue Fund – Other Federal Grants | Other Governmental Funds | Total |
|---|---|---|---|
| Per Schedule of Expenditures of Federal Awards | $ 1,250,556 | $ 447,229 | $ 1,697,785 |
| Non federal programs expenditures and other adjustments | - | 25,842 | 25,842 |
| Total expenditures in the general purpose financial Statements | $ 1,250,556 | $ 473,071 | $ 1,723,627 |

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- Puerto Rico Society of Certified Public Accountants

# 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 the Municipal Legislature**
**Municipality of Luquillo**
**Luquillo, 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 Luquillo, Puerto Rico,** as of and for the year ended June 30, 2010, which collectively comprise the **Municipality's** basic financial statements and have issued our report thereon dated December 15, 2010. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States.

## Internal Control Over Financial Reporting

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

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

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weakness, as defined above. However, we identified certain deficiencies in internal control over financial reporting, described in the accompanying schedule of findings and questioned costs that we consider to be significant deficiencies in internal control over financial reporting. Significant deficiencies are described in the accompanying schedule of findings and questioned costs as item **10-01.** A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.



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## 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* (CONTINUED)

**Compliance and Other Matters**

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

We also noted certain other matters that we reported to management of the **Municipality of Luquillo** in a separate letter dated December 15, 2010.

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

This report is intended solely for the information and use of management and federal awarding agencies and pass-through entities. However, this report is a matter of public record and its distribution is not limited.

LOPEZ-VEGA, CPA, PSC

San Juan, Puerto Rico
December 15, 2010

Stamp No. 2575449 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.

López-Vega, CPA, PSC
Certified Public Accountants / Management Advisors

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- American Institute of Certified Public Accountants
- Puerto Rico Society of Certified Public Accountants

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

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

## Compliance

We have audited the compliance of the **Municipality of Luquillo** with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2010. The **Municipality of Luquillo'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 the **Municipality of Luquillo's** management. Our responsibility is to express an opinion on the **Municipality of Luquillo'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 the **Municipality of Luquillo's** compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the **Municipality of Luquillo's** compliance with those requirements.

In our opinion, the **Municipality of Luquillo** complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2010. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as items **10-02** through **10-04**.



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

**Internal Control Over Compliance**

The management of the **Municipality of Luquillo** 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 the **Municipality of Luquillo's** internal control over compliance with the requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of **Municipality of Luquillo'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, a 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 that might be deficiencies, significant deficiencies, or material weaknesses in internal control over compliance. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above. However, we identified certain deficiencies in internal control over compliance that we consider to be significant deficiencies as described in the accompanying schedule of findings and questioned costs as items **10-02** through **10-04**. A *significant deficiency* in internal control over compliance is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

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

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

We also noted other matters involving the internal control over compliance and certain immaterial instance of noncompliance, which we have reported to management of the **Municipality of Luquillo** in a separate letter dated March 25, 2011.

This report is intended solely for the information and use of management and federal awarding agencies and pass-through entities. However, this report is a matter of public record and its distribution is not limited.

LOPEZ-VEGA, CPA, PSC

San Juan, Puerto Rico
March 25, 2011

Stamp No. 2575450 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

YEAR ENDED JUNE 30, 2010

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**Section I – Summary of Auditor's Results**

***Financial Statements***

| | | |
|---|---|---|
| Type of auditor's report issued: | **Unqualified** | |
| Internal control over financial reporting: | | |
| Material weakness identified? | Yes | No **X** |
| Significant deficiencies identified not considered to be material weaknesses? | Yes **X** | None reported |
| Noncompliance material to financial statements noted? | Yes | No **X** |

***Federal awards***

| | | |
|---|---|---|
| Internal Control over major programs: | | |
| Material weakness identified? | Yes | No **X** |
| Significant deficiencies identified not considered to be material weaknesses? | Yes **X** | None reported |
| 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 Circular A-133, Section .510(a)? | Yes **X** | No |

Identification of major programs:

| CFDA Number | Name of Federal Program or Cluster |
|---|---|
| 14.228 | Community Development Block Grants – State's Program |
| 14.871 | Section 8 Housing Choice Voucher |
| 93.575 | Child Care and Development Block Grant |

| | | |
|---|---|---|
| Dollar threshold used to distinguish between Type A and Type B programs | $300,000 | |
| Auditee qualified as low-risk auditee? | Yes | No **X** |

## Section II – Financial Statements Findings

| | |
|---|---|
| **Finding Reference** | **10-01** |
| **Requirement** | **Financial Reporting – Accounting Records** |
| **Statement of Condition** | During our examination of the Municipality's accounting system, we noted that it does not summarize the transactions in a formal General Ledger in order to properly record and account for the transactions of all of its Governmental Funds (Local, State and Federal funds). |
| **Criteria** | Chapter VIII, Article 8.010 of State Act Number 81 of August 30, 1991 states that the Municipality should maintain an effective and updated accounting system. |
| **Cause of Condition** | The Municipality did not establish effective internal control over the transactions recorded on its accounting records. Also, the accounting data is not summarized in the form of a double-entry general ledger record. |
| **Effect of Condition** | The Municipality's accounting system did not provide updated and complete financial information that present the financial position, the result of operations and the change in fund balances. Such information is necessary to take management decisions. |
| **Recommendation** | We recommend that the Municipality should implement the necessary internal controls and procedures in order to maintain an accounting system that contains information pertaining to authorizations, obligations, unobligated balances, assets, liabilities, expenditures, interfund transactions, etc. |
| **Questioned Cost** | None |
| **Management Response and Corrective Action** | The Municipality maintains two set of accounting records; a manual system and a computerized system provided in the past by the Office of the Commissioner of Municipal Affairs (OCAM). Actually, all of the transactions were recorded in both systems, but the manual system is the primary financial records for financial statements preparation purposes at the end of each fiscal year due to the fact that the computerized system real accounts balances carried forward from prior years were affected by accounting errors in the first years of the system operation. |

## Section II – Financial Statements Findings

**Finding Reference** **10-01 (Continued)**

Nevertheless, as part of the corrective action plan, the Commissioner of Municipal Affairs ("OCAM") consider alternatives to improve the accounting system, including the acquisition of new accounting software, and therefore, we will hope to solve our accounting system condition in a near future. Although, the Legislature of the Commonwealth Government of Puerto Rico has appropriated funds for the design and implementation of a new system, no further action has been taken on this matter.

Implementation Date: July, 2011

Responsible Persons: Efrain Mojica
Finance Director

## Section III – Major Federal Award Program Findings and Questioned Costs

| | |
|---|---|
| **Finding Reference** | **10-02** |
| **Program** | **Section 8 Housing Choice Vouchers Program (CFDA 14.871) U.S. Department of Housing and Urban Development** |
| **Requirement** | **Special Test** |
| **Statement of Condition** | We noted that the Section 8 Housing Choice Voucher Program did not comply with the compliance requirement of Depository Agreements. The PHA is required to enter into depositary agreement with their financial institutions in the form required by HUD. (Form HUD-51999) |
| **Criteria** | 24 CFR Subpart D, Section 982.156 states. (c) The PHA must enter into an agreement with the depositary in the form required by HUD. (d) If required under a written freeze notice from HUD to the depositary: (i) The depositary may not permit any withdrawal by the PHA of funds held under the depositary unless expressly authorized by written notice from HUD to the depositary: and (ii) The depositary must permit withdrawals of such funds by HUD. (2) HUD must send the PHA a copy of the freeze notice from HUD to the depositary. |
| **Cause of Condition** | The Program is not performing an effective review of compliance requirement that are required by HUD. |
| **Effect of Condition** | The PHA is not in compliance with laws and established regulation as prescribed by HUD. |
| **Recommendation** | Procedures should be implemented to ascertain that the PHA complies with the established Federal Regulation, as prescribed by HUD. |
| **Questioned Costs** | None |
| **Management Response and Corrective Action** | The form HUD 52520 B (August 1988) were submitted as evidence of the contract agreement between the Municipality of Luquillo and U.S. Department of Housing where served as supporting document to open the bank account where the federal agency has been depositing the reimbursements since 1988. In order to comply with section III Compliance requirements, N-Special test and provision, 8 Depository agreements, we have been submitting the form HUD-51999 (6/91) as requested.<br><br>Implementation Date: March 2011<br><br>Responsible Person: Marilyn Rodriguez Millan<br>Director Federal Affairs Office |

## Section III – Major Federal Award Program Findings and Questioned Costs

**Finding Reference** 10-03

**Program** **Community Development Block Grants – State's Program (CFDA. No. 14.228); U.S. Department of Housing and Urban Development; Pass through the Commonwealth of Puerto Rico – Office of Commissioner of Municipal Affairs (OCAM)**

**Requirement** **Procurement and Suspension and Debarment**

**Statement of Condition** During our contract provision test, we verified two (2) contracts for the Community Development Block Grants – State's Program, formalized during the fiscal year ended June 30, 2010. The following summarizes the situations found:

a. Two (2) contracts did not include a provision for compliance with executive order 11246 "Equal Employment Opportunity".

b. Two (2) contracts did not include a provision for compliance with Davis Bacon Act.

c. Two (2) contracts did not include a provision for compliance with sections 103 and 107 of the Contract Work Hours & Safety Standards Act.

d. Two (2) contracts did not include a provision for compliance with the Copeland "Anti-kickback".

e. One (1) contract did not include a provision for granting access to GAO or other federally agency, to books, documents, etc.

f. Two (2) contracts did not include a provision for compliance with the Clean Air Act and Water Act.

g. Two (2) contracts did not include a provision for compliance with Energy Policy and Conservation Act.

h. One (1) contract did not include a provision for retention of all required records for three years.

i. Two (2) contracts did not include a provision for compliance with Suspension and Debarment.

## Section III – Major Federal Award Program Findings and Questioned Costs

| | |
|---|---|
| **Finding Reference** | **10-03 (continued)** |
| **Criteria** | Code of Federal Regulation 24, Subpart I, Sec. 570.489 (g) requires that all purchase orders and contracts include all clauses required by Federal Statues, executive orders and implementing regulations. |
| **Cause of Condition** | The Municipality's internal control and procedures failed to detect the exclusion of certain contract clauses in the procurement process. |
| **Effect of Condition** | The Municipality is not in compliance with Code of Federal Regulation 24, Subpart I, Sec.570.489 (g). |
| **Recommendation** | We recommend that the Municipality should strengthen its procedures in order to assure that the contracts contain all provisions requested by federal agencies. |
| **Questioned Costs** | None |
| **Management Response and Corrective Action** | The project contracts under review were prepared by the Municipal Secretary Office and this finding was needed no further corrective action as said in the previous Management Response and Corrective Action (as of June 30 2009) but no actions were performed. For the fiscal year 2010-2011 the Federal Affairs Office, Municipality of Luquillo reviewed contracts in order to comply with the federal regulation as Executive Order 11246-Equal Employment Opportunity; Davis Bacon Act; Section 103/107 of the Contract Work Hours; Copeland "Anti-kickback"; GAO; Clean Air Act and Water Act; Energy Policy and Conservation Act; record retention, Suspension and Debarment. As part of the corrective action all contract provisions were updated in accordance to the federal regulation by December 2010.<br><br>Implementation Date: December 2010<br><br>Responsible Person: Marilyn Rodriguez Millan<br>Director Federal Affairs Office |

## Section III – Major Federal Award Program Findings and Questioned Costs

| | |
|---|---|
| **Finding Reference** | **10-04** |
| **Program** | **Child Care and Development Block Grant (CFDA. No. 93.575); U.S. Department of Health and Human Services; Pass through State – Commonwealth of Puerto Rico Administration for Children and Families.** |
| **Requirement** | **Cash Management** |
| **Statement of Condition** | We performed a Cash Management Test and found that the program requested funds that were not disbursed on a reasonable lapse of time. |
| **Criteria** | CFR 45, Subpart C, Section 92.20 (b)(7), requires a cash management system in order to minimize the time elapsed between the transfer of funds from the U.S. Treasury and disbursements made by the grantee. |
| **Cause of Condition** | The procedures established by ACUDEN in the delegation of funds agreement do not provide a clause to comply with this requirement. |
| **Effect of Condition** | The Municipality is not in compliance with 45 CFR, Subpart C, Section 92.20 (b)(7). |
| **Recommendation** | We recommend management to require ACUDEN alternate methods to request cash in order to comply with this requirement. |
| **Questioned Costs** | None |
| **Management Response and Corrective Action** | The Municipality's Management will instruct the Program accountant to begin the disbursement process when the requisitions of funds are submitted to the Administration for Care and Integral Development of Childhood (ACUDEN) in order to assure that when the funds are transferred by the Pass-through Grantor, the Program will disburse it immediately.<br><br>Implementation Date: July 2011<br><br>Responsible Person: Jennie Erazo Rosario<br>Child Care Coordinator |

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

SUMMARY OF SCHEDULE OF PRIOR YEARS AUDIT FINDINGS

YEAR ENDED JUNE 30, 2010

| Original Finding Number | CFDA No. | Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133) |
|---|---|---|
| 09-02 | 14.871 | We performed a Cash Management Test and after our procedures, we found that during the current fiscal year, the Municipality maintained a monthly average cash balance in books of, approximately, $166,178. Also, at June 30, 2009, the cash balance in book was $153,896.<br><br>Corrective action was taken. |
| 09-03 | 14.228 | During our Davis Bacon Act test, we verified the construction projects 05-FC-41-004, 06-AB-41-006 and 08-AB-41-001. We found the following exceptions: a) For the construction projects 05-FC-41-004, 06-AB-41-006 and 08-AB-41-001, the Municipality did not perform the required visits for monitoring the classifications of the workers and the wage rates paid. Also, the contractor's weekly payrolls were not requested during the construction period.<br><br>Corrective action was taken. |
| 09-04 | 14.228 | During our contract provision test, we verified three (3) contracts for the Community Development Block Grants – State's Program, formalized during the fiscal year ended June 30, 2010. The following summarizes the situations found: a) three (3) contracts did not include a provision for termination by grantee for default, b) three contracts (3) did not include a provision for granting access to GAO or other federally agency, to books, documents, etc., c) Three (3) contracts did not include a provision for compliance with the Clean Air Act and Water Act., d) Three (3) contracts did not include a provision for compliance with Energy Policy and Conservation Act., e) Three (3) contracts did not include a provision for retention of all required records for three years., f) Three (3) contracts did not include a provision for compliance with Suspension and Debartment.<br><br>No corrective action was taken. The auditors reissued the finding for the current year. Finding Reference 10-03 |

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

SUMMARY OF SCHEDULE OF PRIOR YEAR AUDIT FINDINGS (CONTINUED)

YEAR ENDED JUNE 30, 2010

| Original Finding Number | CFDA No. | Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133) |
|---|---|---|
| 09-05 | 93.575 | We performed a Cash Management Test and found that the program requested funds that were not disbursed on a reasonable lapse of time.<br><br>No corrective action was taken. The auditors reissued the finding for the current year. Finding Reference 10-04 |
| 08-02 | 14.871 | We performed a Cash Management Test and after our procedures, we found that during the current fiscal year, the Municipality maintained a monthly average cash balance in books of, approximately, $165,420. Also at June 30, 2008, the cash balance in book was $159,048.<br><br>Corrective action was taken. |
| 08-03 | 14.871 | We performed an eligibility test of fifteen (15) participant files and found the following exceptions: a) In one (1) case, the PHA used an incorrect utility allowance for the HAP calculation. b) In one (1) case, the participant's file did not include the HUD-50058 Family Report Form corresponding to audit period. c) In three (3) cases, the PHA used an incorrect family income for the HAP calculation. d)In one (1) case, the participant's HAP did not agree with the contract amount.<br><br>Corrective action was taken. |
| 08-04 | 14.228 | During our Davis Bacon Act test, we verified the construction projects 06-AB-41-001, 07-AB-41-001 and 07-FC-41-001. We found the following exceptions: a) For the constructions project 06-AB-41-001, the Municipality did not perform the required visits for monitoring the classifications of the workers and the wage rates paid. Also, the contractor's weekly payrolls were not requested during construction period. b)For the construction project 07-AB-41-001 and 07-FC-41-001, the Municipality did not document the required visits for monitoring the classifications of the workers and the wage rates paid. Also, several weekly payrolls were not submitted by the contractor during the fiscal year 2007-2008 (The submitted weekly payrolls were not monitored to verify the compliance with the prevailing wage rates).<br><br>Corrective action was taken. |

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF LUQUILLO

SUMMARY OF SCHEDULE OF PRIOR YEAR AUDIT FINDINGS (CONTINUED)

YEAR ENDED JUNE 30, 2010

| Original Finding Number | CFDA No. | Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133) |
|---|---|---|
| 08-05 | 93.575 | We performed Cash Management Test and found that the program requested funds that were not disbursed on a reasonable lapse of time.<br><br>No corrective action was taken. The auditors reissued the finding for the current year. Finding Reference 10-04. |
| 07-02 | 14.871 | The auditors realized a Cash Management Test and after the procedures, they found that during the current fiscal year, the Municipality maintained a monthly average cash balance in books of, approximately, $121,233. Also, at June 30, 2007, the cash balance in book was $125,728.<br><br>The audit finding does not warrant further action because two years have passed since the audit report in which the finding occurred was submitted to the Federal clearinghouse. |
| 07-03 | 14.871 | The auditors performed an eligibility test of fifteen (15) participant files and found the following exceptions: (a) In eleven (11) cases, the PHA used an incorrect utility allowance for the HAP calculation; (b) In one (1) case, the PHA used an incorrect Fair Market Rent allowance for the HAP calculation and; (c) In one (1) case, the PHA used an incorrect family income for the HAP calculation.<br><br>The audit finding does not warrant further action because two years have passed since the audit report in which the finding occurred was submitted to the Federal clearinghouse. |