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

MUNICIPIO DE NAGUABO
AUDITORÍA 2012-2013

30 DE JUNIO DE 2013

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

BASIC FINANCIAL STATEMENTS AND SUPPLEMENTARY INFORMATION

FISCAL YEAR ENDED JUNE 30, 2013

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

CPA DIAZ-MARTINEZ, PSC
CERTIFIED PUBLIC ACCOUNTANTS AND CONSULTANTS

AICPA Governmental Audit Quality Center

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

FINANCIAL

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INDEPENDENT AUDITOR'S REPORT

To the Honorable Mayor and
Member of the Municipal Legislature
Municipality of Naguabo of the
Commonwealth of Puerto Rico
Naguabo, Puerto Rico

Report on the Financial Statements

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

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

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Basis for Qualified Opinion on Governmental Activities

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

Qualified Opinion

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

Unmodified Opinions

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

Emphasis-of-Matter

Newly Adopted Standards

As discussed in Note 23 to the financial statements, the **Municipality** adopted new accounting guidance, Governmental Accounting Standards Board (GASB) Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position,* and GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities* effective July 1, 2012. Our opinion is not modified with respect to this matter.

Restatement of Prior Year Financial Statements

As discussed in Note 22 to the basic financial statements, the 2012 financial statements have been restated to correct misstatements. Our opinions is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 6 through 16, and budgetary comparison information on pages 60 and 61 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Supplementary Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the **Municipality**'s basic financial statements. The accompanying Financial Data Schedule – Section 8 Housing Choice Vouchers Program, as required by U.S. Department of Housing and Urban Development, on pages 63 through 65, and the Schedule of Expenditures of Federal Awards, as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organization,* on pages 67 through 69, are presented for purposes of additional analysis and are not required parts of the basic financial statements.

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

Other Reporting Required by *Governmental Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated April 30, 2014 on our consideration of the **Municipality**'s internal control over financial reporting on our test of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considered **Municipality**'s internal control over financial reporting and compliance.

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

Caguas, Puerto Rico
April 30, 2014

Stamp No. E100034 was affixed to
the original report.

AICPA Governmental Audit Quality Center

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

FINANCIAL HIGHLIGHTS

Highlights for Government-wide Financial Statements

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

- The assets of the Municipality, on a government-wide basis, exceeded its liabilities at the close of fiscal year 2013 by $41,702,256 (net position).
- Revenues increased by $3,939,569 (20%) and expenses decreased by ($2,069,566) (14%) in comparison with year 2012, as restated.
- Net change in net position amounted to $4,753,396, an increase of $6,009,135 with respect to prior year.

Highlights for Fund Financial Statements

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

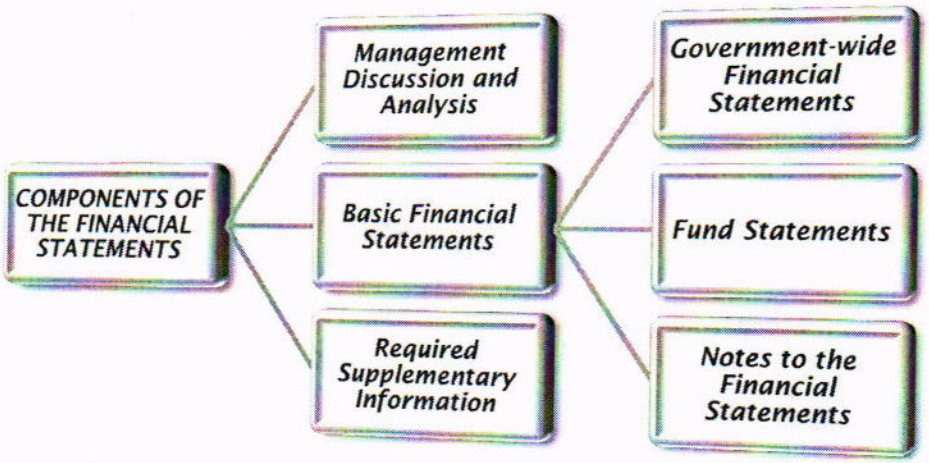
- At the close of the current fiscal year, the Municipality's governmental funds reported combined ending fund balances of $898,631, an increase of $454,060 in comparison with the prior year.
- The General Fund reported an excess of revenues and other financing sources over expenditures and other financing uses of $428,869 and an unassigned (deficit) fund balance of ($4,006,683). Net change in fund balance increased by $2,010,617, when compared with prior year change.

General Financial Highlights

- The investment in capital assets as of June 30, 2013 was $40,968,173 (net of related debt).
- Long-term debt general and special obligation bonds decreased to $6,920,000, approximately (4%) with respect to prior year.
- All other long-term debts decreased and net reductions from payments amounted to ($520,410).
- On a budgetary basis, actual revenues exceeded actual expenditures and transfers by $182,758.
- Revenues increase was mainly in Intergovernmental Revenues of $1,862,300 due to an intergovernmental agreement with Puerto Rico Health Department related to the CDT administered by the Municipality, for which $1,280,196 were received this year.

OVERVIEW OF THE FINANCIAL STATEMENTS

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



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

Basic Financial Statements

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

  The government-wide statements report information about the Municipality as a whole using accounting methods similar to those used by private-sector businesses. They are prepared using the flow of economic resources measurement focus and the accrual basis of accounting.

  Statement of Net Position –The *Statement of Net Position* presents information on all of the Municipality's assets, deferred outflows of resources, liabilities, and deferred inflows of resources, with the difference between them reported as net position. Over time, increases or decreases in net position may serve as a useful indicator of whether its financial position is improving or deteriorating. Other non-financial factors, such as the condition of the Municipality's roads and other infrastructure may need to be considered to assess the overall financial position of the Municipality.

  Statement of Activities – The *Statement of Activities* presents information showing how the Municipality's net position changed during the year. All changes in net position (current year's revenues less expenses) are reported as soon as the underlying event giving rise to the change occurs, *regardless of the timing of related cash flows*. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods (e.g., uncollected taxes and earned but unused vacation leave). The *Statement of Activities* is focused on both the gross and net cost of various activities (including governmental and business-type activities). This is intended to summarize and simplify the reader's analysis of the revenues and costs of various state activities and the degree to which activities are subsidized by general revenues.

  Both of these government-wide financial statements distinguish functions of the Municipality that are principally supported by taxes and intergovernmental revenues (governmental activities) from other functions that are intended to recover all or a significant portion of their costs through user fees and charges (business-type activities).

The governmental activities of the Municipality include general government, public works and sanitation; public safety, culture and recreation, housing, welfare, and community development and education. These activities are primarily financed through property taxes, other local taxes and intergovernmental revenues.

The government-wide financial statements can be found on pages 17-18 of this report.

- ***Fund Financial Statements***

Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide statements. However, unlike the government-wide statements, the governmental funds financial statements focus on near-term inflows and outflows of spendable resources, as well as on balances of spendable resources available at the end of the fiscal year. Such information may be useful in evaluating the Municipality's near-term financing requirements.

In particular, unassigned fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year. At the end of the current fiscal year, the Municipality's governmental funds reported combined ending fund balances of $898,631. Approximately ($4.1) million of this isn't available for spending at the government's discretion [Unassigned Fund Balance (Deficit)]. The remainder of fund balance is restricted, committed or assigned to indicate that is not available for new spending because it has already been committed.

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

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

The governmental funds financial statements can be found on pages 19-22 of this report.

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

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

- ***Required Supplementary Information***

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

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE

Statement of Net Position

Net position (assets over liabilities) may serve over time as a useful indicator of a government's financial position. Net position for the year had an increase of 11% with respect to prior year as restated. The most significant change was a decrease of the unrestricted deficit by $6,475,116. Also, an increase in capital assets by $817,363 (net of depreciation), with a decrease in current liabilities by $8,592,634, due to bank overdraft recognized on prior year.

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

Table 1

Commonwealth of Puerto Rico
Municipality of Naguabo
Statement of Net Position
As of June 30,

	2013	2012
Current and Non-Current Assets	$ 7,868,842	$ 11,613,265
Capital Assets	47,000,942	46,183,579
Total Assets	**54,869,784**	**57,796,844**
Current Liabilities	3,447,891	12,040,525
Unearned Revenues	693,539	675,014
Long-Term Liabilities	9,026,098	8,132,445
Total Liabilities	**13,167,528**	**20,847,984**
Net Position:		
Net Investment in Capital Assets	40,968,173	43,507,438
Restricted	5,017,265	4,199,720
Unrestricted (Deficit)	(4,283,182)	(10,758,298)
Total Net Position	**$ 41,702,256**	**$ 36,948,860**

The largest portion of the Municipality's net position reflects its net investment in capital assets (e.g., land, buildings, equipment, and infrastructure) for $40,968,173; total capital assets ($59,240,374) less accumulated depreciation ($12,239,432) and less any related outstanding debt ($6,032,769) used to acquire those assets. The Municipality uses these assets to provide services to its citizens and consequently, these assets are not available for future spending. The resources needed to repay the debt related to these capital assets must be provided from other sources, because capital assets are not generally liquidated for the purpose of retiring debt.

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

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

As of June 30, 2013 the Municipality presented unrestricted (deficit) net position of ($4,283,182). This balance was affected by long term obligations such as compensated absences $1,621,406 and other debts for the amount of $484,692 for which the Municipality did not provide funding in previous budgets. Historically, such obligations have been budgeted on a pay as you go basis without providing funding for their future liquidation.

Statement of Activities

The following Table compares the revenues and expenses for the current and previous fiscal year.

With respect to prior year, revenues increased by approximately $2.9 million or 18%, principally on operating grants and contributions.

Expenses decreased 14% or $2 million in comparison with 2012. Significant decreases were registered on Urban Development and Health and Sanitation.

Table 2

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

	2013	2012
Revenues:		
Program Revenues:		
Changes for Services	$ -	$ 292,808
Operating Grants and Contributions	5,538,200	1,444,220
Capital Grants and Contributions	993,294	4,348,815
General Revenues:		
Property Taxes	2,623,264	2,567,678
Volume of Business Taxes	1,279,096	597,914
Sales and Usage Taxes	1,038,695	999,858
Construction Excise Taxes	275,183	614,241
Intergovernmental	7,256,897	5,394,597
Other General Revenues	760,992	244,062
Donated Capital Assets	-	277,131
Total Revenues	**19,765,621**	**16,781,324**
Expenses:		
General Administration	5,562,159	1,621,505
Public Safety	719,280	1,695,023
Public Works	1,787,872	-
Culture and Recreation	458,922	1,728,923
Health and Sanitation	1,775,955	3,325,544
Solid Wasted Disposal	1,458,100	-
Human Services and Welfare	1,551,725	2,075,317
Urban Development	1,359,188	6,334,300
Loss on Disposition of Assets	-	-
Interest Costs	339,024	301,179
Total Expenses	**15,012,225**	**17,081,791**
Changes in Net Position	**4,753,396**	**(300,467)**
Net Position-Beginning, as Restated	36,948,860	37,249,327
Net Position-Ending	**$ 41,702,256**	**$ 36,948,860**

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

FIGURE 1

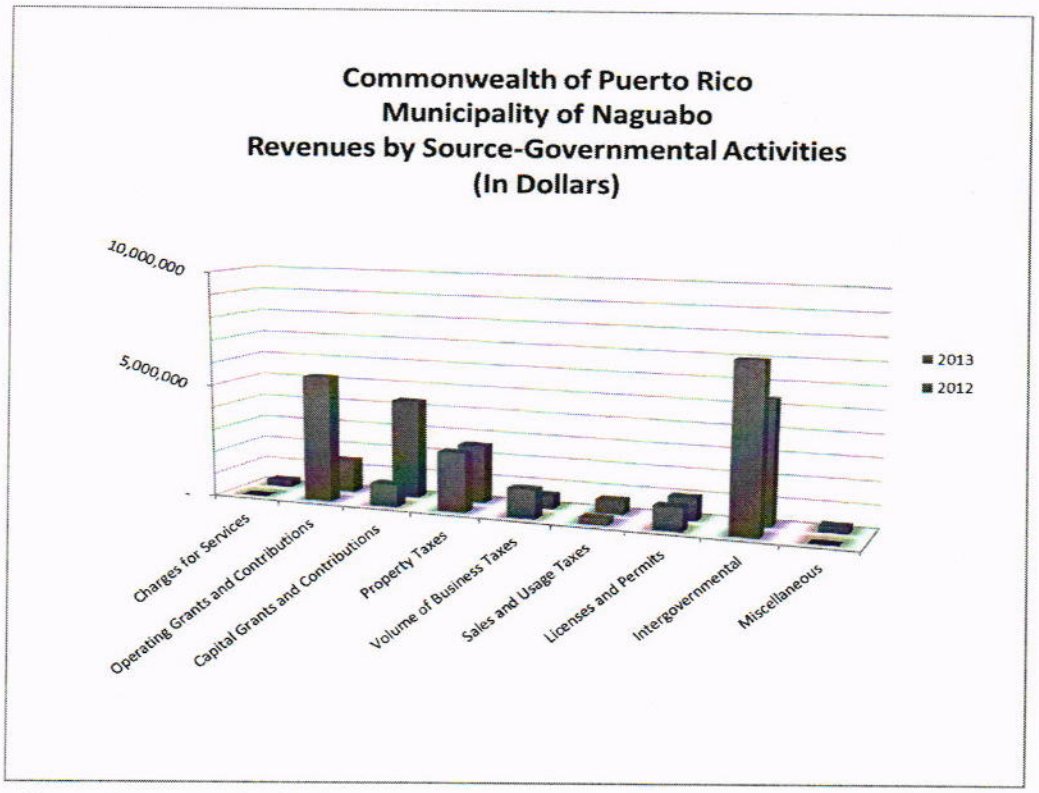
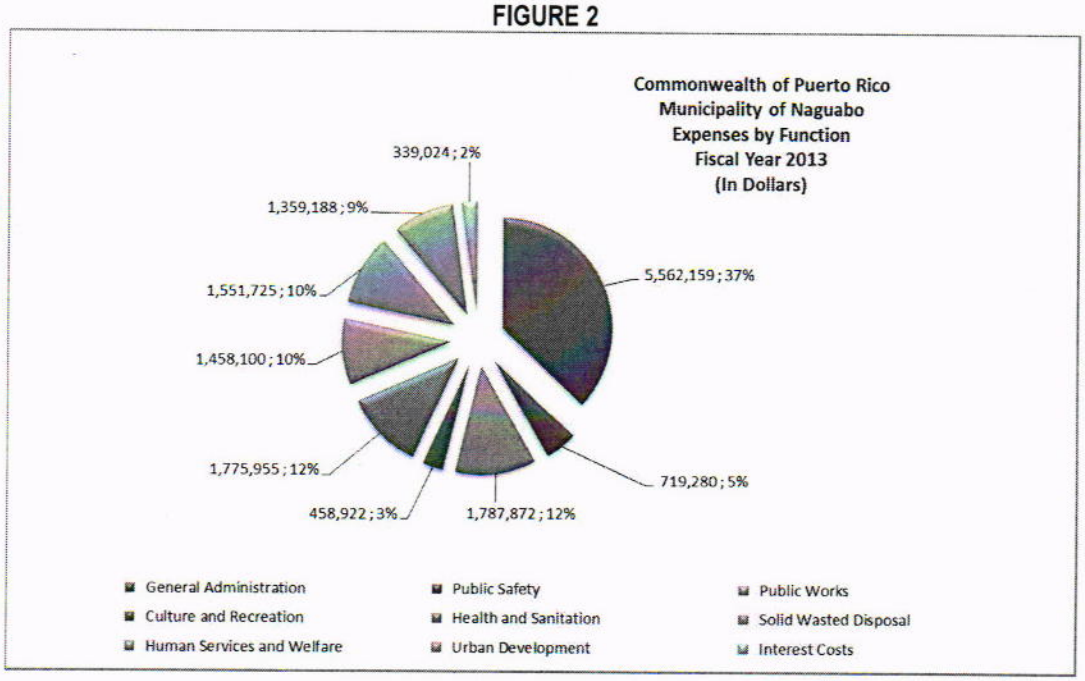


Figure 2 presents expenses by function of the governmental activities during the fiscal year 2012-2013:

FIGURE 2



Approximately 38.2% of the Municipality's revenues came from intergovernmental, 13.8% from property taxes, 29.1% from grants and contributions, and 18.9% from other sources. The Municipality's expenses cover a range of services. The largest expenses are General Administration with 37.1%, Public Works with 11.9%, Health and Sanitation with 11.8%, and Human Services and Welfare with 10.3%. Program revenues of the Municipality covered 44% of total expenses.

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

Table 3

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

	Total Cost of Services		Net Cost of Services	
Functions/Programs	**2013**	**2012**	**2013**	**2012**
General Administration	$ 5,562,159	$ 1,621,505	$ 4,120,913	$ 1,444,579
Public Safety	719,280	1,695,023	719,280	1,677,658
Public Works	1,787,872	-	1,232,670	-
Culture and Recreation	458,922	1,728,923	458,922	1,458,362
Solid Waste Disposal	1,458,100	-	1,458,100	-
Human Services and Welfare	1,551,725	2,075,317	427,118	1,281,239
Urban Development	1,359,188	6,334,300	(2,051,251)	1,620,135
Others	2,114,979	3,626,723	2,114,979	3,142,527
Total	**$ 15,012,225**	**$ 17,081,791**	**$ 8,480,731**	**$ 10,624,500**

Some of the cost of governmental activities in 2013 was paid from other governments and organizations that subsidized certain programs with grants and contributions ($6,531,494). Other general revenues including property, volume of business, sales and usage, construction excise taxes, and intergovernmental revenues substantially covered the $8,480,731 net cost of services.

FINANCIAL ANALYSIS OF THE MUNICIPALITY'S FUNDS

Governmental Funds

The focus of the Municipality's governmental funds is to provide information on near-term inflows, outflows and balances of resources available for spending. Such information is useful in assessing the Municipality's financing requirements. Fund balances for the governmental funds are reported in classifications that comprise a hierarchy based on the extent to which the government honors constraints on the specific purposes for which amounts in those funds can be spent. The following Table presents a comparison of the 2013 and 2012 fund balances.

Table 4

Commonwealth of Puerto Rico
Municipality of Naguabo
Fund Balance
As of June 30,

	2013	**2012**
Fund Balances:		
Nonexpendable	$ -	$ 17,000
Restricted	3,774,934	5,019,058
Committed	1,290,194	-
Assigned	5,279	219,245
Unassigned (Deficit)	(4,171,776)	(4,810,732)
Total	**$ 898,631**	**$ 444,571**

At the end of the current fiscal year, the Municipality's governmental funds reported combined ending fund balances of $898,631. Of this amount ($4,171,776) isn't available for spending at the government's discretion (Unassigned Fund Balance). The remainder of fund balance is restricted, committed or assigned to indicate that is not available for new spending because it has already been committed. For the fiscal year ended June 30, 2013, the governmental funds reported combined ending fund balances of $898,631, with a net increase of $454,060 in comparison with the prior year. This increase was due primarily by new committed funds and a decrease in unassigned fund balance (deficit).

The general fund is the operating fund of the Municipality. Unassigned fund balance (deficit) of the general fund represents 100% of total ending general fund balance.

Table 5

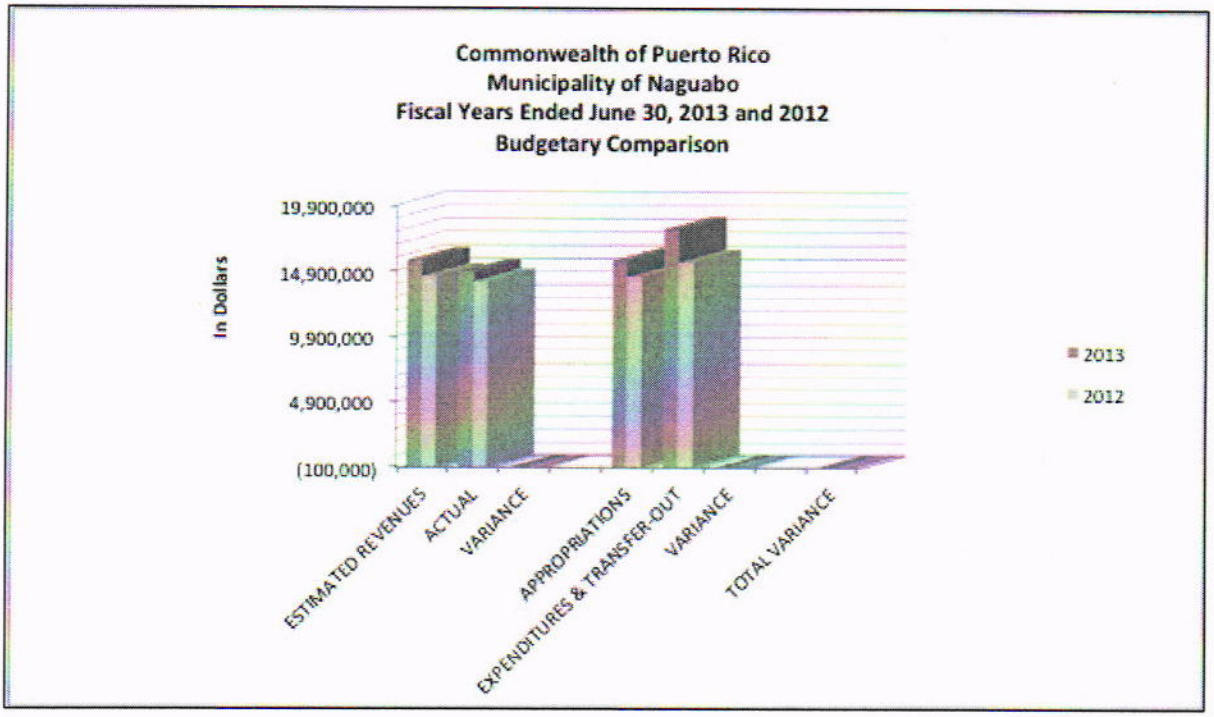
Commonwealth of Puerto Rico
Municipality of Naguabo
General Fund
As of June 30,

Description	2013	2012
Revenues:		
Property Taxes	$ 1,982,274	$ 4,776,357
Volume of Business Taxes	1,279,096	638,310
Sales and Usage Taxes	650,670	628,410
Intergovernmental	7,002,403	1,671,721
Construction Excise Taxes	275,183	614,241
Miscellaneous	760,992	556,406
Total Revenues	11,950,618	8,885,445
Expenditures:		
General Government	5,447,778	955,170
Public Safety	620,417	1,438,299
Public Work	1,201,067	-
Culture and Recreation	393,013	1,220,456
Health and Sanitation	1,690,659	3,010,529
Solid Waste Disposal	1,458,100	-
Human Services and Welfare	445,466	1,100,913
Urban Development	-	3,092,558
Miscellaneous	-	41,541
Capital Outlay	22,858	22,986
Total Expenditures	11,279,358	10,882,452
Net Transfer In (Out)	(242,391)	(77,510)
Proceed of Notes	-	492,769
Net Decrease in Fund Balance	**$ 428,869**	**$ (1,581,748)**

GENERAL FUND BUDGETARY HIGHLIGHTS

The general fund original budget for the fiscal period 2012-2013 presented an immaterial difference with respect to prior year budget with an increase of $186,000. The Municipality does not include an amendment to the budget the positive and negative changes on other revenues, principally in construction excise taxes ($475,177) due to some construction projects that were supposed to produce significant revenues but did not come to fruition during the year, volume of business taxes of ($340,904), and $247,273 from intergovernmental revenues. Budget expenditures were amended during the year in accordance with functions estimates (see **Figure 3** below).

FIGURE 3



The positive variance of $182,758 between revised budget and actual results was due mainly to a decrease in expenditures during the year. The Municipality reported more appropriations than expenditures in those functions for payments to purchase of supplies, professional and nonprofessional services.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

At the end of the fiscal year, the Municipality has invested $47,000,942 (net of accumulated depreciation) in a broad range of capital assets, including buildings, land, infrastructure, construction in progress and equipment. This amount represents a net increase of $818,476 or 2% from the prior year. The Municipality invested a total of $3,813,802 of capital assets during the fiscal year 2012-2013 as follows:

- Construction in Progress – $1,482,215
- Acquisition of Motor Vehicles – $159,005

Table 6

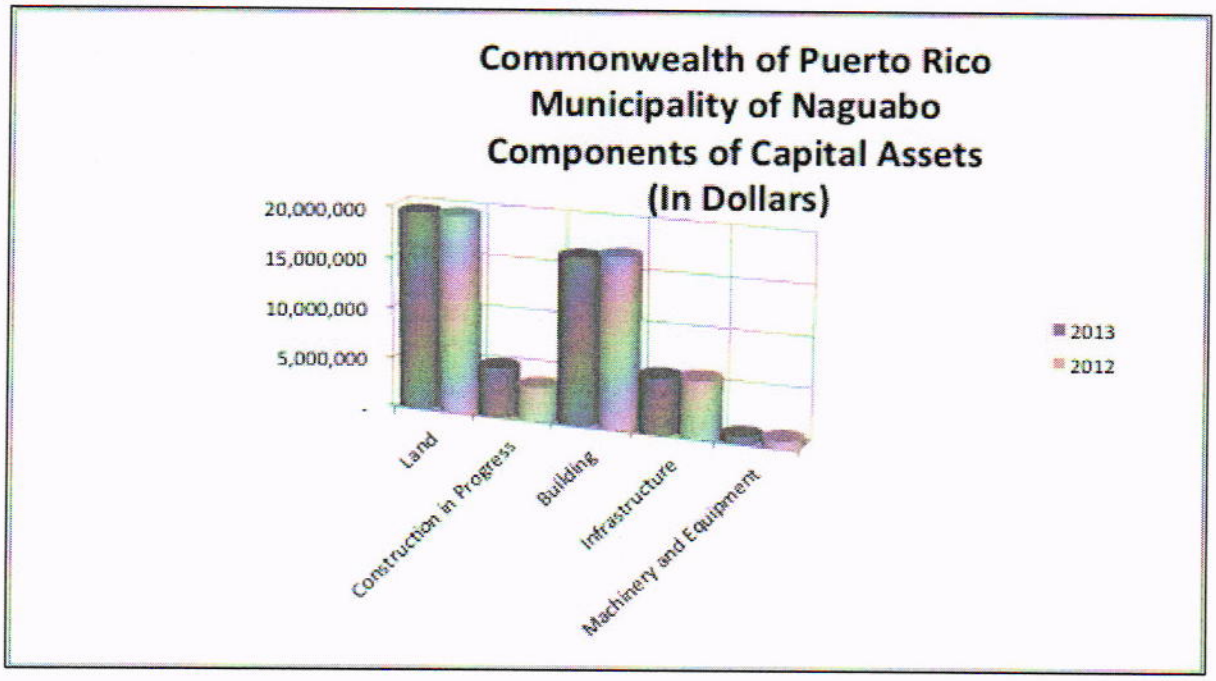
Commonwealth of Puerto Rico
Municipality of Naguabo
Capital Assets (Net)
As of June 30,

	Governmental Activities	
	2013	2012
Non-depreciable assets:		
Land	$ 19,433,560	$ 19,433,560
Work of Art	1,500	1,500
Construction in Progress	4,849,455	3,367,240
Depreciable assets:		
Buildings	16,436,558	16,865,657
Infrastructure	5,564,252	5,751,110
Machinery, Equipment and Vehicles	715,617	764,512
Total	$ 47,000,942	$ 46,183,579

Other projects related to repair and maintenance of roads (not capitalized), were developed during the year 2013. Construction in progress was principally for improvements to existing facilities, a recreational space in Rio Blanco, and improvements to the parking at the Malecón (Beach Front) among other projects around the Municipality.

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

FIGURE 4



Long-Term Debts

At year-end, the Municipality had $6,920,000 in general and special obligations, a decrease of 9% with respect to prior year. The following is a summary of the Municipality's outstanding debts as of June 30, 2013 and 2012:

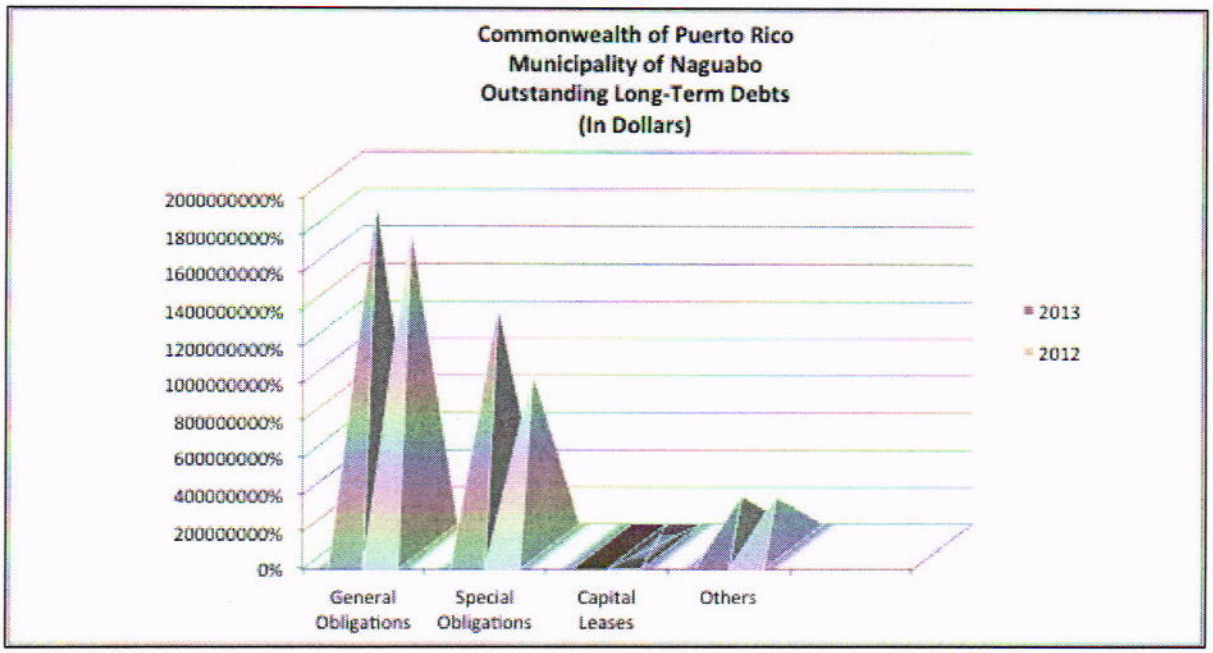
Table 7

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

	Governmental Activities	
	2013	2012
General and Special Obligations	$ 6,920,000	$ 7,190,100
Law No. 42-MRCC	188,683	193,572
Law No. 146-MRCC	73,985	77,880
LIMS - MRCC	-	-
Christmas Bonus	133,612	150,184
Department of Labor	67,412	129,638
Claims and Judgements	21,000	21,000
Compensated Absences	1,621,406	2,054,234
Total	**$ 9,026,098**	**$ 9,816,608**

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

FIGURE 5



More detailed information about the Municipality's long-term liabilities is presented in Note 11 to the financial statements.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

The Municipality's selected and appointed officials considered many factors when setting the fiscal year 2012-2013 budget. One of these factors is the economy. Among economic areas considered are the population growth estimates, personal income, housing statistics and unemployment rates. The Municipality's unemployment rate now stands at 16.3%, which compares with the Commonwealth rate of 13.7%.

The Municipality applied a conservative approach in development budget estimates. Amounts available for appropriations in the General Fund for the fiscal year 2014 are $11.2 million, approximately $258,000 more than fiscal year 2013. The Municipality expects a decrease of revenues in construction excise taxes, but also an increase from intergovernmental. Budgeted expenditures are expected to stabilize accordingly to the projected revenues.

CONTACTING THE MUNICIPALITY'S FINANCIAL MANAGEMENT

This report is designed to provide a general overview of the Municipality's finances and to demonstrate the accountability for the money it receives. If you have any questions about this report or need additional information, contact the Municipality's Finance Department at (787) 874-0520, or PO Box 40, Naguabo, PR 00718.

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STATEMENT OF NET POSITION
JUNE 30, 2013

	GOVERNMENTAL ACTIVITIES
ASSETS:	
Cash and Investments	$ 1,147,006
Cash with Fiscal Agent	3,305,731
Receivables (net):	
Property Taxes	271,197
Sales and Usage Taxes	50,052
Due from Governmental Units	228,598
Federal Grants	2,866,258
Capital Assets:	
Land, Improvement and Construction in Progress	24,284,515
Other Capital Assets [Net of Depreciation]	22,716,427
Total Capital Assets	47,000,942
TOTAL ASSETS	**54,869,784**
LIABILITIES:	
Accounts Payable and Accrued Expenses	1,977,829
Accrued Interest	121,292
Due to Governmental Units	1,348,770
Unearned Revenues - Volume of Business Taxes	693,539
Noncurrent Liabilities:	
Due Within One Year	1,869,014
Due in More than One Year	7,157,084
TOTAL LIABILITIES	**13,167,528**
NET POSITION:	
Net Investment in Capital Assets	40,968,173
Restricted for:	
Capital Projects	1,252,321
Debt Service	1,905,736
Community Development Projects	1,859,208
Unrestricted (Deficit)	(4,283,182)
TOTAL NET POSITION	**$ 41,702,256**

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

STATEMENT OF ACTIVITIES
FOR THE FISCAL YEAR ENDED JUNE 30, 2013

Functions/Programs	Expenses	Program Revenues: Charges For Services	Program Revenues: Operating Grants and Contributions	Program Revenues: Capital Grants and Contributions	Net (Expense) Revenues and Changes in Net Position
Governmental Activities:					
Mayor and Municipal Legislature	$ 913,306	$ -	$ -	$ -	$ (913,306)
General Government	4,648,853	-	447,952	993,294	(3,207,607)
Public Safety	719,280	-	-	-	(719,280)
Public Works	1,787,872	-	555,202	-	(1,232,670)
Culture and Recreation	458,922	-	-	-	(458,922)
Health and Sanitation	1,775,955	-	-	-	(1,775,955)
Solid Waste Disposal	1,458,100	-	-	-	(1,458,100)
Human Services and Welfare	1,551,725	-	1,124,607	-	(427,118)
Urban Development	1,359,188	-	3,410,439	-	2,051,251
Interest on Long-Term Debt	339,024	-	-	-	(339,024)
Total Governmental Activities	**$ 15,012,225**	**$ -**	**$ 5,538,200**	**$ 993,294**	**(8,480,731)**

General Revenues:	
Taxes:	
Property Taxes, levied for General Purposes	1,982,274
Property Taxes, levied for Debt Service	640,990
Volume of Business Taxes	1,279,096
Sales and Usage Taxes	1,038,695
Construction Excise Taxes	275,183
Intergovernmental	7,256,897
Rent	186,179
Miscellaneous	574,813
Total General Revenues	13,234,127
CHANGES IN NET POSITION	**4,753,396**
Net Position – Beginning of Year, As Restated	36,948,860
NET POSITION – ENDING OF YEAR	**$ 41,702,256**

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

BALANCE SHEET – GOVERNMENTAL FUNDS
JUNE 30, 2013

	GENERAL FUND	CDBG FUND	CAPITAL IMPROVEMENT FUND	DEBT SERVICE FUND	OTHER GOVERNMENTAL FUNDS	TOTAL GOVERNMENTAL FUNDS
ASSETS:						
Cash	$ 769,312	$ 975	$ 9	$ -	$ 376,710	$ 1,147,006
Cash with Fiscal Agent	13,949	-	1,003,984	2,018,611	269,187	3,305,731
Receivables:						
Property Taxes	262,780	-	-	8,417	-	271,197
Sales and Usage Taxes	50,052	-	-	-	-	50,052
Due from Governmental Units	67,076	-	-	-	161,522	228,598
Federal Grants	-	2,805,534	-	-	60,724	2,866,258
Due from Other Funds	188,563	-	267,328	-	1,755,252	2,211,143
Total Assets	**$ 1,351,732**	**$ 2,806,509**	**$ 1,271,321**	**$ 2,027,028**	**$ 2,623,395**	**$ 10,079,985**
LIABILITIES:						
Account Payable	$ 1,146,850	$ 758,738	$ 19,000	$ -	$ 53,241	$ 1,977,829
Bond and Notes	-	-	-	585,000	-	585,000
Accrued Interest	-	-	-	121,292	-	121,292
Due to Governmental Units	1,348,770	-	-	-	-	1,348,770
Due to Other Funds	1,839,670	188,563	-	-	182,910	2,211,143
Unearned Revenues - Volume of Business Taxes	693,539	-	-	-	-	693,539
Total Liabilities	**5,028,829**	**947,301**	**19,000**	**706,292**	**236,151**	**$ 6,937,573**
DEFERRED INFLOWS OF RESOURCES:						
Unavailable Revenues - Commonwealth of Puerto Rico	329,586	-	-	-	-	329,586
Unavailable Revenues - Federal Grants	-	1,859,208	-	-	54,987	1,914,195
Total Deferred Inflows of Resources	**329,586**	**1,859,208**	**-**	**-**	**54,987**	**2,243,781**
FUND BALANCES (DEFICIT):						
Restricted	-	-	1,252,321	1,320,736	1,201,877	3,774,934
Committed	-	-	-	-	1,290,194	1,290,194
Assigned	-	-	-	-	5,279	5,279
Unassigned (Deficit)	(4,006,683)	-	-	-	(165,093)	(4,171,776)
Total Fund Balances (Deficit)	(4,006,683)	-	1,252,321	1,320,736	2,332,257	898,631
Total Liabilities, Deferred Inflows of Resources and Fund Balances (Deficit)	**$ 1,351,732**	**$ 2,806,509**	**$ 1,271,321**	**$ 2,027,028**	**$ 2,623,395**	**$ 10,079,985**

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

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

JUNE 30, 2013

Total Fund Balances – Government Funds (Page 19)		**$ 898,631**
Amount reported for Governmental Activities in the Statement of Net Position (Page 19) are different because:		
Capital Assets used in governmental activities are not financial resources and therefore are not reported in the funds. In the current period, these amounts are:		
Non Depreciable Capital Assets	$ 24,284,515	
Depreciable Capital Assets	25,612,965	
Infrastructure Assets	9,342,894	
Accumulated Depreciation	(12,239,432)	
Total Capital Assets		47,000,942
Some of the Municipality's revenues will be collected after year-end but are not available soon enough to pay for the current period's expenditures and therefore are unavailable in the funds:		
Community Development Block Grants/States Program and Non Entitlements Grants in Hawaii (State CDBG)	1,859,208	
Child and Adult Care Food Program	12,650	
Child and Adult Care Food Program - ARRA	175	
Child Care and Development Block Grant	42,162	
Property Taxes	262,780	
Christmas Bonus	66,806	
Total Unavailable Revenues		2,243,781
Some liabilities are not due and payable in the current period and therefore are not reported in the funds. Those liabilities consist of:		
General Obligation Bonds	(6,335,000)	
Christmas Bonus	(133,612)	
Law Number 146-MRCC	(188,683)	
Law Number 42-MRCC	(73,985)	
Department of Labor and Human Resources	(67,412)	
Claims and Judgments	(21,000)	
Compensated Absences	(1,621,406)	
Total Long-Term Liabilities		(8,441,098)
Total Net Position of Governmental Activities (Page 17)		**$ 41,702,256**

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NAGUABO

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

	GENERAL FUND	CDBG FUND	CAPITAL IMPROVEMENT FUND	DEBT SERVICE FUND	OTHER GOVERNMENTAL FUNDS	TOTAL GOVERNMENTAL FUNDS
REVENUES:						
Property Taxes	$ 1,982,274	$ -	$ -	$ 640,990	$ -	$ 2,623,264
Volume of Business Taxes	1,279,096	-	-	-	-	1,279,096
Sales and Usage Taxes	650,670	-	-	388,025	-	1,038,695
Federal Grants	-	1,551,231	-	-	1,624,822	3,176,053
Intergovernmental	7,002,403	-	-	-	1,441,246	8,443,649
Construction Excise Taxes	275,183	-	-	-	-	275,183
Rent	186,179	-	-	-	-	186,179
Miscellaneous	574,813	-	-	-	-	574,813
Total Revenues	**11,950,618**	**1,551,231**	**-**	**1,029,015**	**3,066,068**	**17,596,932**
EXPENDITURES:						
Current:						
Mayor and Municipal Assembly	666,149	-	-	-	-	666,149
General Government	4,781,629	-	-	-	267,193	5,048,822
Public Safety	620,417	-	-	-	-	620,417
Public Works	1,201,067	-	133,802	-	247,039	1,581,908
Culture and Recreation	393,013	-	-	-	-	393,013
Health and Sanitation	1,690,659	-	-	-	85,296	1,775,955
Solid Waste Disposal	1,458,100	-	-	-	-	1,458,100
Human Services and Welfare	445,466	-	-	-	999,158	1,444,624
Urban Development	-	1,309,756	-	-	-	1,309,756
Capital Outlay:	22,858	241,475	894,069	-	482,818	1,641,220
Debt Service:						
Principal	-	-	-	863,884	-	863,884
Interest and Other Charges	-	-	-	339,024	-	339,024
Total Expenditures	**11,279,358**	**1,551,231**	**1,027,871**	**1,202,908**	**2,081,504**	**17,142,872**
EXCESS OF REVENUES OVER (UNDER) EXPENDITURES	671,260	-	(1,027,871)	(173,893)	984,564	454,060
OTHER FINANCING SOURCES (USES):						
Transfers – In	-	-	-	235,391	7,000	242,391
Transfers – Out	(242,391)	-	-	-	-	(242,391)
Total Other Financing Sources (Uses)	**(242,391)**	**-**	**-**	**235,391**	**7,000**	**-**
Net Change in Fund Balances	**428,869**	**-**	**(1,027,871)**	**61,498**	**991,564**	**454,060**
Fund Balances (Deficit) – Beginning, as Restated	(4,435,552)	-	2,280,192	1,259,238	1,340,693	444,571
FUND BALANCES (DEFICIT) – ENDING	**$ (4,006,683)**	**$ -**	**$ 1,252,321**	**$ 1,320,736**	**$ 2,332,257**	**$ 898,631**

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

RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES – GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES

FOR THE FISCAL YEAR ENDED JUNE 30, 2013

Net Change in Fund Balances – Government Funds (Page 21)		**$ 454,060**
Amount reported for Governmental Activities in the Statement of Activities (Page 18) are different because:		
Governmental funds report capital outlays as expenditures. However, in the Statement of Activities the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense. In the current period, these amounts are:		
Capital Outlays	$ 1,641,220	
Depreciation Expense	(823,857)	
Excess of Capital Outlays over Depreciation Expense		817,363
Revenues in the Statement of Activities that do not provide current financial resources are reported as revenues in the funds and vice versa:		
Christmas Bonus	(8,286)	
Community Development Block Grants/States Program and Non Entitlements Grants in Hawaii (State CDBG)	1,859,208	
Child and Adult Care Food Program	12,650	
Child and Adult Care Food Program - ARRA	175	
Child Care and Development Block Grant	42,162	
Property Taxes	262,780	
Total of Revenues		2,168,689
Repayment of long-term principal is expenditure in the governmental funds, but issuing debt reduced Noncurrent Liabilities in the Statement of Net Position. In the current period repayments were		863,884
Some expenses reported in the Statement of Activities do not require the use of current financial resouces and therefore are not reported as expenditures in governmental funds. These activities consist of:		
Decrease in Christmas Bonus	16,572	
Decrease in Compensated Absence	432,828	
Total Additional Expenses		449,400
Change in Net Position of Governmental Activities (Page 18)		**$ 4,753,396**

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

1. FINANCIAL REPORTING ENTITY

The accompanying financial statements present information on the financial activities of the Municipality of Naguabo of the Commonwealth of Puerto Rico (Municipality) over which the Mayor and the Municipal Legislature, have direct or indirect governing and fiscal control. These financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP).

A. Organization

The Municipality was founded in the year 1821, and operates as a governmental unit of the Commonwealth of Puerto Rico (Commonwealth), under the Act Number 81 of August 30, 1991, known as "Autonomy Municipalities Law of the Commonwealth of Puerto Rico". The governmental system of the Municipality is composed of the executive and legislative bodies. The Municipality is governed by a Mayor and is elected every four years in the general elections of the Commonwealth. The legislative body (Municipal Legislature) consists of 14 Legislators also elected in the general elections of Puerto Rico for a four-year period.

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

B. Reporting Entity

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

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

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

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

The Governmental Accounting Standards Board (GASB) has issued Statement 61, *The Financial Reporting Entity: Omnibus an Amendment of GASB Statements No. 14 and No. 34*. GASB 61 provides additional criteria for classifying entities as component units to better assess the accountability of elected officials by ensuring that the financial reporting entity includes only organizations for which the elected officials are financially accountable or that are determined by the government to be misleading to exclude. The Municipality adopted this statement effective July 1, 2012.

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

continue

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

A. Financial Statement Presentation

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

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

Required Supplementary Information – Management's Discussion and Analysis

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

Government-wide Financial Statements (GWFS)

While separate government-wide and fund financial statements are presented, they are interrelated. The GWFS (the *Statement of Net Position* and the *Statement of Activities*) report information of all the activities of the Municipality. For the most part, the effect of interfund activity has been removed from these financial statements. For the most part, the effect of interfund activity has been removed from these financial statements. Exceptions to this general rule are payments in lieu of taxes where the amounts are reasonably equivalent in value to the interfund services provided and other charges between the government's Puerto Rico Electric Power Authority function of the government. Elimination of this charges would distort the direct cost and program revenue reported for the various functions concerned. 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.

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

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

Governmental Funds Financial Statements (GFFS)

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

continue

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

Each fund is a separate accounting entity with a self-balancing set of accounts used to record the financial transactions and balances of that entity. Individual funds have been established as stipulated by legal provisions or by administrative discretion. This presentation deemed most appropriate to (1) demonstrate legal and covenant compliance, (2) demonstrate the source and use of liquid resources, and (3) demonstrate how the Municipality's actual experience conforms to the budgeted fiscal plan.

The Municipality reports the following major governmental funds:

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

CDBG Fund – This is the fund used to account for all the transactions of the Community Development Block Grants/States Program and Non Entitlements Grants in Hawaii (State CDBG). The primarily objectives of this program is to development of viable communities by providing decent housing, a suitable living environment and expanded economic opportunities, principally for persons of low and moderate income.

Capital Improvement Fund – Capital improvement fund is used to account for financial resources to be used for the acquisition or construction of major capital facilities.

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

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

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

The Municipality periodically undertakes a comprehensive evaluation of its fund structure to ensure that it complies with all aspects that are of importance to users of general purpose external financial reports. Consequently, all superfluous funds and some operational funds currently used by the Municipality in the day-to-day accounting procedures have not been reported as individual governmental funds in the accompanying fund financial statements. Accordingly, the accompanying fund financial statements include only the minimum number of funds consistent with legal and operating requirements and, consequently, certain types of similar operational funds have been combined into single funds in the accompanying fund financial statements.

The financial statements of the governmental funds are the following:

Balance Sheet – Reports information at June 30, 2013 about the current financial resources (assets, liabilities, deferred inflows of resources and fund balances) of each major governmental fund.

Statement of Revenues, Expenditures and Changes in Fund Balances – Reports information about the inflows, outflows and balances of current financial resources of each major governmental fund for the fiscal year ended June 30, 2013.

Notes to the Basic Financial Statements

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

Required Supplementary Information

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

continue

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

B. Measurement Focus and Basis of Accounting

The accounting and financial reporting treatment is determined by the applicable measurement focus and basis of accounting. Measurement focus indicates the type of resources being measured such as current financial resources or economic resources. The basis of accounting indicates the timing of transactions or events for recognition in the financial statements.

Government-wide Financial Statements

The government-wide financial statements are reported using the *economic resources measurement focus* and the *full accrual basis of accounting*. Revenue (including interest on deposits and investments) is generally recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Nonexchange transactions, in which the Municipality gives (or receives) value without directly receiving (or giving) equal value in exchange, include property taxes, grants, entitlements and donations. On an accrual basis, revenue from property taxes is recognized in the fiscal year for which the taxes are levied. Nonexchange transactions, in which the Municipality gives (or receives) value without directly receiving (or giving) equal value in exchange, include property taxes, grants, entitlements and donations.

On an accrual basis, revenue from property taxes is recognized in the fiscal year for which the taxes are levied. Revenue from grants, entitlements and donations is recognized in the fiscal year in which all eligibility requirements have been satisfied. Receipts on any type of revenue sources collected in advance for use in the following fiscal year are recorded as unearned revenues.

Governmental Funds Financial Statements

The GFFS are reported using the *current financial resources measurement focus* and the *modified accrual basis of accounting*. Under this method, revenues are recognized as soon as they are both measurable and available. Revenues are considered to be *available* when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For these purposes, the Municipality considers revenues to be available if they are collected within sixty (60) days after the end of the current fiscal period. Revenues that the Municipality earns by incurring obligations are recognized in the same period as when the obligations are recognized. At June 30, 2013, all revenues sources met this availability criterion.

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

Expenditures are recorded when the related fund liability is incurred, as under accrual accounting. However, debt service expenditures, as well as expenditures related to compensated absences, and claims an judgments, are recorded only when payment is due. General capital asset acquisitions are reported as expenditures in governmental funds. Principal and interest on bonds payable are recorded when they matured (when payment is due), except for principal and interest of bonds due on July 1, 2013, which are recorded as governmental fund liabilities of June 30, 2013 which is the date when resources were available in the debt service fund. Proceeds of general long-term debt and acquisitions under capital leases, if any, are reported as other financing sources.

The accompanying Balance Sheet – Governmental Funds generally reflects only assets that will not be converted into cash to satisfy current liabilities. Long-term assets and those assets that will not be converted into cash to satisfy current liabilities are generally not accounted for in the accompanying Balance Sheet – Governmental Funds.

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

continue

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

C. Stewardship, Compliance, and Accountability

Budgetary Information

The Municipality's annually adopts the Budget Resolution for all operating funds of the Municipality except for certain restricted accounts. Budgetary control is legally maintained at the fund level. The budget is prepared using the modified accrual basis of accounting with encumbrance included as budgetary basis expenditures. Unexpended appropriations at the end of the fiscal year generally lapse. However, they may be re-appropriated for expenditures in the following fiscal year.

The Municipality's Budget Resolution provides transfer authority (1) to the Mayor and the Management and Budget Director, within and between departments and funds, as long as the total budget of the Municipality (net of interfund transfers) is not increased; (2) to the Management and Budget Director to implement grant budgets as the grant applications are accepted by the Municipality; and (3) to the Management and Budget Director to amend (re-appropriate) each new year's budget, to the extent of outstanding encumbrances, and/or unexpended project/grant appropriations at year end. Municipality's Legislature action is required for (1) use of the budgeted Legislature contingency, and (2) the approval of a supplemental appropriation(s). During the year, several supplemental appropriations were necessary.

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

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

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

Original Budget

1. Prior of May 15 of each fiscal year, the Mayor submits to the Municipal Legislature a proposed budget for the fiscal year commencing the following July 1 in addition of a budget message.

2. The budget document is available for public inspection prior to its approval by the Municipal Legislature.

3. The Office of the Commissioner of Municipal Affairs examines the budget to verify if it complied with the law's standards and sends it to the Mayor for any comments or recommendation before the limited date establishes by the Law.

4. Prior to June 13, the annual budget is legally enacted through passage of the annual appropriation ordinance to be effective on July 1.

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

Final Budget

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

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

continue

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

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

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

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

1. Encumbrances are recorded as expenditures under the budgetary basis and as restricted, committed and assigned fund balances under GAAP.

2. Interfund transactions of the General Fund are not included in the budgetary basis.

3. Certain accrued liabilities and other debts are not included in the budgetary basis.

4. Certain revenues susceptible to accrual, i.e., both measurable and available, are not included in the budgetary data.

Budgetary Results for the Fiscal Year

For the year ended June 30, 2013, expenditures exceeded appropriations in the general government (the legal level of budgetary control) of the general fund by $200,858. While overspending of this appropriation is authorized by law up to $100,000 if related to cases involving imminent public endangerment (e.g., the need to inspect properties with damage from collision, natural disaster, fire, or water to determine their inherent stability), which was the case this year, it is nevertheless considered a budgetary violation. Further, the overspending was covered by economies on the others functions levels in the amount of $699,194 with a net economies of $498,336. This economies was sufficient to cover the decrease in revenues for a positive variance of $182,758.

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

D. Assets, Liabilities, and Net Position

1) Cash and Investment, and Cash with Fiscal Agent

The Municipality's cash and investment are composed of demand deposits in commercial banks, demand deposits in the Governmental Development Bank of Puerto Rico (GDB), and cash equivalents in commercial banks. The Municipality has adopted the *Statement of Uniform Investment Guidelines for the Municipalities of the Commonwealth of Puerto Rico,* issued by the GDB as promulgated by Act No. 113 of August 3, 1995. The Finance Director of the Municipality, follow the guidelines, is responsible for investing the available resources in certificates of deposit and other short-term investments. Investments are made from the available combined funds of the Municipality and, accordingly, it is not practical to disclose certificates of deposit and other short-term investments individually by fund in the combined financial statements. Interest earned on certificates of deposit and interest bearing commercial bank accounts are recognized as revenue in the General Fund. Cash in the Special Revenue and Capital Project Funds are restricted; accordingly, resources available were not used for pool investments. Cash Equivalents are investments with an original maturity of 90 days or less.

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

continue

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

2) *Receivables and Payables*

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

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

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

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

3) *Inventories*

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

4) *Capital Assets*

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

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

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

continue

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

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

CAPITAL ASSETS	YEARS
Buildings	30-50
Improvement Other Than Buildings	20
Infrastructure	20-50
Vehicles and Furniture	5
Furniture, Fixtures, Machinery And Equipment	5-20
Equipment Under Capital Leases	3-5

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

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

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

5) *Deferred Outflows/Inflows of Resources*

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

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

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

6) *Unearned Revenues*

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

continue

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

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

The liabilities reported in the GWFS include the general and special obligation bonds, long-term notes, other noncurrent liabilities (e.g., vacation, sick leave, claims and judgments, noncurrent liabilities to other governmental entities and third parties, and landfill post closure care costs). Bond premiums and discounts, if any, are deferred and amortized over the life of the bonds using the effective interest method. Bonds payable are reported net of the applicable bond premium or discount, if any. Bond Issuance Costs incurred are reported as expense in the fiscal year incurred.

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

8) *Compensated Absences*

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

In accordance with the above criteria and requirements in conformance with GASB Accounting Standards Codification Section C60, *Compensated Absences,* the Municipality has accrued a liability for compensated absences, which has been earned but not taken by Municipality's employees, including its share of social security and Medicare payments made on behalf of the employees in the accrual for vacation and sick leave pay using salary rates effective at June 30, 2013. All vacation pay is accrued when incurred in the GWFS. For the GWFS, the current portion is the amount estimated to be used in the following year. For the GFFS, all of the compensated absences are considered long-term and therefore, are not a fund liability and represents a reconciling item between the fund level and government-wide presentations.

9) *Claims and Judgments*

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

10) *Accounting for Pension Costs*

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

For the purpose of applying the requirements of GASBS No, 27, as amended, the state government of the Commonwealth is considered to be the sponsor of the Employees' Retirement System of the Government of the Commonwealth of Puerto Rico (ERS), a multiemployer cost-sharing defined benefit pension plan and System 2000, a hybrid defined contribution plan, in which the employees of the Municipality participate. The Municipality is considered a participant, and not a sponsor, of these retirement systems since the majority of the participants in the aforementioned pension trust funds are employees of the Commonwealth and the basic financial statements of such retirement systems are part of the financial reporting entity of Commonwealth. Act No. 3 was enacted on April 4, 2013, amended the Act No. 447 for the purpose of establishing a major reform of the ERS effective on July 1, 2013 (see Note 18).

continue

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

11) Net Position/Fund Balance

A) Net Position

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

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

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

  Net investment in capital assets is comprised of the following:

	Governmental Activities
Capital Assets, Net of Accumulated Depreciation	$47,000,942
Outstanding Balance on Related Debt	(6,920,000)
Unspent Capital Debt Proceeds	887,231
Net Investment in Capital Assets	$40,968,173

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

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

Net Position Flow Assumption

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

B) Fund Balance

Fund Balance Classification

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

continue

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

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

Fund Balance Flow Assumption

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

Fund Balance Policy

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

Policy on Committing Funds

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

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

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

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

continue

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

Policy on Assigning Funds

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

Policy on Unassigned General Fund Balance

It is the goal of the Municipality to achieve and maintain an Unassigned General Fund Balance equal to 10% of budgeted expenditures. The Municipality considers a balance of less than 5% to be a cause for concern, barring unusual or deliberate circumstances, and a balance of more than 15% as excessive. An amount in excess of 15% is to be considered for reservation to accumulate funding for purchase of machinery and equipment, for capital projects, and/or to reduce the tax levy requirements, and shall be determined in conjunction with the annual budget process. In the event that the Unassigned General Fund Balance is less than the policy anticipates, the Municipality shall plan to adjust budget resources in the subsequent fiscal years to restore the balance. Appropriation from Unassigned General Fund Balance shall require the approval of the Municipal Legislature and shall be only for specific disbursements, such as one-time expenditures and capital assets purchases, and not for ongoing expenditures unless a viable plan designated to sustain the expenditures is simultaneously adopted. The Municipality has met its GASB 54 fund balance targets at June 30, 2013.

Prioritization of Fund Balance Use

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

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continue

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

C) Components of Fund Balance

	GENERAL FUND	SBGP FUND	CAPITAL IMPROVEMENT FUND	DEBT FUND	OTHER GOVERNMENTAL FUNDS	TOTAL GOVERNMENTAL FUNDS
Nonspendable	$ -	$ -	$ -	$ -	$ -	$ -
Restricted For:						
Improvement and Construction of Facilities	-	-	1,252,321	-	-	1,252,321
Capital Outlay	-	-	-	-	954,313	954,313
Welfare	-	-	-	-	91,629	91,629
Debt Repayment	-	-	-	1,320,736	-	1,320,736
Total Restricted	-	-	1,252,321	1,320,736	1,045,942	3,618,999
Committed For:						
General Government	-	-	-	-	1,290,194	1,290,194
Total Committed	-	-	-	-	1,290,194	1,290,194
Assigned For:						
General Government	-	-	-	-	5,279	5,279
Total Assigned	-	-	-	-	5,279	5,279
Unassigned:	(4,006,683)	-	-	-	(9,158)	(4,015,841)
Total Fund Balances	$ (4,006,683)	$ -	$ 1,252,321	$ 1,320,736	$ 2,332,257	$ 898,631

E. Interfund Transactions

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

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

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

F. Risk Financing

The Municipality carries commercial insurance to cover property and casualty, theft, tort claims and other losses. Insurance policies are negotiated by the Puerto Rico Treasury Department and costs are allocated among all the municipalities of Puerto Rico. Also, principal officials of the Municipality are covered under various surety bonds. Cost of insurance allocated to the Municipality and deducted from the gross property tax collections by the MRCC for the year ended June 30, 2013 amounted to approximately $256,690. The current insurance policies have not been cancelled or terminated. In addition, MRCC deducted approximately $201,100 for workers compensation insurance covering all municipal employees for the same period.

continue

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

G. Use of Estimates

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

H. Reclassifications

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

I. Future Adoption of Accounting Pronouncements

The Governmental Accounting Standards Board (GASB) issued the following pronouncements that have effective dates after June 30, 2013:

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

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

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

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

continue

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*. This Statement replaces the requirements of Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers* and Statement No. 50, *Pension Disclosures—an amendment of GASB Statements No. 25 and No. 27*as they relate to governments that provide pensions through pension plans administered as trusts or similar arrangements that meet certain criteria. Statement No. 68 requires governments providing defined benefit pensions to recognize their long-term obligation for pension benefits as a liability for the first time, and to more comprehensively and comparably measure the annual costs of pension benefits. The Statement also enhances accountability and transparency though revised and new note disclosures and required supplementary information. The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2014 (FY 2014-2015). Earlier application is encouraged.

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

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

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

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

3. CASH AND INVESTMENTS

Cash in Banks

Municipality's cash and investments at June 30, 2013 are composed of: (1) demand deposits in commercial banks, (2) demand deposits in the Government Development Bank of Puerto Rico (GDB, fiscal agent), and (3) cash equivalents in commercial banks. Cash equivalents of $4.7 million are deposits in commercial bank accounts and interest bearing accounts in GDB, and are recorded at cost, which approximates fair value.

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

continue

3. CASH AND INVESTMENTS – continuation

Municipality follows the practice of pooling cash. At June 30, 2013, the pool cash account in interest bearing commercial banks accounts had a balance of $1.1 million of which $769,312 in the General Fund, $975 in the SBGP Fund, and $376,710 in Other Governmental Funds, all was deposited in Popular Bank of Puerto Rico. The balance in the pooled cash account is available to meet current operating requirements and any unrestricted excess, if any, is generally deposit in accounts with commercial banks. Any deficiency in the pooled cash account is assumed by the general fund and covered through future budgetary appropriation.

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

Cash with fiscal agent in the debt service fund consists of property tax collections and sales and usage taxes amounting to $2,018,611 that are restricted for the payment of the Municipality's debt service, as required by law. Cash with Fiscal Agent in General Fund consist of $13,949, in Capital Improvement Fund consist of $1,003,984 and in other governmental funds consist principally of $269,187 of unspent proceeds of bonds that are restricted for the acquisition, construction or improvement of major capital assets. The amounts deposit in GDB is maintained in interest bearing accounts and is not collateralized.

Municipality follows the provisions of GASB Accounting Standards Codification Section C20, *Cash Deposit with Financial Institutions*, related with cash deposit and interest-earning investment contract with financial institutions. Accordingly, the following is essential information about credit risk, interest rate risk, custodial credit risk, and foreign exchange exposure of deposits and investments of the Municipality at June 30, 2013:

Credit Risk

This is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. At June 30, 2013, the Municipality has invested only in cash equivalents of $1.1 million consisting of deposit in commercial bank accounts, which are insured by the FDIC, generally up to a maximum of $250,000. As previously mentioned, public funds deposited by the Municipality in commercial banks must be fully collateralized for the amounts deposited in excess of the FDIC coverage. No investments in debt of equity securities were made during the Fiscal Year ended June 30, 2013. Therefore, the Municipality's management has concluded that the credit risk related to any possible loss related to defaults by commercial banks on the Municipality's deposits is considered low at June 30, 2013.

Custodial Credit Risk

This is the risk that, in the event of the failure of a depository financial institution, the Municipality will not be able to recover its cash and investments or will not be able to recover collateral securities that are in the possession of an outside party. Pursuant to the Investment Guidelines for the Commonwealth adopted by GDB, the Municipality may invest in obligations of the Commonwealth, obligations of the United States, certificates of deposit, commercial paper, banker's acceptance, or in pools of obligations of the municipalities of Puerto Rico, which are managed by GDB. At June 30, 2013, the Municipality has balances deposited in commercial banks amounting to $1.1 million which are insured by the FDIC up to the established limit and the excess are fully collateralized as explained above. Deposits in GDB, amounting to $3.4 million are uninsured and uncollateralized. However, no losses related to defaults by GDB on deposit transactions have been incurred by the Municipality through June 30, 2013. It is management's policy to only maintain deposits in banks affiliated to FDIC to minimize the custodial credit risk, except for GDB. Therefore, the Municipality's management has concluded that at June 30, 2013, the custodial credit risk associated with the Municipality's cash and cash equivalents is considered low.

Interest Rate Risk

This is the risk that changes in interest rates of debt investments will adversely affect the fair value of an investment. The Municipality manages its exposure to declines in fair values by: (1) not including debt or equity investments in its investments portfolio at June 30, 2013, (2) limiting the weighted average maturity of its investments in certificates of deposit to periods of three months or less, and (3) keeping most of its banks deposits in certificates of deposit and in interest bearing accounts generating interest at prevailing market rates. Therefore, at June 30, 2013, the interest risk associated with the Municipality's cash and cash equivalent is considered low.

continue

3. CASH AND INVESTMENTS – continuation

Foreign Exchange Risk

This is the risk that changes in exchange rates will adversely affect the value of an investment or a deposit. According to the aforementioned investment guidelines, adopted by the Municipality, the Municipality is prevented from investing in foreign securities or any other types of investments for which foreign exchange risk exposure may be significant. Accordingly, management has concluded that the foreign exchange risk related to the Municipality's deposits is considered low at June 30, 2013.

4. DUE FROM GOVERNMENTAL UNITS

The due from governmental units for the fiscal year ended June 30, 2013 corresponds to $66,806 from Puerto Rico Treasury Department for the Christmas Bonus and $161,792 from Puerto Rico Department of Labor and Human Resources for Act Number 52.

5. ACCOUNTS RECEIVABLE – FEDERAL GRANTS

The due from federal grants of the Other Governmental Funds for the fiscal year ended June 30, 2013 corresponds to $2,805,534 from the Community Development Block Grants/States Program and Non Entitlements Grants in Hawaii (State CDBG) (through the Office of the Commissioner of Municipal Affairs), $4,646 from the Child and Adult Care Food Program (through the Puerto Rico Department of Education), and $56,078 from Child Care and Development Block Grant.

6. INTERFUND RECEIVABLE, PAYABLES AND TRANSFERS

a. Interfund Receivable and Payable Balances

Due to/from Other Funds at June 30, 2013 are summarized as follows:

INTERFUND RECEIVABLE	INTERFUND PAYABLE	AMOUNT
Capital Improvement Fund	General Fund	$ 84,418
Other Governmental Funds	General Fund	1,755,252
General Fund	CDBG Fund	188,563
Capital Improvement Fund	Other Governmental Funds	182,910
Total		$ 2,211,143

B. Interfund Transfers

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

INTERFUND TRANSFERS WITHIN THE GOVERNMENTAL FUNDS			
SOURCES	TRANSFER TO	AMOUNT	PURPOSE
General Fund	Other Governmental Funds	$ 7,000	Operating Purpose
General Fund	Debt Service Fund	235,391	Debt Payments
	Total	$ 242,391	

continue

7. UNEARNED REVENUES

Government-wide *Statement of Net Position* does not report *deferred inflows of resources*, but report *unearned* revenues for resources receive before it has a legal claim to them. Governmental funds balance sheet report *unearned revenues* in connection with cash collected for revenues that are not considered to be available to liquidate liabilities of the current period as follows:

Governmental Funds:	
Volume of Business Taxes	$ 693,539
Total Unearned Revenues	$ 693,539

8. DEFERRED INFLOW OF RESOURCES

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

Governmental Funds:	
Christmas Bonus - Commonwealth	$ 66,806
Property Taxes	262,780
Federal Grants:	
CDBG Fund	1,859,208
Other Governmental Funds	54,987
Total Deferred Inflows of Resources	$ 2,243,781

9. DUE TO OTHER GOVERNMENTAL UNITS

As of June 30, 2013, balance due to other governmental units of the General Fund for services rendered to the Municipality, consists of the following:

	AMOUNT
Water and Sewer Authority	$ 105,228
Department of Treasury of Puerto Rico	440,505
Retirement System Administration	787,880
AEELA	15,157
Total Due to Governmental Units	$1,348,770

continue

10. CAPITAL ASSETS

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

DESCRIPTION	BALANCE JULY 1, 2012	ADJUSTMENT	INCREASES	DECREASES	BALANCE JUNE 30, 2013
Non-Depreciable Capital Assets:					
Land	$ 19,433,560	$ -	$ -	$ -	$ 19,433,560
Work of Art	1,500	-	-	-	1,500
Construction in Progress	3,367,240	-	1,482,215	-	4,849,455
Total Non-Depreciable Capital Assets	22,802,300	-	1,482,215	-	24,284,515
Depreciable Capital Assets:					
Buildings and Buildings Improvements	21,454,974	-	-	-	21,454,974
Infrastructure	9,342,894	-	-	-	9,342,894
Vehicles, Machinery and Equipment, and Furniture and Fixtures	3,998,986	-	159,005	-	4,157,991
Total Depreciable Capital Assets	34,796,854	-	159,005	-	34,955,859
Less Accumulated Depreciation:					
Buildings and Buildings Improvements	(4,589,317)	-	(429,099)	-	(5,018,416)
Infrastructure	(3,591,784)	-	(186,858)	-	(3,778,642)
Vehicles, Machinery and Equipment, and Furniture and Fixtures	(3,234,474)	-	(207,900)	-	(3,442,374)
Work of Art	(1,113)	1,113	-	-	-
Total Accumulated Depreciation	(11,416,688)	1,113	(823,857)	-	(12,239,432)
Total Depreciable Capital Assets (Net)	23,380,166	1,113	(664,852)	-	22,716,427
CAPITAL ASSETS, NET	$ 46,182,466	$ 1,113	$ 817,363	$ -	$ 47,000,942

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

	AMOUNT
Mayor and Municipal	$ 247,157
General Government	49,431
Public Safety	98,863
Public Works	205,964
Culture, Recreation and Education	65,909
Health and Welfare	107,101
Urban and Economic Development	49,432
Total Depreciation Expenses	$ 823,857

continue

11. NONCURRENT LIABILITIES

A. General Obligations Bonds and Special Obligations Bonds

The principal long-term obligations of the Municipality are general obligation bonds and special obligation bonds issued to finance the construction and improvements of public facilities and purchase of machinery and equipment. The Municipality's obligations long-term debt retirements are appropriated and paid from resources accumulated in the Debt Service Fund (See Note 12).

The following is a summary of general and special obligation bonds of the Municipality as of June 30, 2013:

Type of Obligation and Purpose	Issue Date	Original Borrowing	Maturity Date	Interest Rate	Balance Amount
General Obligation Bonds:					
Property Taxes Income:					
General Construction	1998	$ 576,000	2023	4.50%	$ 316,000
General Construction	1996	514,000	2020	4.50%	234,000
Operational Purpose	2002	370,000	2016	1.38%	145,000
General Construction	2000	239,000	2025	4.50%	154,000
General Construction	2003	285,000	2027	4.73%	220,000
Operational Purpose	2005	475,000	2014	1.63%	115,000
Operational Purpose	2005	1,140,000	2019	1.63%	635,000
Operational Purpose	2009	1,035,000	2015	4.75%	510,000
Purchase of Equipment	2012	104,000	2019	3.75%	91,000
Total General Obligation Bonds					**2,420,000**
Special Obligation Bonds:					
General Revenues:					
General Construction	1997	400,000	2016	1.63%	100,000
Operational Purpose	2003	990,000	2027	1.63%	730,000
Subtotal					**830,000**
Sales and Usage Taxes:					
Operational Purpose	2008	505,000	2015	1.63%	255,000
Purchase of Equipment	2009	670,000	2015	1.63%	330,000
General Construction	2012	3,160,000	2031	6.00%	3,085,000
Subtotal					**3,670,000**
Total Special Obligation Bonds					**4,500,000**
Total General and Special Obligation Bonds					**$ 6,920,000**

B. Legal Debt Limit and Legal Debt Margin

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

continue

11. NONCURRENT LIABILITIES – continuation

C. Other Noncurrent Liabilities

Borrowing from MRCC

On July 1, 2007, the Municipality entered into a repayment agreement with the GDB and MRCC to repay the uncollectible property tax sale authorized by the enacted Law Number 146. The original amount of debt is $97,362 to be paid during 25 years plus annual interest of 2.504%.

On July 1, 2002, the Municipality entered into a repayment agreement with the GDB and MRCC to repay the uncollectible property tax sale authorized by the enacted Law Number 42. The original amount of debt is $227,770 to be paid during 30 years plus annual interest of 6.1875%.

Christmas Bonus

This amount represents the estimated accrued Christmas bonus accumulated as of June 30, 2013 and payroll related benefits, representing the benefit to employees to be paid during the first week of December 2013.

Department of Labor and Human Resources

On June 30, 2011, the Municipality entered into a repayment agreement with the Department of Labor and Human Resources to repay the unemployment benefit as of June 30, 2011. The repayment agreement is payable in monthly aggregate installments of principals and interest of 8.00% of $6,144.83. The original amount of debt is $221,213.96 under the agreement to be paid during 3 years.

Claims and Judgments

This amount represents the amount accrued for possible claims arising from litigations as recommended by the Municipality's attorneys and classified as due after one year. Only claims is presented as due within one year when the Municipal Legislature approved it in the next fiscal year budget.

Compensated Absences

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

Following are the Other Noncurrent Liabilities:

DESCRIPTION	BALANCE JULY 1, 2012	NEW ISSUES	RETIREMENTS AND ADJUSTMENT	BALANCE JUNE 30, 2013	AMOUNT'S DUE WITHIN ONE YEAR	AMOUNT'S DUE AFTER NEXT YEAR
Law Number 146-MRCC	$ -	$ -	$ 73,985	$ 73,985	$ 3,894	$ 70,091
Law Number 42-MRCC	207,306	-	(18,623)	188,683	5,196	183,487
Christmas Bonus	-	133,612	-	133,612	133,612	-
Puerto Rico Department of Labor and Human Resources	-	-	67,412	67,412	62,226	5,186
Claims and Judgments	348,779	21,000	(348,779)	21,000	21,000	-
Compensated Absences	2,054,234	-	(432,828)	1,621,406	914,486	706,920
TOTAL	$ 2,610,319	$ 154,612	$ (658,833)	$ 2,106,098	$ 1,140,414	$ 965,684

continue

11. NONCURRENT LIABILITIES – continuation

D. Changes in Noncurrent Liabilities

The following is a summary of changes in noncurrent liabilities for the year ended June 30, 2013:

DESCRIPTION	BALANCE JULY 1, 2012	NEW ISSUES	RETIREMENTS AND ADJUSTMENT	BALANCE JUNE 30, 2013	AMOUNT'S DUE WITHIN ONE YEAR	AMOUNT'S DUE AFTER NEXT YEAR
General Obligation Bonds	$ 2,520,100	$ -	$ (100,100)	$ 2,420,000	$ 408,600	$ 2,011,400
Special Obligation Bonds	4,670,000	-	(170,000)	4,500,000	320,000	4,180,000
Other Obligations	2,610,319	154,612	(658,833)	2,106,098	1,140,414	965,684
TOTAL	$ 9,800,419	$ 154,612	$ (928,933)	$ 9,026,098	$ 1,869,014	$ 7,157,084

E. Debt Compliance

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

The annual requirements to amortize the noncurrent liabilities outstanding as of June 30, 2013 are as follows:

	General Obligation Bonds		Special Obligation Bonds		Other Noncurrent Obligations			
YEAR ENDING JUNE 30,	PRINCIPAL PAYMENT	INTEREST PAYMENT	PRINCIPAL PAYMENT	INTEREST PAYMENT	PRINCIPAL PAYMENT	INTEREST PAYMENT	TOTAL PRINCIPAL	TOTAL INTEREST
2014	$ 408,600	$ 84,284	$ 320,000	$ 232,112	$ 142,702	$ 13,447	$ 871,302	$ 329,843
2015	436,200	94,150	350,000	277,750	9,417	13,025	795,617	384,925
2016	400,800	69,466	390,000	446,200	9,764	12,580	800,564	528,246
2017	233,500	51,946	140,000	234,200	10,133	12,113	383,633	298,259
2018	199,100	41,866	155,000	224,250	10,525	11,623	364,625	277,739
2019-2023	609,800	91,916	920,000	946,300	59,422	49,860	1,589,222	1,088,076
2024-2028	132,000	15,999	1,210,000	574,150	73,653	33,191	1,415,653	623,340
2029-2032	-	-	1,015,000	147,875	80,664	11,452	1,095,664	159,327
TOTAL	$ 2,420,000	$ 449,627	$ 4,500,000	$ 3,082,837	$ 396,280	$ 157,291	$ 7,316,280	$ 3,689,755

12. DEBT RETIREMENT

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

These property taxes are accumulated by the Municipal Revenue Collection Center in costs of the general obligations bonds issued by the Municipality (See Note 11). Payments are made to the Government Development Bank of the Commonwealth of Puerto Rico from such accumulated funds by the Municipal Revenue Collection Center of Puerto Rico.

continue

13. PROPERTY TAXES

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

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

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

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

The tax rate for fiscal year 2013 is 9.83% for real property and 6.53% for personal property of which 1.03% of both are for the redemption of public debt issued by the Commonwealth of Puerto Rico and 8.80% and 5.50%, respectively, belongs to the Municipality. Taxpayers pay 9.63% for real property and 6.33% for personal property and the remaining 0.20% is paid by the Commonwealth's Secretary of the Treasury as a subsidy. As part of Act No. 83 of August 30, 1991, as amended, the exempt amount to be paid by the Puerto Rico Secretary of the Treasury to the Municipality was frozen as of January 1, 1992. The remaining percentage is distributed as follows: (a) 6.00% and 4.00%, respectively, represents the Municipality's basic tax rate that is appropriated for general purposes and therefore accounted for through the general fund. A portion of such amount is deposited in an equalization fund together with a percentage of the net revenues of the Puerto Rico electronic lottery and a subsidy from the Commonwealth of Puerto Rico. The remaining portion belonging to the Municipality of 2.80% and 1.50%, respectively, represents the ad-valorem property taxes withheld by the MRCC and restricted for debt service, which is accounted for through the debt service fund (See Note 12). The Municipality has not reached the maximum statutory tax rate limit for the basic tax while there is no limitation for the ad-valorem tax rate.

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

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

14. VOLUME OF BUSINESS TAXES

The volume of business taxes is levied each year based on the prior year's gross revenues for all commercial and industrial organizations doing business in the Municipality and which are not totally or partially exempt from this tax under the Industrial Incentives Acts of the Commonwealth of Puerto Rico. This is a self-assessed tax based on the business volume in gross sales as shown in the tax return that is due five working days after April 15 of each year. Entities with sales volume of $3.0 million or more must include audited financial statements together with the tax return. During the fiscal year ended June 30, 2013, the tax rates were as follows:

a. 1.50% for financial institutions and savings and loan associations.

b. 0.50% for all other organizations.

continue

14. VOLUME OF BUSINESS TAXES – continuation

Taxes are payable in two equal semi-annual installments on July 1 and January 1 following the date of levy. If they are paid with declaration on or before the due date, the taxpayer is granted a 5% of discount. The volume of business tax receivable represents filed tax returns that were uncollected as of June 30, 2013. Collections of taxes during current fiscal year corresponding of the tax return based on the prior year gross sales are applicable to the next fiscal year and recorded as deferred revenues in the General Fund.

15. SALES AND USAGE TAXES

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

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

a. 0.2% will be deposited in a "Municipal Development Fund" to finance costs as restricted by the Act;

b. 0.2% will be deposited in a "Municipal Redemption Fund" to finance loans to municipalities subject to restrictions imposed by the Act; and

c. 0.1% will be deposited in a "Municipal Improvement Fund" to finance capital improvement projects. These funds will be distributed based on legislation from the Commonwealth's Legislature.

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

On February 1, 2014 was enacted the Act Numbers 18 to create the "Law of Municipal Administration Fund (MAF)"and 19 that creates the Municipal Financing Corporation (COFIM by Spanish acronyms). These Acts amend the composition of the SUT effective February 1, 2014 and thereafter. See Note 22 for the changes contemplated by these Acts.

16. CONSTRUCTION EXCISE TAXES

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

The construction excise tax generally is a self-assessed tax imposed over the cost of the project, net of certain exemptions such as the costs associated with the acquisition of land, existing buildings and improvements, project design and other engineering fees, licenses and permits, consulting and legal fees. The general tax rate is paid by the taxpayer before the beginning of the construction project. Tax rate are fixed at 4.0%.

All single-family residential construction projects not related to housing development projects, condominiums, or any similar projects, are partially exempt from construction excise taxes. In addition, a portion of all single-family residential improvement projects are exempt from construction excise taxes.

continue

17. INTERGOVERNMENTAL REVENUES

Taxes are payable before beginning construction or any activity related to the construction. Collections of taxes during current fiscal year, applicable to the next fiscal year, are recorded as deferred revenues in the General Fund.

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

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

18. PENSION PLAN

Description of the Plan

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

Act No. 3 was enacted on April 4, 2013, amended the Act No. 447 for the purpose of establishing a major reform of the ERS effective on July 1, 2013. Employees participating in the current system (ERS) should be retired as of June 30 2013 in order to obtain the current benefits. Also, Act No. 3 amended the Act No. 305 of September 24, 1999 that's created a Defined Contribution Hybrid Program known as System 2000, incorporating the provisions of the system to Chapter 5 of the ERS. The System 2000 applied to employees joining the ERS on or after January 1, 2000.

Follow are the principal amendment of Act No. 447 by Act No. 3:

Chapter 3 of the Act No. 447, established the following date of retirement:

(a) General Rule – The first day of the month that coincides with or is subsequent to the date that the participant of the program reaches the age of sixty (60), except as provided in clause (b) of this subsection.

(b) Public Officers in High-Risk Positions- In the case of Public Officers in High-Risk Positions, it shall mean the first day of the month that coincides with or is subsequent to the date that the Participant reaches the age of fifty-five (55) years. (Public Officers in High-Risk Positions shall mean the Commonwealth of Puerto Rico Police, the Municipal Police, the Commonwealth Firefighter Corps, the Municipal Firefighter Corps, and the Custody Officers Corps.)

(c) Effectiveness of these provisions: the normal date of retirement established in subsections (a) and (b) of this definition shall be in force until June 30, 2013.

Retirement age for participants who joined public service after June 30, 2013. The retirement age shall be 67 years, except in the case of Public Officers in High-Risk Positions, for whom it shall be fifty eight (58) years.

Participant of the Program

Shall mean, until June 30, 2013, every person for whom the Administrator maintains an account under the Retirement Savings Account Program pursuant to the provisions of Chapter 3 of Act No. 447. Beginning on July 1, 2013, it shall mean every person for whom the Administrator maintains an account under the Defined Contribution Hybrid Program pursuant to the provisions of Chapter 5 of this Act.

The membership of the System shall be constituted by every person who holds a regular position as a career, trust, temporary employee or with probationary personnel status in any executive department, agency, administration, board, commission, office, or instrumentality of the Executive Branch, by the Justices of the Peace, the regular employees and officials of the Judiciary Branch, and by all regular officials and employees of the municipalities, including the mayors. Temporary municipal employees shall not participate in the Retirement System.

continue

18. PENSION PLAN – continuation

Membership in the Retirement System shall be optional for the Governor of Puerto Rico, for all the Secretaries of Government, heads of public agencies and instrumentalities, the Governor's aides, the members of commissions and boards appointed by the Governor, the members of the Legislative Assembly of Puerto Rico, for the employees and officials of the Legislative Assembly of Puerto Rico, the Office of Legislative Services and the office of the Superintendent of the Capitol, and the Comptroller of Puerto Rico. These officials may, at any time, request to be discharged from, or readmitted into the System. The period of services rendered to the Government while separated from the System, shall be credited as creditable service, provided said officials pay the individual and employer contributions, plus interest, that correspond to the period of separation, to the system.

As of July 1, 2013, every employee who is a participant of the System, including mayors, regardless of the date when he/she was first appointed to the Government of the Commonwealth of Puerto Rico, its instrumentalities, municipalities or participating employers of the System, shall become part of the Defined Contribution Hybrid Program.

Notwithstanding the fact that a superannuation retirement annuity is payable for life, if annuitants return to the service, the payment of their annuity shall be suspended. After an annuitant separates from service, payment of the suspended annuity shall resume and he/she shall also have the option to withdraw the contributions made since the date he/she returned to service up until he/she separates from service if, after returning to service, he/she worked less than five (5) years or accrued contributions for less than ten thousand dollars ($10,000). In the event the annuitant worked five (5) years or more and contributed ten thousand dollars ($10,000) or more, after returning to service, he/she shall be entitled, after his/her separation from service and after reaching the age established in Section 5-110 of Act No. 447, to receive an additional annuity computed pursuant to Section 5-110 of this Act, on the basis of the contributions made since the date said annuitant returned to service until his/her separation from it.

Annuity for Years of Service

As per Act No. 3, retirement shall be optional for new participants joining the System for the first time after April 1, 1990, as of the date in which they reach the age of sixty-five (65), have completed a minimum of ten (10) years of accredited services and have not requested or received the reimbursement from the accrued contributions. The amount of the annuity shall be one point five percent (1.5%) of the average compensation multiplied by the years of accredited services. However, a minimum pension of five hundred dollars ($500) per month, effective July 1, 2013, is hereby fixed for those participants who retired in accordance with the provisions of this Chapter 2. Every pensioner who receives a pension of less than five hundred dollars ($500) per month shall receive, effective July 1, 2013, the increase required for his/her pension to be five hundred dollars ($500).

Public Officers in High-Risk Positions may voluntarily opt to retire after reaching the age of fifty-five (55) and thirty (30) years of service. Retirement shall be mandatory on the date the participant reaches both thirty (30) years of service and the age of fifty-eight (58). Provided, that the Superintendent of the Puerto Rico Police, the Chief of the Firefighter Corps or the corresponding appointing authority may grant dispensations authorizing members of this group to work for an additional maximum period of two (2) years performing the functions assigned to them; provided that their health and safety are not compromised. Such a request for dispensation shall be made by the member, not later than ninety (90) days before his/her retirement date. It is hereby provided that the Superintendent of the Puerto Rico Police, the Chief of the Firefighter Corps or the corresponding appointing authority shall make the necessary regulatory provisions to comply with this Act.

Retirement shall be optional for the members of the System in active service, on and after the date they have attained the age of fifty-five (55) years and have completed at least twenty-five (25) years of creditable service; and for members of the System who having reached the age of fifty-eight (58) years, and have completed at least ten (10) years of creditable service. The members of the Police Corps or the Firefighting Corps shall also have the option to avail themselves of a retirement annuity on and after the date on which they have attained the age of fifty (50) years and have completed at least twenty-five (25) years of creditable service.

Any participant whose separation from the service occurs prior to having attained the age of fifty-eight (58) years, who shall have completed at least ten (10) years of creditable service, and who shall have not applied for, nor received reimbursement of accumulated contributions shall be entitled to receive a deferred retirement annuity. Said participants shall receive a deferred retirement annuity which shall commence upon attaining the age of fifty eight (58) years or after attaining the age of fifty (50) years in the case of policemen or firemen, and fifty-five (55) years in the case of the other participants, if they have completed at least twenty-five (25) years of service in one case or the other.

continue

18. PENSION PLAN – continuation

The amount of the annuity shall be one and one-half percent (1.50%) of the average compensation multiplied by the number of years of creditable service up to twenty (20) years, plus two percent (2%) of the average compensation multiplied by the number of years of creditable service in excess of twenty (20) years. Said annuity shall be payable in full to the members who retire at the age of fifty-eight (58) years or more, and to the members of the Police Corps [or] the Firefighting Corps who retire at the age of fifty (50) years or more and who have completed at least twenty-five (25) years of creditable service. The maximum retirement annuity for the participants shall be seventy-five percent (75%) of the average compensation.

The amount of the superannuation retirement annuity of mayors who are participants of the System shall be computed on the basis of the highest salary he/she may have received while discharging his/her government duties in the following manner:

(1) For services performed as mayor, five percent (5%) of said salary for each year of creditable service up to a maximum of ten (10) years or fifty percent (50%), plus

(2) For other services performed not included in the above computation, one and one half percent (1.50%) of said salary multiplied by the number of years of such other creditable services up to twenty (20) years, or two percent (2%) of said salary multiplied by the number of years of such other creditable services in excess of twenty (20) years.

The maximum superannuation retirement annuity to be granted under this subsection shall be ninety percent (90%) of the highest salary that the mayor may have received. The payments of the retirement annuity shall begin on and after the date of separation from service, but never before the mayor has attained fifty (50) years of age.

Retirement shall be optional for any participant of the System in active service who shall have completed at least thirty (30) years of creditable service. Said participant shall be entitled to receive the Merit Annuity for thirty (30) years or more of service in accordance with subsections (b) and (c) of this section thereof. Participants of the System under the Coordinating Plan and receiving Social Security benefits, who have not attained sixty-five (65) years of age, shall receive a merit annuity to be computed as provided for hereinafter:

(1) For those participants who have completed thirty (30) years or more of creditable services and have not attained fifty-five (55) years of age or more, sixty-five percent (65%) of the average compensation.

(2) For those who have completed thirty (30) years or more of creditable services and have attained fifty-five (55) years of age or more, seventy-five (75%) of the average compensation.

(3) Years in excess of thirty (30) may only serve as basis to calculate the average compensation

As per Act No. 447 the following provisions shall apply to employees who participate in the System that (i) began to work before January 1, 2000, (ii) as of June 30, 2013, are not participants of the Retirement Savings Account Program established in Chapter 3 of this Act and (iii) as of June 30, 2013, do not meet the requirements of years of service and age to retire that are required in Chapter 2 of this Act:

(1) New Retirement Age for participants who joined the System for the first time before April 1, 1990. For those participants who, as of June 30, 2013, have not reached the age of 58 and completed at least 10 years of service, or have not reached the age of 55 and completed at least 25 years of service, retirement shall be optional when they meet the following age and service requirements:

   (i) If, as of June 30, 2013, the participant is 57 years of age, the retirement will be optional when he/she reaches 59 years of age and has completed at least 10 years of service.

   (ii) If, as of June 30, 2013, the participant is 56 years of age, the retirement will be optional when he/she reaches 60 years of age and has completed at least 10 years of service.

   (iii) If, as of June 30, 2013, the participant is 55 years of age or less, the retirement will be optional when he/she reaches 61 years of age and has completed at least 10 years of service.

(2) Retirement Age for participants who joined the System for the first time between April 1, 1990, and December 31, 1999 – For participants who, as of June 30, 2013, have not reached the age of 65 and completed at least 10 years of service, retirement shall be optional when the participant reaches 65 years of age and has completed 10 years of service.

continue

18. PENSION PLAN – continuation

(3) For Public Officers in High-Risk Positions who began to work before April 1, 1990 and who, as of June 30, 2013, have not reached the age of 50 and completed at least 25 years of service, or who have not completed 30 years of service, regardless of their age, retirement shall be optional when they reach 55 years of age and have completed 30 years of service.

(4) For Public Officers in High-Risk Positions who began to work between April 1, 1990, and December 31, 1999, and who, as of June 30, 2013, are not 55 years old and have completed 25 years of service, or who have not completed 30 years of service, regardless of their age, retirement shall be optional when they reach 55 years of age and have completed 30 years of service.

(5) Public Officers in High-Risk Positions who separate from active service before meeting the requirements of age and service provided in subsection (a)(3) or (a)(4) of this Section may only receive their accrued pension when they meet the following age and service requirements:

(i) If the participant joined the System for the first time before April 1, 1990, after he/she meets the age and service requirements established in subsection (a) 1 of this Section.

(ii) If the participant joined the System for the first time between April 1, 1990, and December 31, 1999, after he/she meets the age and service requirements established in subsection (a) 2 of this Section.

Pension Computation

When the participant meets the age and service requirements established above, he/she shall be entitled to receive an annuity computed on the basis of years of service accrued as of June 30, 2013, in accordance with the following rules:

(i) The average salary of employees who began to work before April 1, 1990, shall be the one established in definition number 15 of Section 1-104 of Act No 447.

(ii) The average salary of employees who began to work between April 1, 1990, and December 31, 1999, shall be the one established in Section 1-108 of this Act.

(iii) The pension computation of employees who began to work before April 1, 1990, shall be made on the basis of one and one half percent (1.5%) of the average salary, multiplied by the number of years of creditable service up to twenty (20) years, plus two percent (2.0%) of the average salary, multiplied by the number of years of creditable service in excess of twenty years, in each case up to June 30, 2013.

(iv) The pension computation of employees who began to work between April 1, 1990 and December 31, 1999, shall be made on the basis of one and one half percent (1.5%) of the average salary, multiplied by the number of years of creditable service up to June 30, 2013.

(v) Participants of the System who, as of June 30, 2013, have availed themselves to the Coordinating Plan and are receiving Social Security benefits will have their annuities adjusted in accordance with the provisions of subsection (e) of Section 2-101 of this Act. Provided that until the participant is entitled to receive the Social Security benefits, he/she may receive an annuity in accordance with Section 5-103 of this Act.

(vi) This pension shall be received together with the annuity accrued by a participant under Section 5-110 of this Act.

Beginning on July 1, 2013, participants shall not accrue any more years of service for the determination of the average salary and computation of a pension under Section 5-103(a)(4). In addition, participants may not have services not credited recognized, contributions transferred or returned for periods worked before June 30, 2013, except for those exceptions specifically established in Act No 447.

Those participants who began to work on or after January 1, 2000, or those who as of June 30, 2013, were participants in the Retirement Savings Program and who as of June 30, 2013, could retire from service because they are sixty (60) years old, may retire on any later date and they shall be entitled to receive the annuity that could be acquired with the balance of the contributions under the Retirement Savings Account Program and those accrued under the Defined Contribution Hybrid Program.

continue

18. PENSION PLAN – continuation

The savings accounts under the Retirement Savings Account Program of employees who joined the System for the first time on or after January 1, 2000, shall be rolled over to the Defined Contribution Hybrid Program. Be it provided that if, as of June 30, 2013, the employees have not reached the age of sixty (60), they shall be entitled to the annuity established in Section 5-110 of Act No. 447 when they meet the following age requirements:

(i) If, as of June 30, 2013, the participant is 59 years old, the retirement will be optional when he/she has reached 61 years of age.

(ii) If, as of June 30, 2013, the participant is 58 years old, the retirement will be optional when he/she has reached 62 years of age.

(iii) If, as of June 30, 2013, the participant is 57 years old, the retirement will be optional when he/she has reached 63 years of age.

(iv) If, as of June 30, 2013, the participant is 56 years old, the retirement will be optional when he/she has reached 64 years of age.

(v) If, as of June 30, 2013, the participant is 55 years old or less, the retirement will be optional when he/she has reached 65 years of age.

For Public Officers in High-Risk Positions who began to work after December 31, 1999, and who, as of June 30, 2013, are not 55 years old, retirement shall be optional when they reach 55 years of age.

Funding Policy

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

Contributions of Participants of Defined Benefit Program

Contribution requirements are established by law and are as follows:

Complete supplementation plan between ERS and the Federal Social Security	
Hired on or before March 31, 1990	8.275% of gross salary
Coordination plan between ERS and the Federal Social Security	
Hired on or before March 31, 1990	5.775% of gross salary up to $6,600 8.275% of gross salary over $6,600
Mayors and members of the Police Corps	8.275% of gross salary

Contributions of Participants of Hybrid Program

Contribution requirements are established by law and are as follows:

(a) Every participant of the Hybrid Program shall compulsorily have to contribute ten percent (10%) of his/her salary while he/she is an employee.

(b) Contributions under the Plan of Coordination with Social Security benefits.- The participants of the System who, as of June 30, 2013, have availed themselves to the Plan of Coordination with Social Security benefits shall contribute to the Hybrid Program:

(1) Effective July 1, 2013, shall contribute seven percent (7%) of their monthly salaries up to five-hundred fifty dollars ($550) and ten percent (10%) of their monthly salaries in excess of said amount.

continue

18. PENSION PLAN – continuation

(2) Effective July 1, 2014, shall contribute eight point five percent (8.5%) of their monthly salaries up to five-hundred fifty dollars ($550) and ten percent (10%) of their monthly salaries in excess of said amount.

(3) Effective July 1, 2015, shall contribute ten percent (10%) of their full monthly salaries.

The participants of the Program under subsections (a) and (b) of this Section may voluntarily contribute to their account an amount in addition to the one established here. These contributions shall be credited to the contribution account of each participant of the Hybrid Program. The Administrator shall establish the way in which the participants may make additional contributions.

(c) Mandatory Contribution for the Purchase of Disability Insurance – Every participant of the Hybrid Program shall mandatorily contribute to the disability insurance established in Section 5-112 of Chapter 5 of Act No. 447, for which he/she shall have to contribute such sums, fixed in dollars or a percent of the salary, that the Administrator, with the approval of the Board, determines that are needed to provide the disability benefit, provided the contribution required by the Administrator is equal to or less than point twenty five percent (0.25%) of the participant's salary. The contributions made pursuant to this subsection may be credited against and will reduce the contributions that the participant of the Program is bound to pay to the Commonwealth of Puerto Rico Employees Association as provided in Section 8 of Act No. 133 of June 28, 1966, as amended. The contributions made under this subsection shall not be credited to the participant's account.

Employer Contributions to the System (ERS and Hybrid Program)

Every employer shall mandatorily contribute to the System the following:

July 1, 2011	Ten point two hundred seventy-five percent (10.275%) of the salary of each participant
July 1, 2012	Eleven point two hundred seventy-five percent (11.275%) of the salary of each participant

Every employer, beginning on July 1, 2013 and thereafter, shall mandatorily contribute to the System the following:

July 1, 2013	Twelve point two hundred seventy-five percent (12.275%) of the salary of each participant
July 1, 2014	Thirteen point two hundred seventy-five percent (13.275%) of the salary of each participant
July 1, 2015	Fourteen point two hundred seventy-five percent (14.275%) of the salary of each participant
July 1, 2016	Fifteen point five hundred twenty-five percent (15.525%) of the salary of each participant
July 1, 2017	Sixteen point seventy hundred seventy-five percent (16.775%) of the salary of each participant
July 1, 2018	Eighteen point twenty-five percent (18.025%) of the salary of each participant
July 1, 2019	Nineteen point two hundred seventy-five percent (19.275%) of the salary of each participant
July 1, 2020	Twenty point five hundred twenty-five percent (20.525%) of the salary of each participant

It is provided that the established increases applicable to the municipalities for fiscal years 2012-2013 and 2013-2014, shall be included in the budget petition submitted by the Office of Management and Budget to the Legislative Assembly.

continue

18. PENSION PLAN – continuation

Death, Disability or Terminal Illness Benefits

Death of a Participant in Active Service

Upon death of any person who is rendering services and who had contributions accrued in the Hybrid Program, these contributions shall be reimbursed to the person or persons the participant had designated through written order duly acknowledged and submitted to the Administrator, or to his/her heirs, in the event such designation had not been made. The reimbursement shall be equal to the sum of the contributions and the investment yields up to the date of the demise of the participant. The Administrator shall collect from the contributions any debt the participant may have with the System.

Death of a Pensioner

If a pensioner dies without having consumed all of his/her pension payment contributions, his/her designated beneficiaries or, absent such designation, his/her heirs, shall continue receiving the monthly pension payments until the contributions of the participant are completely consumed.

Separation from Service for Disability or Terminal Illness

The balance in the contribution account of every participant of the Hybrid Program who is permanently separated from service due to total and permanent disability, due to disability pursuant to Act No. 127 of June 27, 1958, as amended, or due to terminal illness, as determined by the Administrator, shall be distributed to the participant by the Administrator in a lump sum, or through the grant of an annuity, or any other optional form of payment pursuant to Section 5-110 of Act No. 447, at the option of the participant.

Beginning on June 30, 2013, no disability pensions shall be awarded pursuant to Sections 2-107 thru 2-111 of Act No. 447.

Disability Insurance

The Administrator, with the approval of the Board, shall establish a disability benefits program, which shall provide a temporary annuity in the event of total and permanent disability. Disability benefits may be provided through one or more disability insurance contracts with one or more insurance companies authorized by the Insurance Commissioner of Puerto Rico to conduct business in Puerto Rico. The determination as to whether a person is partially or totally and permanently disabled, shall be made by the insurance company that issues the insurance policy covering the person. All the participants of the Program who are employees shall avail themselves to the disability benefits program in the manner and form established by the Administrator.

Additional Benefits Program

The Additional Benefits Program is established for pensioners of the ERS; said benefits are separate and shall not form part of the pension or annuity.

Except for those persons who retire under Chapter 5 of Act No. 447 of May 15, 1951, as amended, every person who was receiving a pension or benefit under Act No. 447, or the pension plans superseded by it, or any other law administered by the Administrator of the ERS, excluding any person who is receiving a pension or benefit under Act No. 12 of October 19, 1954, as amended, shall be entitled to receive the following benefits:

(a) A Medication Bonus equal to one hundred ($100), which shall be paid no later than July 15 of each year;

(b) A Christmas Bonus equal to two hundred dollars ($200), which shall be paid no later than December 20 of each year; and

(c) A Government contribution for health benefits for employees covered by health benefit plans under Act No. 95 of June 29, 1963, as amended, of one hundred dollars ($100) monthly for pensioners of the Employees Retirement System of the Government of the Commonwealth of Puerto Rico, but it shall not exceed the total amount of the corresponding fee to be paid to any employee.

In order to fund the Additional Benefits Program and the ERS, beginning on fiscal year 2013-2014 and every subsequent fiscal year, the ERS shall receive a contribution equal to two thousand dollars ($2,000) as of July 1 of every year for every pensioner of the ERS who began to work in the Public Service on or before of December 31, 1999.

continue

18. PENSION PLAN – continuation

The Administration of the ERS shall determine the total amount of the special additional contribution provided in the above paragraph and shall send a certification to the Director of the Office of Management and Budget and to each public corporation and municipality whose employees are retired under the ERS, informing them the amount corresponding to the special additional contribution.

The funds to cover the contribution described above, with respect to pensioners of the Central Government, shall be allocated in the Budget of Expenses of the Government of the Commonwealth of Puerto Rico. Public corporations and municipalities whose employees are covered under this Act shall provide the funds to cover the contribution described in Section 2 with respect to their pensioners.

The persons who retire under the provisions of Act 305-1999, known as 'Retirement Savings Accounts Program', and under Chapter 5 of Act No. 447 of May 15, 1951, as amended, shall be excluded from receiving the benefits granted under Act.

Annual Contribution

The Municipality's contributions during the year are recognized as total pension expenditures/expenses in the category of administration as follow: Defined Benefit $156,428 and Hybrid Program $167,674.

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

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

19. HEALTHCARE COSTS

During the year ended June 30, 2000 the Governor of the Commonwealth of Puerto Rico required to the municipalities of Puerto Rico an annual contribution to subsidy the cost of the implementation and administration of the Healthcare Reform. Such contributions are required to be disbursed from general fund operating budget. Total contributions made by the Municipality amounted to approximately $365,618 for the fiscal year ended June 30, 2013.

20. CONTINGENCIES

A. Claims and Judgments

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

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

B. Federal Grants

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

continue

21. COMMITMENTS

A. Operating Leases

The Municipality leases real property, buildings, and equipment under various operating lease agreements, which generally have terms of one year or less and are automatically renewed for the same term. Rental expenditures/expenses recorded in the general fund for the year ended June 30, 2013, amounted to approximately $15,000. Management believes that the summary of the future minimum rental commitments under noncancelable real property and equipment lease with terms exceeding one year is not material to the basic financial statements taken as a whole.

B. Construction

The Municipality had encumbrances at June 30, 2013 for the construction, improvements, or renovation of several municipal facilities in the following funds:

Fund	Encumbered For	Amount	Reported within Fund Balance Classification
Other Governmental Funds	Bridge Construction	$ 90,963	Restricted to Improvement and Construction of Facilities
	Construction of Facilities	46,098	Restricted to Improvement and Construction of Facilities

C. Solid Waste Disposal Contract

The Municipality has a solid waste disposal contract with M.R. Waste, Inc. until June 30, 2019, to provide the service for the recollection, management and disposal of solid waste. In the contract it was established that the Municipality is committed to pay M.R. Waste Inc. $9.99 per unit served applied to a starting minimum of 12,163 units with annual increase of 0.04% up to fiscal year to be ended at June 30, 2019. Expenditure for the year ended June 30, 2013 for this service amounts to $1,458,100.

In addition, the Municipality is committed to pay an additional cost for recollection of such solid wastes for special activities such as festivals promoted by the Municipality. Future commitments are scheduled as follows:

Year	Amount
2014	$1,458,100
2015	1,458,100
2016	1,458,100
2017	1,458,100
2018	1,458,100
2019	1,458,100
Total	$8,748,600

D. Other Commitments

At June 30, 2013, the general fund and other governmental funds had a deficit of $4,171,776. The deficits result from the accrual of expenditures without accruing intergovernmental revenues for reimbursement of expenditures. As required by current standards, the Municipality recorded intergovernmental revenues for reimbursement-based (expenditure-driven) grants on GFFS when all applicable eligibility requirements have been met and the resources are available. Any amount not covered by the corresponding award will be covered with future budgetary appropriations of the general fund, if necessary.

continue

22. NET POSITION / FUND BALANCES RESTATEMENTS

A. Net Position

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

	GOVERNMENTAL ACTIVITIES
Net Position, as Previously Reported, At June 30, 2012	$ 39,245,255
Adjustments to Accumulated Depreciation (Work of Arts)	1,113
Adjustments (Fund Accounting)	(2,270,671)
Adjustments to Laws 42 and 146	64,146
Adjustments to Christmas Bonus	(75,092)
Adjustments to Recognized Department of Labor Debt	129,638
Adjustments to Claims and Judgments	327,779
Adjustments to Long Term Debt	(473,308)
Beginning Net Position, as Restated, At July 1, 2012	**$ 36,948,860**

B. Fund Balance

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

	GENERAL FUND	CAPITAL IMPROVEMENT FUND	DEBT SERVICE FUND	OTHER GOVERNMENTAL FUND
Fund Balance (Deficit), as Previously Reported, At June 30, 2012	$ (3,737,140)	$ 3,833,594	$ 1,259,238	$ 1,359,550
To Reclassified Major Funds Balance	-	(1,668,402)	-	1,668,402
Reclassified Fund Balance to Implement GASB No. 54	1,621,297	-	-	(1,621,297)
Adjustment to Recognized Accounts Payable FEMA	(1,080,557)	-	-	-
Adjustment to Fund Balance	(115,000)	115,000	-	(155,935)
Adjustment to Section 8 Housing Choice Vouchers Fund Balance	-	-	-	89,973
Adjustment to Revenues	(1,124,152)	-	-	-
Beginning Fund Balance, as Restated, At July 1, 2012	$ (4,435,552)	$ 2,280,192	$ 1,259,238	$ 1,340,693

23. NEW ACCOUNTING STANDARDS

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

continue

23. NEW ACCOUNTING STANDARDS – continuation

The GASB has issued Statement 63, Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position. GASB 63 provides guidance for reporting deferred outflows of resources, deferred inflows of resources, and net position in the statement of financial position and related disclosures. Deferred outflows is defined as the consumption of net assets by the government that is applicable to a future reporting period and deferred inflows is defined as the acquisition of net assets by the government that is applicable to a future reporting period. In compliance with GASB 63, the Statement of Net Assets has been renamed the Statement of Net Position and includes four components as applicable: assets, deferred outflows of resources, liabilities, and deferred inflows of resources. The adoption of this Statement resulted in a change in the term "Net Assets" to "Net Position" throughout the financial statements.

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

GASB Statement No. 65 ("GASB 65") Items Previously Reported as Assets and Liabilities was issued in March 2012. This Statement establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities. The requirements of this Statement improve financial reporting by clarifying the appropriate use of the financial statement elements deferred outflows of resources and deferred inflows of resources to ensure consistency in financial reporting. The requirements of this Statement are effective for financial statements for periods beginning after December 15, 2012 and were early adopted by the Municipality effective July 1, 2012. As a result of implementing this statement the Municipality changed the classification of certain liabilities to deferred inflows.

24. SUBSEQUENT EVENT

On October 2, 2013, the Municipality authorized the mayor to rent the facilities and administration of the Family Health Center of Peña Pobre. The terms and conditions of the contract are pending to be formalize.

On October 15, 2013, the Municipality approved the issuance of general obligation bonds, Series of 2013-2014 in the amount of $1,685,000 for operational purpose and bond issue costs; principal and variable interest at 6.0%, payable semi-annually on the 1st day of January and July of each year through 2033.

On October 15, 2013, the Municipality approved the issuance of general obligation bonds, Series of 2013-2014 in the amount of $740,000 to refinance a special obligation bonds and bond issue costs; principal and variable interest at 6.0%, payable semi-annually on the 1st day of January and July of each year through 2027.

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

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

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

continue

24. SUBSEQUENT EVENT – continuation

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

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

Municipality has evaluated subsequent events through April 30, 2014, the date which the financial statements were available to be issued. Except for the subsequent events mentioned above, no additional events were identified that should be disclosed or adjusted in the Financial Statements or its Notes.

END OF NOTES

REQUIRED SUPPLEMENTARY INFORMATION

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

	Budget Amounts		Actual Amounts (Budgetary Basis) (See Acompanying Notes)	Variance with Final Budget
	Original	Final		
BUDGETARY FUND BALANCE (DEFICIT), JULY 1, 2012	$ (4,455,977)	$ (4,455,977)	$ (4,455,977)	$ -
Resources (Inflows):				
Property Taxes	1,982,274	1,982,274	1,982,274	-
Volume of Business Taxes	1,620,000	1,620,000	1,279,096	(340,904)
Sales and Usage Taxes	601,675	601,675	650,670	48,995
Intergovernmental Revenues	5,474,934	5,474,934	5,722,207	247,273
Construction Excise Taxes	750,360	750,360	275,183	(475,177)
Rent	151,772	151,772	186,179	34,407
Miscellaneous	404,985	404,985	574,813	169,828
Total Resources (Inflows)	**10,986,000**	**10,986,000**	**10,670,422**	**(315,578)**
Amounts Available for Appropriation	6,530,023	6,530,023	6,214,445	(315,578)
Charges to Appropriations (Outflows):				
Mayor and Municipal Legislature	992,832	918,852	725,434	193,418
General Government	4,468,454	4,568,793	4,769,651	(200,858)
Public Safety	809,298	710,598	622,704	87,894
Public Works	1,248,027	1,324,627	1,231,968	92,659
Culture and Recreation	408,459	424,609	396,048	28,561
Health and Sanitation	650,401	647,801	548,749	99,052
Solid Waste Disposal	1,538,886	1,538,886	1,458,100	80,786
Human Services and Welfare	529,128	535,428	446,368	89,060
Urban Development	39,015	35,015	10,251	24,764
Capital Outlays	69,000	39,000	36,000	3,000
Transfer to Other Funds	232,500	242,391	242,391	-
Total Charges to Appropriations	10,986,000	10,986,000	10,487,664	498,336
BUDGETARY FUND BALANCE (DEFICIT), JUNE 30, 2013	$ (4,455,977)	$ (4,455,977)	$ (4,273,219)	$ 182,758

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

1. Budgetary Reporting

The Budgetary Comparison Schedule - General Fund is presented as Required Supplementary Information in accordance with GASB Accounting Standards Codification Section 1700, *The Budget and Budgetary Accounting.* Formal and legal budgetary control is based upon major classes of expenditures known as functions. The Municipality's expenditures in General Government function exceeded the budgetary amount by $200,858, due to far greater than expected increased expenditures for professional services and citizence support.

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

	General Fund
Sources/Inflows of Resources:	
Actual Amounts (Budgetary Basis) "Available for Appropriation" from the Budgetary Comparison Schedule (See Page 60)	$ 6,214,445
Difference – Budget to GAAP:	
Non-Budgetary Revenues (Medical Diagnostic and Treatments Center)	1,280,196
The Fund Balance (Deficit) at the Beginning of Year is a budgetary resource but is not a Current-Year Revenue for financial reporting purposes	4,455,977
Total Revenues as Reported on the Statement of Revenues, Expenditures, and Changes in Fund Balance - Governmental Funds (See Page 21)	$ 11,950,618
Uses/Outflows of Resources:	
Actual Amounts (Budgetary Basis) "Total Charges to Appropriation" from the Budgetary Comparison Schedule (See Page 60)	$ 10,487,664
Difference – Budget to GAAP:	
Encumbrances for supplies and equipment ordered but not received are reported in the year the order is placed for budgetary reporting purposes	(233,731)
Non-Budgetary Expenditures (Medical Diagnostic and Treatments Center)	1,267,816
Transfers to other funds are outflows of budgetary resources but are not expenditures for financial reporting purposes	(242,391)
Total Expenditures as Reported on the Statement of Revenues, Expenditures, and Changes in Fund Balance - Governmental Funds (See Page 21)	$ 11,279,358

END OF THIS SECTION

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

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Line Ited No. Assets		Value
	Current Assets - Cash:	
111	Cash - Unrestricted	$ 71,772
113	Cash - Other Restricted	33,239
100	**Total Cash**	**105,011**
150	**Total Current Assets**	**105,011**
190	**Total Assets**	**$ 105,011**
Liabilities and Equity		
	Current Liabilities:	
312	Accounts Payable <= 90 days	$ 5,000
333	Accounts Payable - Other Government	35,148
310	**Total Current Liabilities**	**40,148**
300	**Total Liabilities**	**40,148**
	Equity:	
511.1	**Restricted Net Position**	**33,239**
512.1	**Unrestricted Net Position**	**31,624**
513	**Total Equity / Net Position**	**64,863**
600	**Total Liabilities and Equity / Net Position**	**$ 105,011**

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

SECTION 8 HOUSING CHOICE VOUCHERS –
FINANCIAL DATA SCHEDULE (RQ047)
PROGRAM REVENUES AND EXPENSES SUMMARY
FOR THE FISCAL YEAR ENDED JUNE 30, 2013

Line Ited No. Revenues		Value
70600	HUD PHA Operating Grants	$ 589,838
70700	**Total Fees Revenues**	**589,838**
71400	Fraud Recovery	4,612
71500	Other Revenue	11,812
70000	**Total Revenues**	**606,262**
Expenses		
	Administrative:	
91100	Administrative Salaries	67,286
91500	Employee Benefit Contributions - Administrative	12,341
91600	Office Expense	1,425
91900	Other	5,000
91000	**Total Operating - Administrative**	**86,052**
96900	**Total Operating Expenses**	**86,052**
97000	**Excess of Operating Revenue over Operating Expenses**	**520,210**
97300	Housing Assitance Payments	535,720
97350	HPA Portability-In	9,600
90000	**Total Expenses**	**631,372**
97000	**Excess (Deficiency) of Total Revenue over (under) Total Expenses**	**$ (25,110)**
	Memo Account Information:	
*110030	Beginning Equity	$ 89,973
*11170	Administrative Fee Equity	$ 31,624
*11180	Housing Assistance Payments Equity	$ 33,239
*11190	Unit Months Available	1,336
*11210	Number of Unit Months Leased	1,299

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

1. BASIS OF PRESENTATION

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

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

3. RELATIONSHIP TO BASIC FINANCIAL STATEMENTS

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

END OF NOTES

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PART II

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

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FEDERAL GRANTOR / PASS THROUGH GRANTOR / PROGRAM OR CLUSTER TITLE	FEDERAL CFDA NUMBER	PASS-THROUGH ENTITY IDENTIFYING NUMBER	FEDERAL EXPENDITURES
U.S. Department of Agriculture:			
Pass-Through Puerto Rico Department of Education:			
Child and Adult Care Food Program	10.558	CCC-176	$ 15,018
Total U. S. Department of Agriculture			15,018
U.S. Department of Housing and Urban Development:			
Direct Program:			
Shelter Plus Care	14.238		28,134
Housing Opportunities for Persons with AIDS	14.241		40,139
Section 8 Housing Choice Vouchers	14.871		621,772
Sub-total U.S. Department of Housing and Urban Development – Direct Program			690,045
Pass-Through State – Office of the Commissioner of Municipal Affairs:			
Community Development Block Grants/States Program and Non Entitlements Grants in Hawaii (State CDBG)	14.228	12-AB-47	1,551,231
Total U.S. Department of Housing and Urban Development			2,241,276
U. S. Department of Energy:			
Pass-Through Puerto Rico Energy Affairs Administration:			
ARRA – Energy Efficiency and Conservation Block Grant Program (EECBG)	81.128	EAA-FOA-0013-27	140,994
Total U. S. Department of Energy			140,994
U.S. Department of Health and Human Services:			
Pass-Through Administration for the Childhood Care and Integral Development:			
Child Care and Development Block Grant	93.575	N/AV	280,477
Total U. S. Department of Health and Human Services			280,477

continue

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

FEDERAL GRANTOR / PASS THROUGH GRANTOR / PROGRAM OR CLUSTER TITLE	FEDERAL CFDA NUMBER	PASS-THROUGH ENTITY IDENTIFYING NUMBER	FEDERAL EXPENDITURES
U.S. Department of Homeland Security:			
Pass-Through Puerto Rico Office for Public Security:			
Disaster Grants – Public Assistance (Presidentially Declared Disasters)	97.036	FEMA 1798, FEMA 4017	247,039
Total U. S. Department of Homeland Security			247,039
TOTAL EXPENDITURES OF FEDERAL AWARDS			**$2,924,804**

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

1. BASIS OF PRESENTATION

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

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Expenditures reported on the Schedule are reported on the modified accrual basis of accounting. Such expenditures are recognized following the cost principles contained in OMB Circular A-87, *Cost Principles for State and Local Government,* wherein certain types of expenditures are not allowable or are limited as to reimbursement.

B. Negative amounts, if any, shown on the Schedule represent adjustments or credits made in the normal course of business to amounts reported as expenditures in prior years.

C. Pass-through entity identifying numbers are presented where available.

3. FEDERAL CFDA NUMBER

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

4. RELATIONSHIP TO FEDERAL FINANCIAL REPORTS

Expenditures of federal awards are reported in the Municipality's Statement of Revenues, Expenditures and Changes in Fund Balances – Governmental Fund as follows: CDBG Fund – $1,551,231 and Other Governmental Funds $1,373,573.

END OF NOTES

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CPA DIAZ-MARTINEZ, PSC
CERTIFIED PUBLIC ACCOUNTANTS AND CONSULTANTS

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

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

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the **Municipality of Naguabo of the Commonwealth of Puerto Rico** (**Municipality**), as of and for the fiscal year ended June 30, 2013, and the related notes to the financial statements, which collectively comprise **Municipality**'s basic financial statements, and have issued our qualified report thereon dated April 30, 2014. Our report was qualified because the **Municipality** did not provide a subsidiary of capital assets that agreed with the amounts reported in governmental activities of the Governmental-Wide Financial Statements and, also, the depreciation expense on those assets is not supported. In addition, no construction in progress is reported.

Internal Control Over Financial Reporting

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

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

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

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Compliance and Other Matters

As part of obtaining reasonable assurance about whether the **Municipality**'s financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying Schedule of Findings and Questioned Costs as items 2013-003 through 2013-005.

Municipality's Response to Findings

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

Purpose of this Report

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

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

Caguas, Puerto Rico
April 30, 2014

Stamp No. E100035 was affixed to
the original report.

AICPA Governmental Audit Quality Center

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

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

Report on Compliance for Each Major Federal Program

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

Management's Responsibility

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

Auditor's Responsibility

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

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

Basis for Qualified Opinion (See the following Table)

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

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Finding Number	CFDA Number	Program (or Cluster) Name	Compliance Requirement
2013-006	14.871	Section 8 Housing Choice Vouchers	Cash Management
2013-007	ALL	ALL PROGRAMS	Reporting
2013-008	14.228 and 14.871	Community Development Block Grants/States Program and Non Entitlements Grants in Hawaii (State CDBG); Section 8 Housing Choice Vouchers	Reporting
2013-009	14.871	Section 8 Housing Choice Vouchers	Reporting

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

Qualified Opinion (See the above Table)

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

Other Matters

The results of our auditing procedures disclosed an instance of noncompliance, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying Schedule of Findings and Questioned Costs as item 2013-010. Our opinion on each major federal program is not modified with respect to these matter.

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

Report on Internal Control Over Compliance

Management of **Municipality** is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered **Municipality**'s internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of **Municipality**'s internal control over compliance.

A *deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. We consider the deficiencies in internal control over compliance described in the accompanying Schedule of Findings and Questioned Costs as items 2013-006 through 2013-009 to be material weaknesses.

A *significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance. We consider the deficiency in internal control over compliance described in the accompanying Schedule of Findings and Questioned Costs as item 2013-010 to be significant deficiency.

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

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

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

Caguas, Puerto Rico
April 30, 2014

Stamp No. E100036 was affixed to
the original report.

AICPA Governmental Audit Quality Center

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PART III

FINDINGS AND QUESTIONED COSTS

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SECTION I – SUMMARY OF AUDITOR'S RESULTS

Financial Statements

Type of auditor's report issued: ☐ Unmodified Opinion
Modified: ☒ Qualified Opinion ☐ Adverse Opinion ☐ Disclaimer Opinion

Internal control over financial reporting:

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

Noncompliance material to financial statements noted? ☒ Yes ☐ No

Federal Awards

Internal control over major programs:

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

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

☐ Unmodified Opinion
☒ Qualified Opinion
- Community Development Block Grants/States Program and Non Entitlements Grants in Hawaii (State CDBG)
- Section 8 Housing Choice Vouchers

☐ Adverse Opinion ☐ Disclaimer Opinion

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

Identification of Major Programs:

CFDA Number	Name of Federal Program or Cluster
14.228	Community Development Block Grants/States Program and Non Entitlements Grants in Hawaii (State CDBG)
14.871	Section 8 Housing Choice Vouchers

Dollar threshold used to distinguish between Type A and Type B Programs: $300,000

Auditee qualified as low-risk auditee? ☐ Yes ☒ No

continue

FINDING REFERENCE NUMBER 2013-001

TYPE OF FINDING MATERIAL WEAKNESS IN PREPARED FINANCIAL STATEMENTS

CRITERIA

AU-C Section 265, *Communicating Internal Control Related Matters Identified in an Audit,* paragraph .A11, states the follows:

"Indicators of material weaknesses in internal control include

...

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

- identification by the auditor of a material misstatement of the financial statements under audit in circumstances that indicate that the misstatement would not have been detected by the entity's internal control; and" [underlying by us]

...

Paragraph 4.23, *Communicating Deficiencies in Internal Control, Fraud, Noncompliance with Provisions of Laws, Regulations, Contracts, and Grant Agreements, and Abuse*, of the *Government Auditing Standards* issued by the Comptroller General of the United States, 2011 Revision, states the follows:

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

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

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

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

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

a. ...

b. ...

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

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

continue

SECTION II – FINANCIAL STATEMENT FINDINGS

FINDING REFERENCE NUMBER	**2013-001** – continuation
CONDITION	During the preparation of the financial statements by the **Municipality**, they noted material misstatements in prior year audited financial statements that required significant adjustments to the assets, liabilities, revenues, and interfund expenditures/expenses.
CAUSE	The **Municipality** accounting system does not provide for some mechanized transaction that could lead to errors if proper trace is not maintained.
EFFECT OR POSSIBLE EFFECT	The financial statements for the fiscal year ended June 30, 2013, prepared by the **Municipality** presented material adjustments and restatement of the beginning balance of the net position/fund balance in order to reconcile the trial balances data with aging and schedules.
RECOMMENDATION	We recommend the **Municipality** to monitor subsidiaries of interfund and payable transactions in order to make the required adjustments and take the corrective actions timely.
RESPONSIBLE OFFICIAL'S RESPONSE AND CORRECTIVE ACTION PLANNED	During the contract process of hiring a consulting firm to generate the next Financial Reports cycle; we will include provisions to ensure that necessary measures are taken to correct and prevent the deficiencies found.
IMPLEMENTATION DATE	Fiscal Year 2013-2014
RESPONSIBLE PERSON	Mr. Luis Cruz, Finance Director

continue

SECTION II – FINANCIAL STATEMENT FINDINGS

FINDING REFERENCE NUMBER	**2013-002**
TYPE OF FINDING	**MATERIAL WEAKNESS IN PREPARED FINANCIAL STATEMENTS**
CRITERIA	Codification of Governmental Accounting and Financial Reporting Standards, Section 1400.101 states that the reporting entities should report general capital assets in governmental activities, proprietary and fiduciary funds. Capital assets includes land, improvements to land, easements, buildings, building improvements, vehicles, machinery, equipment, works of art and historical treasures, infrastructure, and all other tangible or intangible assets that are used in operations and that have initial useful lives extending beyond a single reporting period (AU § 1400.103). The **Municipality** should have established internal control policies and procedures in order to properly account for capital assets and to maintain adequate and updated inventory records that provide sufficient and competent evidence to support the existence, rights and obligations, completeness, and valuation and allocation, applicable to the capital assets in governmental activities of the Governmental-Wide Financial Statements.
CONDITION	During our audit the **Municipality** did not provide a subsidiary of capital assets that agreed with the amounts reported in governmental activities of the Governmental-Wide Financial Statements. Capital assets are the most significant assets of the **Municipality** and therefore, have a significant impact on the Governmental-Wide Financial Statements.
CAUSE	The **Municipality**'s internal control system, failed to keep track of the additions of capital assets and to assure that the subsidiaries agree with the amounts presented in the Governmental-Wide Financial Statements.
EFFECT OR POSSIBLE EFFECT	The financial statements prepared by the **Municipality** presented the capital assets and depreciation expense in the Governmental-Wide Financial Statements that do not agree with the subsidiaries provided.
RECOMMENDATION	We recommend that the **Municipality** review the subsidiaries of capital assets in order to assure that they reconcile with the amounts presented in Governmental-Wide Financial Statements.
RESPONSIBLE OFFICIAL'S RESPONSE AND CORRECTIVE ACTION PLANNED	Upon receipt of this finding, instructions were given to create a subsidiary journal for capital assets. This shall provide certainty regarding capital transactions and thus achieve a more assertive control of this area.
IMPLEMENTATION DATE	Fiscal Year 2013-2014
RESPONSIBLE PERSON	Mr. Luis Cruz, Finance Director

continue

SECTION II – FINANCIAL STATEMENT FINDINGS

FINDING REFERENCE NUMBER	**2013-003 (See FINDING REFERENCE NUMBER 2013-007)**
TYPE OF FINDING	**MATERIAL NONCOMPLIANCE AND MATERIAL WEAKNESS IN PREPARED SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**
CRITERIA	OMB Circular A-102 (Common Rule) Section__.20 Standards for financial management systems states: (a) A State must expand and account for grant funds in accordance with State laws and procedures for expending and accounting for its own funds. Fiscal control and accounting procedures of the State, as well as its subgrantees and cost-type contractors, must be sufficient to– (1) Permit preparation of reports required by this part and the statutes authorizing the grant, and (2) Permit the tracing of funds to a level of expenditures adequate to establish that such funds have not been used I violation of the restrictions and prohibitions of applicable statutes. The Objectives of internal control pertaining to the compliance requirements for Federal programs (Internal Control Over Federal Programs) as found in §__.105 of OMB Circular A-133, includes: Transactions are properly recorded and accounted for to permit the preparation of reliable financial statements and Federal reports.
CONDITION	During our audit procedures of the SEFA prepared by the **Municipality** we identified material misstatements related to the expenditures presented of all Federal programs.

continue

SECTION II – FINANCIAL STATEMENT FINDINGS

FINDING REFERENCE NUMBER	**2013-004 (See FINDING REFERENCE NUMBER 2013-008)**
TYPE OF FINDING	**MATERIAL WEAKNESS AND MATERIAL NONCOMPLIANCE – REPORTING PACKAGE OF SINGLE AUDIT**
CRITERIA	OMB Circular A-133, Subpart C, Section .320 (a), (c), state all the audit shall be completed and the Data Collection Form and Reporting Package shall be submitted to the Federal Audit Clearinghouse designated by OMB within the earlier of 30 days after receipt of the auditor's report(s), or nine months after the end of the audit period, unless a longer period is agreed to in advance by the cognizant or oversight agency for audit.
CONDITION	The **Municipality** did not submit the Data Collection Form and Reporting Package to the Federal Audit Clearinghouse of fiscal year ending June 30, 2013 during the required period.

continue

SECTION II – FINANCIAL STATEMENT FINDINGS

FINDING REFERENCE NUMBER	**2013-005 (See FINDING REFERENCE NUMBER 2013-009)**
TYPE OF FINDING	**MATERIAL WEAKNESS AND MATERIAL NONCOMPLIANCE**
CRITERIA	24 CFR Section 5.801 (c) (1) states that the financial information to be submitted to HUD in accordance with paragraph (b) of this section, must be submitted to HUD annually, no later than 60 days after the end of the fiscal year of the reporting period, and as otherwise provided by law. In addition, on Section (d) (1) states that audited financial statements will then be required no later than 9 months after the PHA's fiscal year end, in accordance with the Single Audit Act and OMB Circular A-133.
CONDITION	The **Municipality** did not submit the required Financial Reports to the US Housing and Urban Development of fiscal year ending June 30, 2013 during the required period. The unaudited version was submitted on August 28, 2013. Although, the audited Financial Reports were not submitted on due date of March 31, 2014.

continue

SECTION III – FINANCIAL STATEMENT FINDINGS

FINDING REFERENCE NUMBER	**2013-006**
FEDERAL PROGRAM	**SECTION 8 HOUSING CHOICE VOUCHERS (CFDA NO. 14.871) U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT**
AWARD NUMBER	**RQ047**
COMPLIANCE REQUIREMENT	**CASH MANAGEMENT**
TYPE OF FINDING	**NONCOMPLIANCE AND MATERIAL WEAKNESS**
CRITERIA	Notice PIH 2011-67 states that Disbursements will continue to be scheduled to arrive at the PHA's banks on the first business day of which is the date on which PHA's issue their Housing Assistance Payments checks to property owners. This schedule ensures that PHA's do not receive advances from HUD for more than each PHA's immediate disbursement needs.
CONDITION	During our audit over HAP payment to owners we noted that the **Municipality** (PHA) made payments to four owners within one through three months after scheduled day as required by HUD.
CAUSE	The **Municipality** does not have adequate internal control procedures in order to made payments on the first business day of the payment period.
INFORMATION TO PROVIDE PROPER PERSPECTIVE	This is a systematic deficiency due to the fact that the **Municipality** don't have internal control in order to verify that the payments to the owners were done within the first business days of the payment period.
EFFECT OR POSSIBLE EFFECT	The **Municipality** could suffer a reduction on the advances received from HUD due to they are not used the advances for immediate disbursements needs.
QUESTIONED COSTS	None Noted.
RECOMMENDATION	We recommend management to implement adequate internal control procedures in order to assure that the payments to owners are done in the first business day of the payment period.
RESPONSIBLE OFFICIAL'S RESPONSE AND CORRECTIVE ACTION PLANNED	Assign Responsibility to a staff member to oversee the signing of the contract and pay the owners within the period of time required by law.
IMPLEMENTATION DATE	Immediately
RESPONSIBLE PERSON	Marisol Meléndez Vázquez, Section 8 Coordinator

continue

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING REFERENCE NUMBER	**2013-007 (See FINDING REFERENCE NUMBER 2013-003)**
FEDERAL PROGRAMS	**ALL**
AWARD NUMBERS	**(See Schedule of Expenditures of Federal Awards)**
COMPLIANCE REQUIREMENT	**REPORTING**
TYPE OF FINDING	**MATERIAL NONCOMPLIANCE AND MATERIAL WEAKNESS IN PREPARED SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**
CRITERIA	OMB Circular A-102 (Common Rule) Section__.20 Standards for financial management systems states: (a) A State must expand and account for grant funds in accordance with State laws and procedures for expending and accounting for its own funds. Fiscal control and accounting procedures of the State, as well as its subgrantees and cost-type contractors, must be sufficient to– (1) Permit preparation of reports required by this part and the statutes authorizing the grant, and (2) Permit the tracing of funds to a level of expenditures adequate to establish that such funds have not been used I violation of the restrictions and prohibitions of applicable statutes. The Objectives of internal control pertaining to the compliance requirements for Federal programs (Internal Control Over Federal Programs) as found in §__.105 of OMB Circular A-133, includes: Transactions are properly recorded and accounted for to permit the preparation of reliable financial statements and Federal reports.
CONDITION	During our audit procedures of the SEFA prepared by the **Municipality** we identified material misstatements related to the expenditures presented of all Federal programs.
CAUSE	The SEFA prepared by the **Municipality** was understated because the expenditures reported were under the cash basis of accounting, not under the modified accrual basis of accounting, as disclosed in the notes of the SEFA.
EFFECT OR POSSIBLE EFFECT	The SEFA prepared by the **Municipality** presented incomplete information related to total Federal expenditures for the fiscal year under audit. Adjustments were required to reconcile the SEFA amounts with those reported in the audited financial statements.
QUESTIONED COSTS	None Noted.
RECOMMENDATION	We recommend that the **Municipality** maintain records in order to assure that all expenditures incurred from federal awards are properly incorporated in the SEFA.
RESPONSIBLE OFFICIAL'S RESPONSE AND CORRECTIVE ACTION PLANNED	To ensure the correctness of the SEFA Report, we will hire a consulting firm to assist in its generation; therefore minimize errors in this report.
IMPLEMENTATION DATE	Fiscal Year 2013-2014
RESPONSIBLE PERSON	Mr. Luis Cruz, Finance Director

continue

SECTION III – FINANCIAL STATEMENT FINDINGS

FINDING REFERENCE NUMBER	**2013-008 (See FINDING REFERENCE NUMBER 2013-004)**
FEDERAL PROGRAM	**COMMUNITY DEVELOPMENT BLOCK GRANTS/STATES PROGRAM AND NON ENTITLEMENTS GRANTS IN HAWAII (STATE CDBG) (CFDA NO. 14.228) U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT**
AWARD NUMBER	**12-AB-47-001**
FEDERAL PROGRAM	**SECTION 8 HOUSING CHOICE VOUCHERS (CFDA NO. 14.871) U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT**
AWARD NUMBER	**RQ047**
COMPLIANCE REQUIREMENT	**REPORTING**
TYPE OF FINDING	**MATERIAL WEAKNESS AND MATERIAL NONCOMPLIANCE – REPORTING PACKAGE OF SINGLE AUDIT**
CRITERIA	OMB Circular A-133, Subpart C, Section .320 (a), (c), state all the audit shall be completed and the Data Collection Form and Reporting Package shall be submitted to the Federal Audit Clearinghouse designated by OMB within the earlier of 30 days after receipt of the auditor's report(s), or nine months after the end of the audit period, unless a longer period is agreed to in advance by the cognizant or oversight agency for audit.
CONDITION	The **Municipality** did not submit the Data Collection Form and Reporting Package to the Federal Audit Clearinghouse of fiscal year ending June 30, 2013 during the required period.
CAUSE	The **Municipality** were unable to provide timely the financial statements and related supporting documentation in order to apply required audit procedures.
INFORMATION TO PROVIDE PROPER PERSPECTIVE	During fiscal year 2012-2013, the **Municipality** did not have adequate accounting records in order to produce the financial statements with supporting documentation timely.
EFFECT OR POSSIBLE EFFECT	The **Municipality** did not comply with the submission date required for the Data Collection Form and Reporting Package.
QUESTIONED COSTS	None Noted.
RECOMMENDATION	We recommend management to implement adequate internal control procedures in order to assure that accounting records and supporting documentation is available on a timely manner.
RESPONSIBLE OFFICIAL'S RESPONSE AND CORRECTIVE ACTION PLANNED	Within the specifications of the new consulting firm contract we will require the submission of the necessary reports on or before December 31st, this will allow us to meet the submission deadline requirements.
IMPLEMENTATION DATE	Fiscal Year 2013-2014
RESPONSIBLE PERSON	Mr. Luis Cruz, Finance Director

continue

SECTION III – FINANCIAL STATEMENT FINDINGS

FINDING REFERENCE NUMBER	**2013-009 (See FINDING REFERENCE NUMBER 2013-005)**
FEDERAL PROGRAM	**SECTION 8 HOUSING CHOICE VOUCHERS (CFDA NO. 14.871) U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT**
AWARD NUMBERS	**RQ047**
COMPLIANCE REQUIREMENT	**REPORTING**
TYPE OF FINDING	**MATERIAL WEAKNESS AND MATERIAL NONCOMPLIANCE**
CRITERIA	24 CFR Section 5.801 (c) (1) states that the financial information to be submitted to HUD in accordance with paragraph (b) of this section, must be submitted to HUD annually, no later than 60 days after the end of the fiscal year of the reporting period, and as otherwise provided by law. In addition, on Section (d) (1) states that audited financial statements will then be required no later than 9 months after the PHA's fiscal year end, in accordance with the Single Audit Act and OMB Circular A-133.
CONDITION	The **Municipality** did not submit the required Financial Reports to the US Housing and Urban Development of fiscal year ending June 30, 2013 during the required period. The unaudited version was submitted on August 28, 2013. Although, the audited Financial Reports were not submitted on due date of March 31, 2014.
CAUSE	The **Municipality** accounting records related to the financial statement audit were not available timely in order to comply with the Single Audit requirement.
INFORMATION TO PROVIDE PROPER PERSPECTIVE	The **Municipality** accounting records did not reconciled with the audited financial statements of prior year. Furthermore, during fiscal year 2012-2013, the **Municipality** did not have adequate accounting records in order to produce the financial statements with supporting documentation timely.
EFFECT OR POSSIBLE EFFECT	The **Municipality** did not comply with the submission date required for the Financial Reports to the US Housing and Urban Development, and this can affect the funding amounts related to Administration
QUESTIONED COSTS	None Noted.
RECOMMENDATION	We recommend management to implement adequate internal control procedures in order to assure that accounting records and supporting documentation is available on a timely manner.
RESPONSIBLE OFFICIAL'S RESPONSE AND CORRECTIVE ACTION PLANNED	A clause will be added to the new consulting firm contract, requiring the submission of the Unaudited Preliminary Financial Reports on or before the 30th of August and the Preliminary Financial Statements on or before January 31st. This provision will enable us to submit our Financial Reports on a timely manner.
IMPLEMENTATION DATE	Fiscal Year 2013-2014
RESPONSIBLE PERSON	Mr. Luis Cruz, Finance Director

continue

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING REFERENCE NUMBER	**2013-010**
FEDERAL PROGRAM	**SECTION 8 HOUSING VOUCHERS (CFDA NO. 14.871)** **U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT**
AWARD NUMBERS	**RQ047**
COMPLIANCE REQUIREMENT	**SPECIAL TESTS AND PROVISIONS**
TYPE OF FINDING	**NONCOMPLIANCE AND SIGNIFICANT DEFICIENCY**
CRITERIA	Code of Federal Regulations, 24 CFR, Subpart K, Section 982.517(4) (d) stated that the **Municipality** must use the appropriate utility allowance for the size of dwelling unit actually leased by the family (rather than the family unit size as determined under the PHA subsidy standards). Also, at reexaminations, the PHA must use the PHA current utility allowance schedule.
CONDITION	During our utility allowance schedule test, we noticed that the **Municipality** didn't used the appropriate a utility allowance for one unit leased. The **Municipality** used the 2 bedrooms utility allowance rate instead of the 4 bedrooms rate, according to the annual re-examination file
CAUSE	**Municipality** don't have appropriate internal control in order to monitor the annual re-examination file.
INFORMATION TO PROVIDE PROPER PERSPECTIVE	This is a systematic deficiency due to the fact that the **Municipality** don't have internal control in order to verify the determination of eligibility and amount approved for HAP and utility allowance.
EFFECT OR POSSIBLE EFFECT	**Municipality** is not paying the utility allowance that was appropriate for the size of the dwelling unit.
QUESTIONED COSTS	None Noted.
RECOMMENDATION	We recommend management to monitor the determinations of utility allowance in order to assure the accuracy of the rates used.
RESPONSIBLE OFFICIAL'S RESPONSE AND CORRECTIVE ACTION PLANNED	By unintentional mistake, we used 2 bedrooms utility allowance rate when it should have been used the 4 bedrooms rate. When the participants was re-examined, it was corrected immediately according to the current utility allowance rates.
IMPLEMENTATION DATE	Immediately
RESPONSIBLE OFFICIAL	Marisol Meléndez Vázquez- Section 8 Coordinator

END OF SCHEDULE

(1) Audit Findings that have been Fully Corrected:

NONE

(2) Audit Findings not Corrected or Partially Corrected:

NONE

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

NONE

(4) Audit findings is no longer valid:

NONE

END OF SCHEDULE