

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

**MUNICIPIO DE OROCOVIS
AUDITORÍA 2011-2012
30 DE JUNIO DE 2012**

Oficina del Comisionado
de Asuntos Municipales

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**Commonwealth of Puerto Rico
Municipality of Orocovis, Puerto Rico**

**BASIC FINANCIAL STATEMENTS
AND SUPPLEMENTARY INFORMATION**

Fiscal Year Ended June 30, 2012

(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



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Puerto Rico Society of Certified Public Accountants
Enrolled in the AICPA Peer Review Program Since 1988

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PART I
FINANCIAL



INDEPENDENT AUDITOR'S REPORT

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

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of **Municipality of Orocovis, Puerto Rico (Municipality)**, as of and for the fiscal year ended June 30, 2012, which collectively comprise **Municipality's** basic financial statements as listed in the Table of Contents. These financial statements are the responsibility of **Municipality's** management. Our responsibility is to express an opinion on these basic 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 basic financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the basic financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall basic financial statements presentation. We believe that our audit provide a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information of the **Municipality**, as of June 30, 2012, and the respective changes in financial position thereof for the fiscal year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated January 23, 2013 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* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 4 through 14, and budgetary comparison information on pages 48 and 49 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.

INDEPENDENT AUDITOR'S REPORT
To the Honorable Mayor and
Member of the Municipal Legislature
Municipality of Orocovis, Puerto Rico
Page 2

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, as required by U.S. Department of Housing and Urban Development, on pages 51 through 53, is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relate directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other 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 information is fairly stated in all material respects in relation to the financial statements as a whole.

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 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*, is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relate directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other 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 Schedule of Expenditures of Federal Awards is fairly stated in all material respects in relation to the financial statements as a whole.



CPA Díaz-Martínez, PSC
Certified Public Accountants & Consultants
License Number 12, expires on December 1, 2013

Caguas, Puerto Rico
January 23, 2013

Stamp No. E26826 was affixed to
the original report.



As management of the **Municipality of Orocovis** (the "**Municipality**"), we offer the reader of the **Municipality's** financial statements this narrative overview of the financial activities of the **Municipality** for the fiscal year ended June 30, 2012. We encourage readers to consider the information presented here in conjunction with the **Municipality's** financial statements (beginning on page 15).

HIGHLIGHTS

Financial Highlights

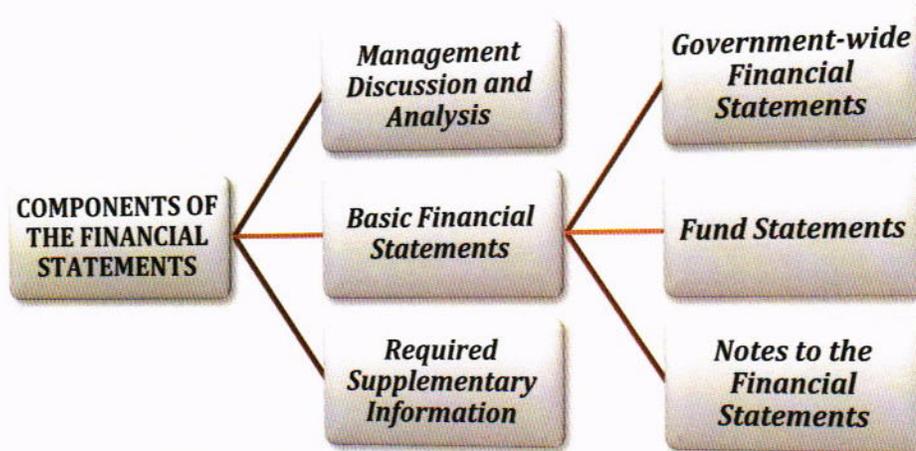
- The assets of the **Municipality** exceeded its liabilities at the close of the current fiscal year by \$32.4 million (net assets).
- As of June 30, 2012, the **Municipality's** General Fund (the primary operating fund) reported a fund balance of \$367,461, an increase of \$384,759 in comparison with the prior year, as restated.
- The **Municipality's** activities expenses show an increase of \$8.3 million in comparison with prior year and revenues show an increase of \$5.4 million dollars. These increases were primarily to funds received for improvement and construction of infrastructure. The results of activities for fiscal year 2011-12 produced an increase of net assets of \$1.7 million.
- The total cost of the **Municipality's** major program (Head Start) amounted to \$7 million and \$7.1 million during fiscal year 2011-12 and 2010-11, respectively. This represented a decrease of \$100 thousand (or 7%).
- The investment in capital assets, net of related debt for this year is \$28.8 million representing an increase of \$2.5 million (or 4.58%) in comparison with prior year.
- Loans principal payments were approximately \$430,000, decreasing long-term debt. The **Municipality** issued two bonds which proceeds will be used for general construction. One of the bonds is through the US Development of Agriculture, Rural Development (RD) for the amount of \$500,000. This bond will be used to finance the improvements of the Community Center. Terms will be determined by RD upon completion of the construction. The other bond is a special obligation bond for the amount of \$210,000, also for construction purposes. The balance due for compensated absences decreased by \$24,503 during this fiscal year.
- Resources available for appropriation were \$96,168 more than budgeted for the General Fund.

Municipality Highlights

- The **Municipality** has several improvement projects to the infrastructure of the road PR-143, with a budget of approximately \$4,138,000. During this fiscal year, a total of approximately \$253,000 was invested on these projects.
- During this fiscal year, the **Municipality** entered into an agreement with Puerto Rico Department of Transportation, in order to perform major improvements in state roads, with a budget of \$7,029,900. The actual amount invested in these projects was \$7,024,000.
- In addition, various municipal vehicles will be replaced at an investment of \$453,000.
- The **Municipality** administered funds from the Disaster Grants – Public Assistance (FEMA) to perform various improvements to municipal roads. Total funds invested during this fiscal year amounted to \$1,294,301.

OVERVIEW OF THE FINANCIAL STATEMENTS

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



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

Basic Financial Statements

Government-Wide Financial Statements

The government-wide statements report information about the **Municipality** as a whole using accounting methods similar to those used by private-sector businesses. They are prepared using the flow of economic resources measurement focus and the accrual basis of accounting. The first government-wide statement – the *Statement of Net Assets* – presents information on all of the **Municipality's** assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in the **Municipality's** net assets are an indicator of whether its financial health is improving or deteriorating. Other non-financial factors such as the condition of the **Municipality's** roads and other infrastructure may need to be considered to assess the overall health of the **Municipality**. The second statement – the *Statement of Activities* – presents information showing how the net assets changed during the year. All of the current year's revenues and expenses are taken into account in the statement of activities regardless of when cash is received or paid.

The government-wide statements reports as governmental activities the **Municipality's** basic services such as public safety, public works, health and sanitation, culture and recreation, solid waste disposal, human services and welfare, and community development; education and general administration. These activities are primarily financed through property taxes, other local taxes and intergovernmental revenues. Included in the governmental activities are the governmental funds.

Fund Financial Statements

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

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

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

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 \$2,160,444.

Notes to the Basic Financial Statements

The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements can be found on pages 21 through 46.

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.

GOVERNMENT-WIDE STATEMENT

Statement of Net Assets

The following table presents a summary of the Statements of Net Assets as of June 30, 2012 and 2011:

| Commonwealth of Puerto Rico Municipality of Orocovis, Puerto Rico Statement of Net Assets As of June 30, | | |
|-------------------------------------------------------------------------------------------------------------------|----------------------|----------------------|
| | 2012 | 2011 |
| Current and Non-Current Assets | \$ 11,164,583 | \$ 10,545,616 |
| Capital Assets | 33,567,881 | 31,090,275 |
| Total Assets | 44,732,464 | 41,635,891 |
| Current Liabilities | 2,657,982 | 1,273,690 |
| Deferred Revenues | 606,636 | 478,014 |
| Long-Term Liabilities | 9,025,709 | 9,096,150 |
| Total Liabilities | 12,290,327 | 10,847,854 |
| Net Assets: | | |
| Investment in Capital Assets, | | |
| Net of Related Debt | 28,798,461 | 26,277,644 |
| Restricted (As Restated) | 6,086,482 | 7,492,735 |
| Unrestricted (Deficit) | (2,442,806) | (2,982,342) |
| Total Net Assets | \$ 32,442,137 | \$ 30,788,037 |

Net assets (assets over liabilities) may serve over time as a useful indicator of a government's financial position. Net assets for the year increased 3% with respect to prior year. The most significant changes were an increase in Investment in Capital Assets of \$2,520,817 and a decrease in Unrestricted Deficit of \$539,536.

The largest portion of the **Municipality's** net assets reflects its investment in capital assets (e.g., land, buildings, equipment, and infrastructure) for \$28,798,461; total capital assets (\$41,455,917) less accumulated depreciation (\$7,888,036) and less any related outstanding debt (\$4,769,420) used to acquire or construct those assets. The **Municipality** uses these assets to provide services to its citizens and consequently, these assets are not available for future spending. The resources needed to repay the debt related to these capital assets must

be provided from other sources, because capital assets are not generally liquidated for the purposes of retiring debt.

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

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

As of June 30, 2012 the **Municipality** presented unrestricted (deficit) net assets of (\$2,442,806). This balance was affected by long term obligations such as compensated absences \$2,555,428 and other debts for the amount of \$1,156,945 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

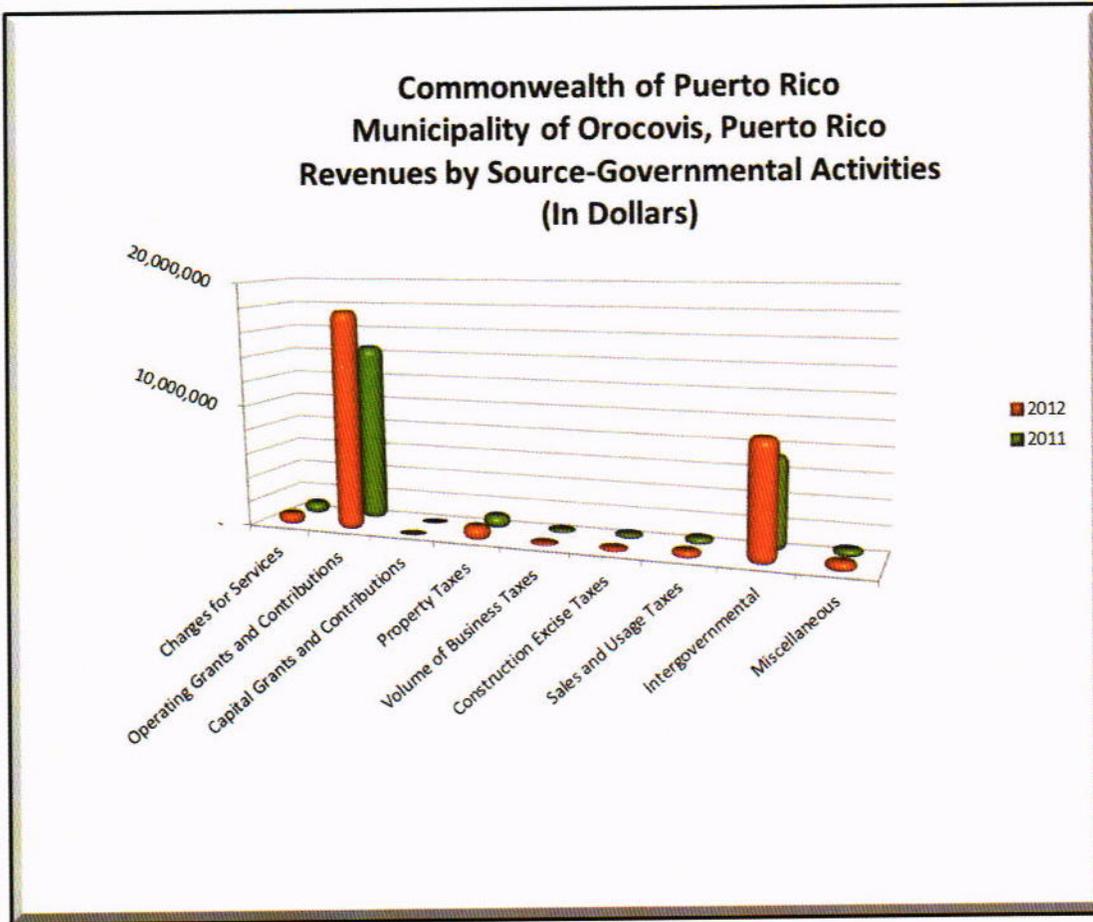
The following table compares the revenues and expenses for the current and previous fiscal year.

| Commonwealth of Puerto Rico Municipality of Orocovis, Puerto Rico Changes in Net Assets For Fiscal Years Ending June 30, | | |
|-----------------------------------------------------------------------------------------------------------------------------------|-----------------------------|-----------------------------|
| | <u>2012</u> | <u>2011</u> |
| Revenues: | | |
| Program Revenues: | | |
| Changes for Services | \$ 1,000,000 | \$ 1,000,000 |
| Operating Grants and Contributions | 17,822,702 | 14,581,655 |
| Capital Grants and Contributions | - | - |
| General Revenues: | | |
| Property Taxes | 1,168,356 | 1,095,387 |
| Volume of Business Taxes | 330,994 | 396,191 |
| Sales and Usage Taxes | 698,450 | 655,695 |
| Construction Excise Taxes | 416,957 | 518,315 |
| Intergovernmental | 9,453,982 | 7,378,855 |
| Other General Revenues | 853,748 | 688,967 |
| Total Revenues | <u>31,745,189</u> | <u>26,315,065</u> |
| Expenses: | | |
| General Administration | 6,069,613 | 5,257,027 |
| Public Safety | 600,112 | 606,700 |
| Public Works | 3,386,095 | 2,796,578 |
| Culture and Recreation | 1,026,794 | 867,668 |
| Health and Sanitation | 508,953 | 465,341 |
| Solid Wasted Disposal | 115,625 | 150,525 |
| Human Services and Welfare | 1,236,018 | 1,177,171 |
| Urban Development | 8,589,314 | 2,005,032 |
| Public Instruction | 8,292,020 | 8,193,372 |
| Interest on Long-Term Debt | 266,545 | 254,865 |
| Total Expenses | <u>30,091,089</u> | <u>21,774,279</u> |
| Changes in Net Assets | 1,654,100 | 4,540,786 |
| Net Assets-Beginning, as Restated | <u>30,788,037</u> | <u>26,247,251</u> |
| Net Assets-Ending | <u>\$ 32,442,137</u> | <u>\$ 30,788,037</u> |

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

FIGURE 1

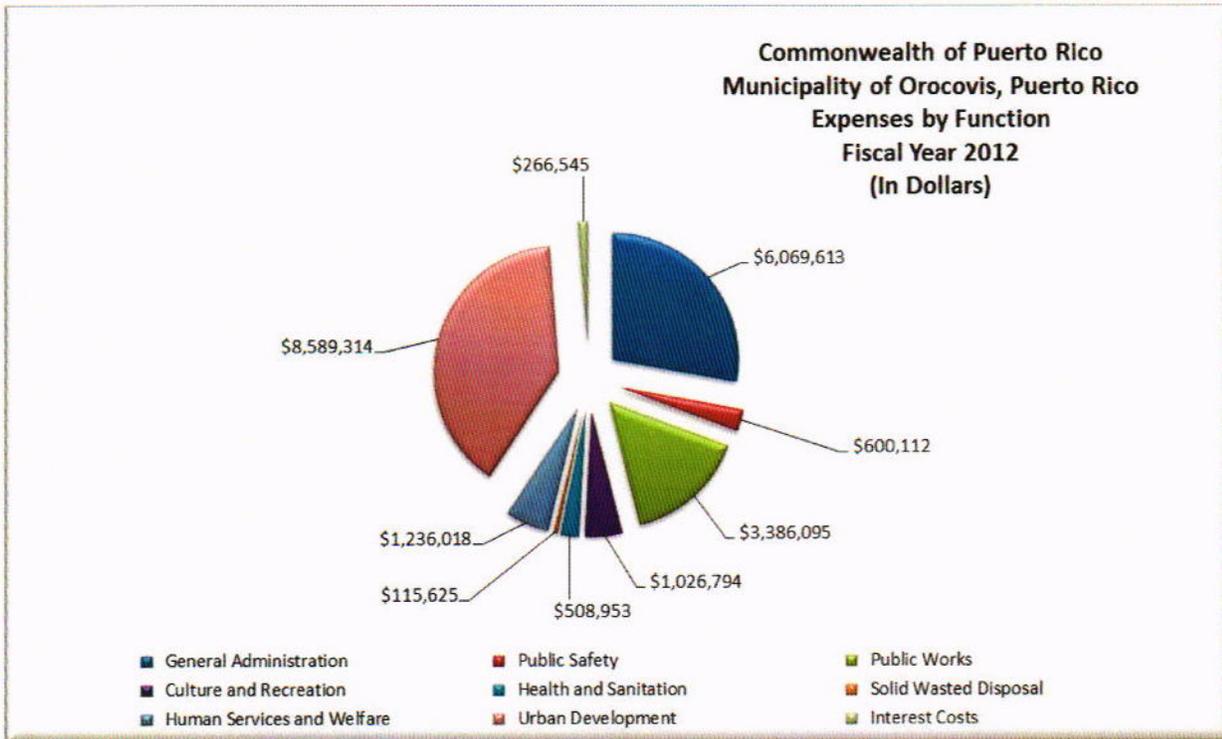
Revenues by Source – Governmental Activities
Fiscal Year ended June 30, 2012 and 2011



Approximately 59% of the Municipality's revenues came from grants and contributions, 30% from intergovernmental, 3.7% from property taxes, and 7.3% from other sources. With respect to prior year, revenues increased by approximately \$2,500,000, due to operating grants and contributions from Disasters Grants – Public Assistance (FEMA) (approximately \$1,035,000), State Agency for Emergency and Disaster Management (\$1,000,000) received during this fiscal year

Figure 2 presents expenses by function of the governmental activities during the fiscal year 2011-2012:

FIGURE 2
Expenses by Function



The Municipality's expenses cover a range of services. The largest expenses are general administration with 27.8%, 39.4% for urban development, public works with 15.5%, human services and welfare with 5.7%, and culture and recreation with 4.7%. Program revenues of the Municipality covered 63% 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):

| Functions/Programs | Total Cost of Services | | Net Cost of Services | |
|----------------------------|------------------------|----------------------|----------------------|---------------------|
| | 2012 | 2011 | 2012 | 2011 |
| General Administration | \$ 6,069,613 | \$ 5,257,027 | \$ 3,870,914 | \$ (457,518) |
| Public Safety | 600,112 | 606,700 | 600,112 | 606,700 |
| Public Works | 3,386,095 | 2,796,578 | 3,386,095 | 2,796,578 |
| Culture and Recreation | 1,026,794 | 867,668 | 1,026,794 | 867,668 |
| Health Sanitation | 508,953 | 465,341 | 508,953 | 465,341 |
| Solid Waste Disposal | 115,625 | 150,525 | 115,625 | 150,525 |
| Human Services and Welfare | 1,236,018 | 1,177,171 | 280,254 | 185,538 |
| Urban Development | 8,589,314 | 2,005,032 | (175,319) | 771,595 |
| Public Instruction | 8,292,020 | 8,193,372 | 1,388,414 | 551,332 |
| Others | 266,545 | 254,865 | 266,545 | 254,865 |
| Total | \$ 30,091,089 | \$ 21,774,279 | \$ 11,268,387 | \$ 6,192,624 |

Those who directly benefited from the programs and other governments and organizations that subsidized certain programs with grants and contributions paid some of the cost of governmental activities in 2012. Other general revenues including property, volume of business license taxes, and the sales and usage taxes and intergovernmental revenues substantially covered the \$11,268,387 net cost of services.

THE MUNICIPALITY'S FUNDS

Governmental Funds

The Municipality implemented GASB Statement 54, *Fund Balance Reporting and Governmental Fund Type Definitions* effective with the June 30, 2012 financial statements. Fund balances for the governmental funds are reported in classifications that comprise a hierarchy based on the extent to which the government honors constraints on the specific purposes for which amounts in those funds can be spent. The following table presents a comparison of the 2012 and 2011 fund balances:

| Commonwealth of Puerto Rico Municipality of Orocovis, Puerto Rico | | |
|----------------------------------------------------------------------|---------------------|---------------------|
| Fund Balance As of June 30, | | |
| | 2012 | 2011 |
| Fund Balances: | | |
| Nonexpendable | \$ - | \$ - |
| Restricted | 2,166,721 | 3,016,623 |
| Committed | 346,934 | 157,857 |
| Assigned | 57,991 | 194,334 |
| Unassigned | (411,202) | (441,941) |
| Total | \$ 2,160,444 | \$ 2,926,873 |

| Commonwealth of Puerto Rico Municipality of Orocovis, Puerto Rico | | |
|----------------------------------------------------------------------|-------------------|---------------------|
| General Fund As of June 30, | | |
| Description | 2012 | 2011 |
| Revenues: | | |
| Property Taxes | \$ 968,700 | \$ 956,787 |
| Volume of Business Taxes | 330,994 | 396,191 |
| Sales and Usage Taxes | 352,171 | 322,778 |
| Intergovernmental | 8,600,069 | 8,372,460 |
| Construction Excise Taxes | 416,957 | 518,315 |
| Miscellaneous | 853,748 | 696,170 |
| Total Revenues | 11,522,639 | 11,262,701 |
| Expenditures: | | |
| General Government | 4,971,288 | 4,579,321 |
| Public Safety | 551,239 | 564,217 |
| Public Work | 3,035,839 | 2,492,114 |
| Culture and Recreation | 624,484 | 643,512 |
| Health and Sanitation | 500,807 | 465,341 |
| Solid Waste Disposal | 115,625 | 150,525 |
| Public Instruction | 745,363 | 776,752 |
| Human Services and Welfare | 224,336 | 196,261 |
| Urban Development | - | 6,116 |
| Capital Outlay | 114,470 | 22,452 |
| Total Expenditures | 10,883,451 | 9,896,611 |
| Net Transfer In (Out) | (254,429) | (352,624) |
| Other Financing Sources | - | - |
| Net Increase (Decrease) in Fund Balance | \$ 384,759 | \$ 1,013,466 |

As of the end of the current fiscal year, the Municipality's governmental funds (as presented on the balance sheet on page 17) reported a combined fund balance of \$2.2 million, which decreased from last year's total by \$766 thousand. Some of the governmental funds are capital expenditure oriented and, therefore, may reflect capital expenditures. The General Fund experienced a \$384,759 increase from a fund balance deficit of \$17,298 (as restated) in the previous year to a fund balance of \$367,461 at the end of the current year.

At the end of the Fiscal Year 2012, the General Fund presented Committed (\$346,934) and Assigned (\$20,527) Fund Balance, with no Unassigned Fund Balance. In order to accomplish with the provisions stated on our Ordinance that implemented the GASB Statement No. 54, regarding the Minimum Fund Balance Policy, the Municipality is in the process of making the arrangements to comply.

Budgetary Highlights

During the current year, the Municipal Legislature revised the **Municipality's** budget several times increasing the original budget by \$1,105,770 (see pages 48 and 49 for budget to actual comparisons). The current year operations resulted in a \$104,781 net profit, for budgetary purposes.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

At June 30, 2012, the **Municipality** had \$33.6 million invested in a variety of capital assets, as reflected in the following table, which represents a net increase (additions less depreciation) of \$2.5 million or 3.83% from the end of last year.

| Commonwealth of Puerto Rico Municipality of Orocovis, Puerto Rico Capital Assets, net As of June 30, | | |
|---------------------------------------------------------------------------------------------------------------|-------------------------|----------------------|
| | Governmental Activities | |
| | 2012 | 2011 |
| Non-depreciable assets: | | |
| Land | \$ 6,994,384 | \$ 6,852,834 |
| Construction in Progress | 2,243,996 | 6,412,646 |
| Depreciable assets: | | |
| Buildings | 15,774,156 | 10,424,632 |
| Equipment and Vehicles | 66,694 | 129,170 |
| Furniture and Fixtures | 277,937 | 152,592 |
| Heavy Equipment | 1,403,309 | 1,274,588 |
| Infrastructure | 6,807,405 | 5,843,813 |
| Total | \$ 33,567,881 | \$ 31,090,275 |

Debt Outstanding

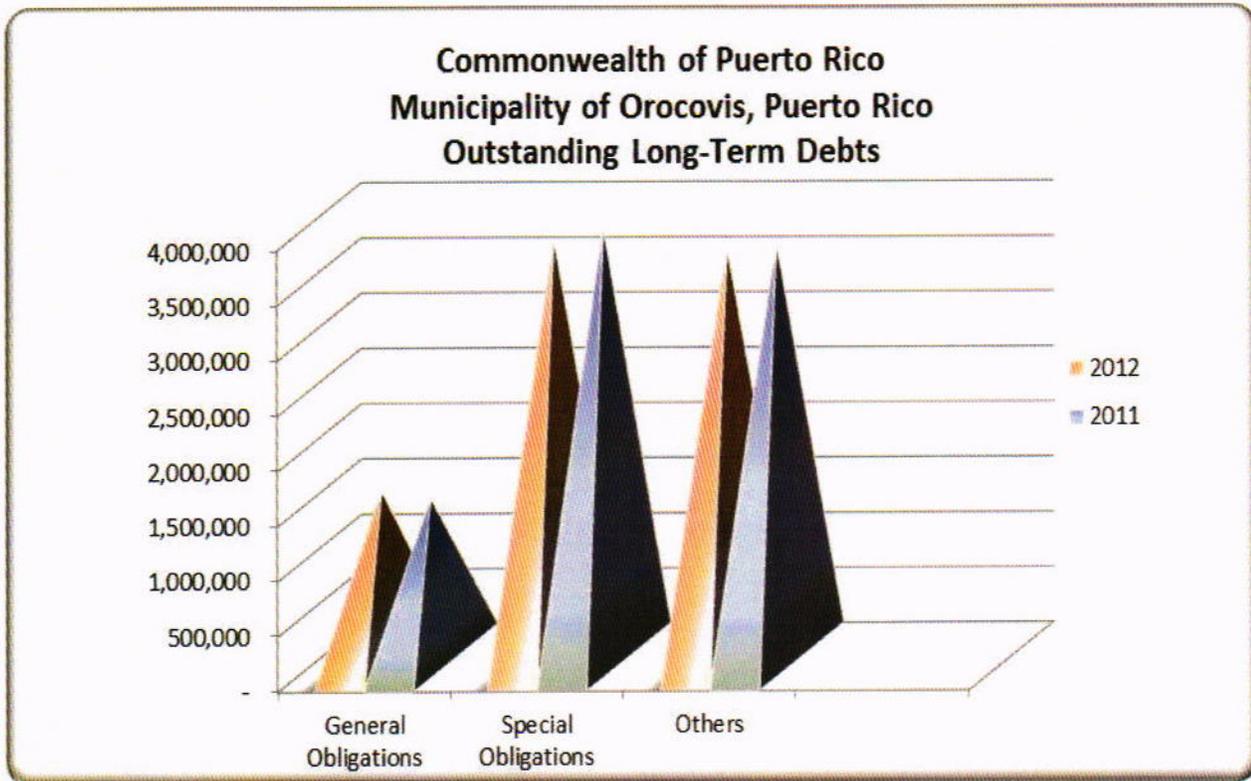
As of year-end, the **Municipality** had \$9,025,709 in debts (bonds and other long-term debts) outstanding compared to \$9,096,150 of last year.

Outstanding Debt at Year-End

The Municipality made principal payments of \$430 thousand during the current year. During the year, an obligation granted by US Department of Agriculture, Rural Development (RD) for the amount of \$199,336 of the original loan of \$500,000, to be used for the improvement of the Community Center of the **Municipality**. In addition, a special bond was issued for the amount of \$210,000 for general construction purpose.

| Commonwealth of Puerto Rico Municipality of Orocovis, Puerto Rico Outstanding Long-Term Debt As of June 30, | | |
|----------------------------------------------------------------------------------------------------------------------|-------------------------|---------------------|
| | Governmental Activities | |
| | 2012 | 2011 |
| General and Special Obligations | \$ 5,313,336 | \$ 5,346,000 |
| Law No. 42-MRCC | 881,033 | 902,891 |
| Law No. 146-MRCC | 67,319 | 70,685 |
| LIMS - MRCC | - | 3,632 |
| Christmas Bonus | 196,928 | 185,376 |
| Deferred Charges | 11,665 | 7,635 |
| Compensated Absences | 2,555,428 | 2,579,931 |
| Total | \$ 9,025,709 | \$ 9,096,150 |

The **Municipality** levies an annual special tax of 1.50% of the assessed value of real property located within the **Municipality**, which is not exempted by law. The proceeds of this tax are required to be credited to the Debt Service Fund for payment of general obligation bonds and notes of the **Municipality**. The amount of general obligation debt that the **Municipality** can issue is limited by law to 10% of the total assessment of the taxable property located within the boundaries of the **Municipality**. The outstanding general obligation debt of the **Municipality** of \$1.5 million is below the legal limitation. More detailed information about the **Municipality's** long-term debts is presented in Note 10 to the Basic Financial Statements.



ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

The **Municipality** is a political legal entity with full legislative and administrative powers in every area of municipal government, with perpetual existence and legal personality, separate and independent from the central government of Puerto Rico. The Municipal Government comprises the executive and legislative branches. The executive power is exercised by the Mayor and the legislative by the Municipal Assembly, which has 14 members. The Mayor and the Municipal Assembly are elected every four years in general elections.

The **Municipality** provides a full range of services including health, public works, environmental control, education, public safety, public housing and community development, culture and recreation as well as many other general and administrative services. The **Municipality's** principal sources of revenue are property taxes, municipal license taxes, contributions by the state government and federal grants.

The **Municipality's** elected and appointed officials considered many factors when setting the fiscal year 2012 budget. One of the factors is the economy, which is affected by the population, family income and unemployment growth of the **Municipality**.

The **Municipality** has a higher unemployment rate compared to all municipalities in Puerto Rico. As of June 2012 the unemployment rate of the **Municipality** averaged 23.3% as compared to 13.9% in Puerto Rico (Source Workforce Development Administration of the Commonwealth of Puerto Rico).

The above-mentioned factors, among others, were taken into account when adopting the **Municipality's** budget for fiscal year 2012-13. Amounts available for appropriations (revenues) in the General Fund Budget are \$10.6 million, an increase of 3% over the 2011-2012 original budget of \$10.3 million. Property taxes and other local charges for services, licenses and permits are expected to lead this increase. The **Municipality** will use the increase in revenues to finance programs we currently offer and to account for the deficit effect on the resources available to expend. Budgeted expenditures are expected to rise slightly below of revenue increases.

If these estimates are realized, the **Municipality's** budgetary General Fund balance is expected to increase modestly by the close of fiscal year 2012-2013.

AMERICAN RECOVERY AND REINVESTMENT ACT

The **Municipality** received the following federal awards from the American Recovery and Reinvestment Act during fiscal year 2011-2012:

| Federal Program | CFDA Number | Total Award | Total Expended |
|------------------------------------------------------|--------------------|--------------------------|--------------------------|
| Homelessness Prevention and Rapid Re-Housing Program | 14.257 | \$ 314,176 | \$ 314,176 |
| Energy Efficiency and Conservation Block Grant | 81.128 | <u>160,000</u> | <u>152,260</u> |
| Total | | <u>\$ 474,176</u> | <u>\$ 466,436</u> |

CONTACTING THE MUNICIPALITY'S FINANCIAL MANAGEMENT

The **Municipality's** financial statements are designed to present users (citizens, taxpayers, customers, investors and creditors) with a general overview of the **Municipality's** finances and to demonstrate the **Municipality's** accountability for the money it receives. If you have questions about the report or need additional financial information, contact the **Municipality's** Director of Finance Office on the 2nd floor of the City Hall, State Road #156, P.O. Box 2106, Orocovis, Puerto Rico 00720.

| | GOVERNMENTAL ACTIVITIES |
|---------------------------------------------------|------------------------------------|
| ASSETS: | |
| Cash | \$ 1,925,836 |
| Cash with Fiscal Agent | 1,665,204 |
| Receivables (Net): | |
| Federal Grants | 6,092,831 |
| Due from Government Units | 1,402,608 |
| Sales and Usage Taxes | <u>50,923</u> |
| Deferred Charges | <u>27,181</u> |
| Capital Assets: | |
| Land, Improvement and Construction in Progress | 9,238,380 |
| Other Capital Assets [Net of Depreciation] | <u>24,329,501</u> |
| Total Capital Assets | <u>33,567,881</u> |
| TOTAL ASSETS | <u>44,732,464</u> |
| LIABILITIES: | |
| Accounts Payable and Accrued Expenses | 2,505,472 |
| Accrued Interest | 90,678 |
| Due to Governmental Units | 61,832 |
| Deferred Revenues | 606,636 |
| Long-Term Liabilities: | |
| Due Within One Year | 2,623,817 |
| Due in More than One Year | <u>6,401,892</u> |
| TOTAL LIABILITIES | <u>12,290,327</u> |
| NET ASSETS: | |
| Investment in Capital Assets, Net of Related Debt | 28,798,461 |
| Restricted for: | |
| Capital Projects | 51,000 |
| Head Start | 4,373,266 |
| Debt Service | 1,172,001 |
| Community Development Projects | 490,215 |
| Unrestricted (Deficit) | <u>(2,442,806)</u> |
| TOTAL NET ASSETS | <u>\$ 32,442,137</u> |

See accompanying Notes to Basic Financial Statements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OROCOVIS, PUERTO RICO

STATEMENT OF ACTIVITIES
FOR THE FISCAL YEAR ENDED JUNE 30, 2012

| Functions/Programs | Expenses | Program Revenues | | | Net (Expense) Revenues (See Next Page) |
|---------------------------------------------|----------------------|-------------------------|------------------------------------------|----------------------------------------|----------------------------------------------|
| | | Charges For Services | Operating Grants and Contributions | Capital Grants and Contributions | |
| Governmental Activities: | | | | | |
| Mayor and Municipal Assembly | \$ 737,569 | \$ - | \$ - | \$ - | \$ (737,569) |
| General Government | 5,332,044 | 1,000,000 | 1,198,699 | - | (3,133,345) |
| Public Safety | 600,112 | - | - | - | (600,112) |
| Public Works | 3,386,095 | - | - | - | (3,386,095) |
| Culture and Recreation | 1,026,794 | - | - | - | (1,026,794) |
| Health and Sanitation | 508,953 | - | - | - | (508,953) |
| Solid Waste Disposal | 115,625 | - | - | - | (115,625) |
| Human Services and Welfare | 1,236,018 | - | 955,764 | - | (280,254) |
| Urban Development | 8,589,314 | - | 8,764,633 | - | 175,319 |
| Public Instruction | 8,292,020 | - | 6,903,606 | - | (1,388,414) |
| Interest on Long-Term Debt | 266,545 | - | - | - | (266,545) |
| Total Governmental Activities | \$ 30,091,089 | \$ 1,000,000 | \$ 17,822,702 | \$ - | (11,268,387) |
| General Revenues: | | | | | |
| Taxes: | | | | | |
| Property Taxes, levied for General Purposes | | | | | 968,700 |
| Property Taxes, levied for Debt Service | | | | | 199,656 |
| Sales and Usage Taxes | | | | | 698,450 |
| Volume of Business Taxes | | | | | 330,994 |
| Construction Excise Taxes | | | | | 416,957 |
| Intergovernmental | | | | | 9,453,982 |
| Rent | | | | | 33,851 |
| Miscellaneous | | | | | 819,897 |
| Total General Revenues | | | | | 12,922,487 |
| CHANGES IN NET ASSETS | | | | | |
| | | | | | 1,654,100 |
| Net Assets – Beginning of Year | | | | | 30,788,037 |
| NET ASSETS – ENDING OF YEAR | | | | | \$ 32,442,137 |

See accompanying Notes to Basic Financial Statements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF OROCOVIS, PUERTO RICO

BALANCE SHEET – GOVERNMENTAL FUNDS
JUNE 30, 2012

| | GENERAL FUND | HEAD START FUND | DEBT SERVICE FUND | STATE ROADS IMPROVEMENT FUND | OTHER GOVERNMENTAL FUNDS | TOTAL GOVERNMENTAL FUNDS |
|--------------------------------------------|---------------------|---------------------|----------------------|------------------------------------|--------------------------------|--------------------------------|
| ASSETS: | | | | | | |
| Cash | \$ 297,140 | \$ 258,238 | \$ - | \$ - | \$ 1,370,458 | \$ 1,925,836 |
| Cash with Fiscal Agent | - | - | 1,262,679 | - | 402,525 | 1,665,204 |
| Receivables: | | | | | | |
| Sales and Usage Taxes | 50,923 | - | - | - | - | 50,923 |
| Federal Grants | - | 4,949,940 | - | - | 1,142,891 | 6,092,831 |
| Due from Other Funds | 621,149 | 31,705 | - | - | - | 652,854 |
| Due from Governmental Units | 98,464 | - | - | 1,175,000 | 129,144 | 1,402,608 |
| Total Assets | \$ 1,067,676 | \$ 5,239,883 | \$ 1,262,679 | \$ 1,175,000 | \$ 3,045,018 | \$ 11,790,256 |
| LIABILITIES AND FUND BALANCES: | | | | | | |
| Liabilities: | | | | | | |
| Account Payable | \$ 217,881 | \$ 201,567 | \$ - | \$ 1,207,240 | \$ 878,784 | \$ 2,505,472 |
| Bond and Notes | - | - | 280,000 | - | - | 280,000 |
| Accrued Interest | - | - | 90,678 | - | - | 90,678 |
| Due to Governmental Units | 61,832 | - | - | - | - | 61,832 |
| Due to Other Funds | 31,705 | - | - | 8,058 | 613,091 | 652,854 |
| Deferred Revenues: | | | | | | |
| Volume of Business Tax | 290,333 | - | - | - | - | 290,333 |
| Commonwealth of Puerto Rico | 98,464 | - | - | - | - | 98,464 |
| Federal Grants | - | 4,843,662 | - | - | 806,517 | 5,650,179 |
| Total Liabilities | 700,215 | 5,045,229 | 370,678 | 1,215,298 | 2,298,392 | 9,629,812 |
| Fund Balances: | | | | | | |
| Restricted | - | 194,654 | 892,001 | - | 1,080,066 | 2,166,721 |
| Committed | 346,934 | - | - | - | - | 346,934 |
| Assigned | 20,527 | - | - | - | 37,464 | 57,991 |
| Unassigned (Deficit) | - | - | - | (40,298) | (370,904) | (411,202) |
| Total Fund Balances | 367,461 | 194,654 | 892,001 | (40,298) | 746,626 | 2,160,444 |
| Total Liabilities and Fund Balances | \$ 1,067,676 | \$ 5,239,883 | \$ 1,262,679 | \$ 1,175,000 | \$ 3,045,018 | \$ 11,790,256 |

See accompanying Notes to Basic Financial Statements.

| | | |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------|-----------------------------|
| Total Fund Balances – Government Funds (Page 17) | | \$ 2,160,444 |
| Amount reported for Governmental Activities in the Statement of Net Assets (Page 15) 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 | \$ 9,238,380 | |
| Depreciable Capital Assets | 24,688,857 | |
| Infrastructure Assets | 7,528,680 | |
| Accumulated Depreciation | <u>(7,888,036)</u> | |
| Total Capital Assets | | 33,567,881 |
| Other Assets used in governmental activities are not financial resources and therefore are not reported in the funds: | | |
| Deferred Charges | | 27,181 |
| Some of the Municipality's revenues will be collected after year-end but are not available soon enough to pay for the current period's expenditures and therefore are deferred in the funds: | | |
| SBGP | 490,214 | |
| Christmas Bonus Reimbursement | 98,464 | |
| Head Start Program | <u>4,843,662</u> | |
| Total Deferred Revenues | | 5,432,340 |
| 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 | (1,277,000) | |
| Special Obligation Bonds | (3,756,336) | |
| Deferred Credits | (11,665) | |
| Law Number 146-MRCC | (67,319) | |
| Law Number 42-MRCC | (881,033) | |
| Christmas Bonus | (196,928) | |
| Compensated Absences | <u>(2,555,428)</u> | |
| Total Long-Term Liabilities | | <u>(8,745,709)</u> |
| Total Net Assets of Governmental Activities (Page 15) | | <u>\$ 32,442,137</u> |

See accompanying Notes to Basic Financial Statements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF OROCOVIS, PUERTO RICO

STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES
IN FUND BALANCE – GOVERNMENTAL FUNDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2012

| | GENERAL FUND | HEAD START FUND | DEBT SERVICE FUND | STATE ROADS IMPROVEMENT FUND | OTHER GOVERNMENTAL FUNDS | TOTAL GOVERNMENTAL FUNDS |
|-----------------------------------------------|-------------------|--------------------|----------------------|------------------------------------|--------------------------------|--------------------------------|
| REVENUES: | | | | | | |
| Property Taxes | \$ 968,700 | \$ - | \$ 199,656 | \$ - | \$ - | \$ 1,168,356 |
| Volume of Business Taxes | 330,994 | - | - | - | - | 330,994 |
| Sales and Usage Taxes | 352,171 | - | 346,279 | - | - | 698,450 |
| Federal Grants | - | 6,957,641 | - | - | 3,528,657 | 10,486,298 |
| Intergovernmental | 8,600,069 | - | - | 7,426,783 | 1,848,137 | 17,874,989 |
| Construction Excise Taxes | 416,957 | - | - | - | - | 416,957 |
| Rent | 33,851 | - | - | - | - | 33,851 |
| Miscellaneous | 819,897 | - | - | - | - | 819,897 |
| Total Revenues | 11,522,639 | 6,957,641 | 545,935 | 7,426,783 | 5,376,794 | 31,829,792 |
| EXPENDITURES: | | | | | | |
| Current | | | | | | |
| Mayor and Municipal Legislature | 737,569 | - | - | - | - | 737,569 |
| General Government | 4,233,719 | - | - | 402,455 | 433,975 | 5,070,149 |
| Public Safety | 551,239 | - | - | - | - | 551,239 |
| Public Works | 3,035,839 | - | - | - | - | 3,035,839 |
| Culture and Recreation | 624,484 | - | - | - | 149,800 | 774,284 |
| Health and Sanitation | 500,807 | - | - | - | - | 500,807 |
| Solid Waste Disposal | 115,625 | - | - | - | - | 115,625 |
| Public Instruction | 745,363 | 6,988,285 | - | - | 687,750 | 8,421,398 |
| Human Services and Welfare | 224,336 | - | - | - | 995,392 | 1,219,728 |
| Urban Development | - | - | - | 4,629,208 | 3,960,106 | 8,589,314 |
| Capital Outlay | 114,470 | - | - | 2,475,728 | 701,956 | 3,292,154 |
| Debt Service: | | | | | | |
| Bond Issue Costs | - | - | 1,050 | - | - | 1,050 |
| Principal | - | - | 429,856 | - | - | 429,856 |
| Interest and Other Charges | - | - | 266,545 | - | - | 266,545 |
| Total Expenditures | 10,883,451 | 6,988,285 | 697,451 | 7,507,391 | 6,928,979 | 33,005,557 |
| EXCESS OF REVENUES OVER (UNDER) | | | | | | |
| EXPENDITURES | 639,188 | (30,644) | (151,516) | (80,608) | (1,552,185) | (1,175,765) |
| OTHER FINANCING SOURCES (USES): | | | | | | |
| Proceed of Bonds | - | - | - | - | 409,336 | 409,336 |
| Transfers – In | - | - | 211,926 | - | 43,553 | 255,479 |
| Transfers – Out | (254,429) | - | - | - | (1,050) | (255,479) |
| Total Other Financing Sources and Uses | (254,429) | - | 211,926 | - | 451,839 | 409,336 |
| Net Change in Fund Balances | 384,759 | (30,644) | 60,410 | (80,608) | (1,100,346) | (766,429) |
| Fund Balances – Beginning, as Restated | (17,298) | 225,298 | 831,591 | 40,310 | 1,846,972 | 2,926,873 |
| FUND BALANCES – ENDING | \$ 367,461 | \$ 194,654 | \$ 892,001 | \$ (40,298) | \$ 746,626 | \$ 2,160,444 |

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**RECONCILIATION OF THE STATEMENT OF REVENUES,
EXPENDITURES, AND CHANGES IN FUND BALANCE OF
GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES
FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF OROCOVIS, PUERTO RICO**

Net Change in Fund Balances – Government Funds (Page 18) \$ (766,429)

Amount reported for Governmental Activities in the Statement of Activities (Page 17)
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 | \$ 3,292,154 | |
| Depreciation Expense | <u>(814,548)</u> | |
| Excess of Capital Outlays over Depreciation Expense | | 2,477,606 |

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

| | | |
|-----------------|-----------------|----------|
| Head Start | (54,035) | |
| Christmas Bonus | 5,776 | |
| SBGP | <u>(36,344)</u> | (84,603) |

Bonds proceeds provide current financial resources to governmental funds, but issuing debt
increase Long-Term Liabilities in the Statement of Net Assets. In the current period,
proceeds received was (409,336)

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

| | | |
|----------------------------------|----------------|---------|
| Bond Issuance Costs | (1,050) | |
| Amortization of Deferred Charges | <u>(4,895)</u> | (5,945) |

Repayment of long-term principal is expenditure in the governmental funds, but issuing debt
reduced Long-Term Liabilities in the Statement of Net Assets. In the current period
repayments were 429,856

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

These activities consist of:

| | | |
|---------------------------------|---------------|---------------|
| Increase in Christmas Bonus | (11,552) | |
| Decrease in Compensated Absence | <u>24,503</u> | |
| Total Additional Expenses | | <u>12,951</u> |

Change in Net Assets of Governmental Activities (Page 17) \$ 1,654,100

1. FINANCIAL REPORTING ENTITY

The accompanying financial statements present information on the financial activities of the **Municipality of Orocovis, 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 1825, and operates as a governmental unit of the Commonwealth of Puerto Rico, under the Law Number 81 of August 30, 1991, known as "Autonomy Municipalities Law of the Commonwealth of Puerto Rico". The governmental system of the **Municipality** is composed of the executive and legislative bodies. The Mayor is the Chief Executive Officer and is elected every four years in the general elections of the Commonwealth of Puerto Rico. The legislative body consists of 14 Legislators also elected in the general elections of Puerto Rico for a four-year period.

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

B. Reporting Entity

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

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

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

There are two methods of presentation of the component unit in the financial statements: blending – the financial data of the component unit's balances and transactions in a manner similar to the presentation of the **Municipality's** 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. Our specific evaluations of the criteria applicable to the **Municipality** indicate no organizations meet the criteria to be included as component units. Accordingly, these basic financial statements present only the **Municipality** as the reporting entity.

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, 2012, and the respective changes in financial position, where applicable, thereof for the fiscal year then ended.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Financial Statement Presentation

The basic financial statements of the **Municipality** have been prepared in conformity with accounting principles generally accepted in the United States of America as applicable to local governmental units. 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)

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

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

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

Governmental Funds Financial Statements (GFFS)

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

Traditional users of governmental financial statements will find the Fund Financial Statements presentation more familiar. The focus is on major funds, rather than the previous financial model’s fund types. This is the manner in which these funds are normally budgeted. 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.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

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

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

State Roads Improvement Fund – This is used to account for major improvements made by the **Municipality** in coordination with Puerto Rico Department of Transportation to state roads.

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.

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

Notes to the Basic Financial Statements

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

Required Supplementary Information

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

B. Measurement Focus and Basis of Accounting

Government-wide Financial Statements

The 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.

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. 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 deferred revenues.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

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, 2012, all revenues sources met this availability criterion.

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 and judgments, are recorded only when payment is due. General capital asset acquisitions are reported as expenditures in governmental funds. Proceeds of general long-term debt and acquisitions under capital leases, if any, are reported as other financing sources.

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). Expenditure-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**.

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.

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.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

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.
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.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

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

D. Assets, Liabilities, and Net Assets

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

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

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

2) *Receivables and Payables*

Activity between funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as either "due to/from other funds" (i.e., the current portion of interfund loans) or "advances to/from other funds" (i.e., the non-current portion of interfund loans). All other outstanding balances between funds are reported as "due to/from other funds." 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, 2012. These account receivables are shown net of estimated allowances for uncollectible accounts, which are determined upon past collection experience, historical trends, and current economic conditions. Intergovernmental receivables in the general fund represent mostly sales and usage taxes, federal grant and contributions, property tax accounts that are levied by Municipal Revenue Collection Center (MRCC), a governmental entity created by the Government. Intergovernmental receivables in the other governmental funds represent amounts owed to the **Municipality** for reimbursement of expenditures incurred pursuant to federally funded grant and contributions and state appropriations, and the amount in the debt service fund represents the distribution of property tax collected which is restricted for the debt service.

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.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

4) **Deferred Charges**

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

5) **Capital Assets**

Capital assets, which include land, buildings and improvement, machinery and equipment, motor vehicles, and infrastructure assets (e.g., roads, bridges, sidewalks, and similar items), are reported in the applicable governmental or business-type activities columns in the GWFS. Capital assets, other than infrastructure assets, are defined by the government as assets with an initial, individual cost of more than \$25 (amount not rounded) and an estimated useful life in excess of two years. For improvements other than buildings, the capital outlay must be greater than \$10,000, extend the estimated useful life for ten years, and be greater than 10% of the original cost of the asset. The **Municipality** reports infrastructure assets on a network and subsystem basis. Accordingly, the amounts spent for the construction or acquisition of infrastructure assets are capitalized and reported in the government-wide financial statements regardless of their amount.

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

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

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

| CAPITAL ASSETS | YEARS |
|----------------------------------|-------|
| Buildings | 50-60 |
| Improvement Other Than Buildings | 45 |
| Infrastructure | 50 |
| Vehicles and Furniture | 5-10 |
| Machinery and Equipment | 10-15 |

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

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

6) **Deferred and Unearned Revenues**

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

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

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

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, 2012. All vacation pay is accrued when incurred in the GWFS and PFFS. For the GWFS, the current portion is the amount estimated to be used in the following year. For the GFFS, all of the compensated absences are considered long-term and therefore, are not a fund liability and represents a reconciling item between the fund level and government-wide presentations.

9) *Claims and Judgments*

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

10) *Accounting for Pension Costs*

The **Municipality** 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 Government is considered to be the sponsor of the Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS) and System 2000, a multiemployer cost-sharing defined benefit pension plan and a hybrid defined contribution plan, respectively, in which the employees of the **Municipality** participate. The **Municipality** is considered a participant, and not a sponsor, of these retirement systems since the majority of the participants in the aforementioned pension trust funds are employees of the Government and the basic financial statements of such retirement systems are part of the financial reporting entity of the Government.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

11) Net Assets/Fund Balance

A) Net Assets

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

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

Net assets invested in capital assets, net of related debt is comprised of the following:

| | <u>Governmental Activities</u> |
|------------------------------------------------------------|------------------------------------|
| Capital Assets, Net of Accumulated Depreciation | \$ 33,567,881 |
| Outstanding Balance on Related Debt | (5,114,000) |
| Unspent Capital Debt Proceeds | <u>344,580</u> |
| Total Invested in Capital Assets, Net of Related Debt..... | <u>\$ 28,798,461</u> |

- *Restricted Net Assets* – These result when constraints placed on net assets use are either externally imposed by creditors, grantors, contributors, and the like, or imposed by law through constitutional provisions or enabling legislation.
- *Unrestricted Net Assets* – These consist of net assets which do not meet the definition of the two preceding categories. Unrestricted net assets often are designated, to indicate that management does not consider them to be available for general operations. Unrestricted net assets often have constraints on resources that are imposed by management, but can be removed or modified.

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

B) Fund Balance

Fund Balance Classification

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

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

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.

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.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

Policy on Unassigned General Fund Balance

It is the goal of the **Municipality** to achieve and maintain an Unassigned General Fund Balance equal to 15% of budgeted expenditures. The **Municipality** considers a balance of less than 10% to be a cause for concern, barring unusual or deliberate circumstances, and a balance of more than 20% as excessive. An amount in excess of 20% is to be considered for reservation to accumulate funding for the purchase of machinery and equipment, for capital projects, and/or reduces 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 asset purchases, and not for ongoing expenditures unless a viable plan designated to sustain the expenditures is simultaneously adopted.

C) **Components of Fund Balance**

| | GENERAL FUND | HEAD START FUND | DEBT SERVICE FUND | STATE ROADS IMPROVEMENT FUND | OTHER GOVERNMENTAL FUNDS | TOTAL GOVERNMENTAL FUNDS |
|--------------------------------------------|-------------------|--------------------|----------------------|------------------------------------|--------------------------------|--------------------------------|
| Nonexpendable | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - |
| Restricted For: | | | | | | |
| Debt Repayment | - | - | 892,001 | - | - | 892,001 |
| Public Instruction | - | 194,654 | - | - | - | 194,654 |
| Safety | - | - | - | - | 3,268 | 3,268 |
| Improvement of Streets and Sidewalks | - | - | - | - | 303,150 | 303,150 |
| Improvement and Construction of Facilities | - | - | - | - | 487,268 | 487,268 |
| Improvement of sewer system | - | - | - | - | 98,822 | 98,822 |
| Welfare | - | - | - | - | 100,460 | 100,460 |
| Capital Outlay - Purchase of Equipment | - | - | - | - | 87,098 | 87,098 |
| Total Restricted | - | 194,654 | 892,001 | - | 1,080,066 | 2,166,721 |
| Committed To: | | | | | | |
| Waste Disposal | 54,375 | - | - | - | - | 54,375 |
| Professional Services | 74,283 | - | - | - | - | 74,283 |
| Improvement and Construction of Facilities | 218,276 | - | - | - | - | 218,276 |
| Total Committed | 346,934 | - | - | - | - | 346,934 |
| Assigned To: | | | | | | |
| Improvement and Construction of Facilities | - | - | - | - | 37,464 | 37,464 |
| General Government | 20,527 | - | - | - | - | 20,527 |
| Total Assigned | 20,527 | - | - | - | 37,464 | 57,991 |
| Unassigned | - | - | - | (40,298) | (370,904) | (411,202) |
| Total Fund Balances | \$ 367,461 | \$ 194,654 | \$ 892,001 | \$ (40,298) | \$ 746,626 | \$ 2,160,444 |

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:

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

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, 2012 amounted to approximately \$433,272. The current insurance policies have not been cancelled or terminated. In addition, MRCC deducted approximately \$182,957 for workers compensation insurance covering all municipal employees for the same period.

G. Use of Estimates

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

H. Reclassifications

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

I. Future Adoption of Accounting Pronouncements

The Governmental Accounting Standards Board (GASB) issued the following pronouncements that have effective dates after June 30, 2012:

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

This Statement requires disclosures about an SCA including a general description of the arrangement and information about the associated assets, liabilities, and deferred inflows, the rights granted and retained, and guarantees and commitments. The requirements of this Statement are effective for financial statements for periods beginning after December 15, 2011 (FY 2012-2013). The provisions of this Statement generally are required to be applied retroactively for all periods presented.

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

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

This Statement also amends the criteria for reporting component units as if they were part of the primary government (that is, blending) in certain circumstances. Lastly, additional reporting guidance is provided for blending a component unit if the primary government is a business-type activity that uses a single column presentation for financial reporting. This Statement also clarifies the reporting of equity interests in legally separate organizations. It requires a primary government to report its equity interest in a component unit as an asset. The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2013 (FY 2013-2014). Earlier application is encouraged.

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

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

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

Hereinafter, these pronouncements collectively are referred to as the "FASB and AICPA pronouncements." This Statement also supersedes Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, thereby eliminating the election provided in paragraph 7 of that Statement for enterprise funds and business-type activities to apply post-November 30, 1989 FASB Statements and Interpretations that do not conflict with or contradict GASB pronouncements. The requirements of this Statement are effective for financial statements for periods beginning after December 15, 2011 (FY 2012-2013). Earlier application is encouraged. The provisions of this Statement generally are required to be applied retroactively for all periods presented.

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

Concepts Statement 4 also identifies net position as the residual of all other elements presented in a statement of financial position. This Statement amends the net asset reporting requirements in Statement No. 34, *Basic Financial Statements— and Management's Discussion and Analysis—for State and Local Governments*, and other pronouncements by incorporating deferred outflows of resources and deferred inflows of resources into the definitions of the required components of the residual measure and by renaming that measure as net position, rather than net assets. The provisions of this Statement are effective for financial statements for periods beginning after December 15, 2011 (FY 2012-2013). Earlier application is encouraged.

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*. 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.

Concepts Statement No. 4, *Elements of Financial Statements*, introduced and defined the elements included in financial statements, including deferred outflows of resources and deferred inflows of resources. In addition, Concepts Statement 4 provides that reporting a deferred outflow of resources or a deferred inflow of resources should be limited to those instances identified by the Board in authoritative pronouncements that are established after applicable due process. Prior to the issuance of this Statement, only two such pronouncements have been issued. Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, requires the reporting of a deferred outflow of resources or a deferred inflow of resources for the changes in fair value of hedging derivative instruments, and Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*, requires a deferred inflow of resources to be reported by a transferor government in a qualifying service concession arrangement. This Statement amends the financial statement element classification of certain items previously reported as assets and liabilities to be consistent with the definitions in Concepts Statement 4.

This Statement also provides other financial reporting guidance related to the impact of the financial statement elements deferred outflows of resources and deferred inflows of resources, such as changes in the determination of the major fund calculations and limiting the use of the term deferred in financial statement presentations. 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. 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, 2014 (FY 2014-2015). Earlier application is encouraged.

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 through 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.

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, 2012 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 \$4.2 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 Government. **Municipality** is also allowed to invest in bank acceptances, other bank obligations and certificates of deposit in financial institutions authorized to do business under the federal and Government laws.

Municipality follows the practice of pooling cash. At June 30, 2012, the pool cash account in interest bearing commercial banks accounts had a balance of \$1.9 million of which \$297,140 in the General Fund, \$258,238 in the Head Start Fund, and \$1.4 million 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 Government, public funds deposited by the **Municipality** in commercial banks must be fully collateralized for the amounts deposited in excess of the Federal Deposit Insurance Corporation (FDIC) coverage. All securities pledged as collateral are held by agents designated by the Government's Secretary of the Treasury, but not in the **Municipality's** name.

Cash with fiscal agent in the debt service fund consists of property tax collections and sales and usage taxes amounting to \$1,262,679 that are restricted for the payment of the **Municipality's** debt service, as required by law. Cash with Fiscal Agent in other governmental funds consist principally of \$402 thousand 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, 2012:

Credit Risk

This is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. At June 30, 2012, the **Municipality** has invested only in cash equivalents of \$1.9 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, 2012. 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, 2012.

3. CASH AND INVESTMENTS – continuation

Custodial Credit Risk

This is the risk that, in the event of the failure of a depository financial institution, the **Municipality** will not be able to recover its cash and investments or will not be able to recover collateral securities that are in the possession of an outside party. Pursuant to the Investment Guidelines for the Government adopted by GDB, the **Municipality** may invest in obligations of the Government, obligations of the United States, certificates of deposit, commercial paper, banker's acceptance, or in pools of obligations of the municipalities of Puerto Rico, which are managed by GDB. At June 30, 2012, the **Municipality** has balances deposited in commercial banks amounting to \$1.8 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 \$1.7 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, 2012. 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, 2012, 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, 2012, (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, 2012, the interest risk associated with the **Municipality's** cash and cash equivalent is considered low.

Foreign Exchange Risk

This is the risk that changes in exchange rates will adversely affect the value of an investment or a deposit. According to the aforementioned investment guidelines, adopted by the **Municipality**, the **Municipality** is prevented from investing in foreign securities or any other types of investments for which foreign exchange risk exposure may be significant. Accordingly, management has concluded that the foreign exchange risk related to the **Municipality's** deposits is considered low at June 30, 2012.

4. DUE FROM GOVERNMENTAL UNITS

The due from governmental units for the fiscal year ended June 30, 2012 corresponds to \$98,464 from Puerto Rico Treasury Department for the Christmas Bonus. The State Roads Improvement Fund has a due from Puerto Rico Department of Transportation for the amount of \$1,175,000. The Other Governmental funds amount is comprised of \$75,601 from the Puerto Rico Department of Agriculture for the Development of Agriculture Enterprises Program, \$50,028 from the Puerto Rico Office of Public Safety for the installation of security cameras, and \$3,515 from the Puerto Rico Police Department.

5. ACCOUNTS RECEIVABLE – FEDERAL GRANTS

The due from federal grants of the Other Governmental Funds for the fiscal year ended June 30, 2012 corresponds to \$892,750 from the Community Development Block Grant/States Program (SBGP) (through the Office of the Commissioner of Municipal Affairs), \$35,592 from the Law Enforcement Terrorism Prevention Program (through the Puerto Rico Office for Public Security), and \$214,549 from the Child and Adult Care Food Program (through the Puerto Rico Department of Education).

6. INTERFUND RECEIVABLE, PAYABLES AND TRANSFERS

A. Interfund Receivable and Payable Balances

Due to/from Other Funds at June 30, 2012 are summarized as follows:

| INTERFUND RECEIVABLE | INTERFUND PAYABLE | AMOUNT |
|----------------------|------------------------------|-------------------|
| Head Start | General Fund | \$ 31,705 |
| General Fund | State Roads Improvement Fund | 8,058 |
| General Fund | Other Fund | 613,091 |
| Total | | <u>\$ 652,854</u> |

6. INTERFUND RECEIVABLE, PAYABLES AND TRANSFERS – continuation

B. Interfund Transfers

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

| INTERFUND TRANSFERS WITHIN THE GOVERNMENTAL FUNDS | | | |
|---------------------------------------------------|--------------------------|-------------------|-----------------------|
| SOURCES | TRANSFER TO | AMOUNT | PURPOSE |
| General Fund | Debt Service Fund | \$ 210,876 | Debt Payments |
| Other Governmental Funds | Debt Service Fund | 1,050 | Bond Issue Costs |
| General Fund | Other Governmental Funds | <u>43,553</u> | Matching Requirements |
| | Total | <u>\$ 255,479</u> | |

7. DEFERRED REVENUES

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

| | UNAVAILABLE | UNEARNED |
|---------------------------------|---------------------|---------------------|
| Volume of Business Taxes | \$ - | \$ 290,333 |
| Other Governmental Funds | - | 806,517 |
| Head Start | 4,843,662 | - |
| Intergovernmental | <u>98,464</u> | - |
| Total Deferred/Unearned Revenue | <u>\$ 4,942,126</u> | <u>\$ 1,096,850</u> |

8. DUE TO OTHER GOVERNMENTAL UNITS

As of June 30, 2012, 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 | \$ 33,356 |
| General Administration Services | 1,551 |
| Retirement System Administration | 26,030 |
| AEELA | <u>895</u> |
| Total Due to Governmental Units | <u>\$ 61,832</u> |

9. CAPITAL ASSETS

Capital Assets activities for the fiscal year ended June 30, 2012 was as follows:

| DESCRIPTION | BALANCE | | | BALANCE JUNE 30, 2012 |
|----------------------------------------|----------------------|---------------------|-----------------------|-----------------------------|
| | JULY 1, 2011 | INCREASES | DECREASES | |
| Non-Depreciable Capital Assets: | | | | |
| Land | \$ 6,852,834 | \$ 141,550 | \$ - | \$ 6,994,384 |
| Construction in Progress | 6,412,646 | 1,399,601 | (5,568,251) | 2,243,996 |
| Total Non-Depreciable Capital Assets | <u>13,265,480</u> | <u>1,541,151</u> | <u>(5,568,251)</u> | <u>9,238,380</u> |
| Depreciable Capital Assets: | | | | |
| Buildings and Buildings Improvements | 13,483,927 | 5,686,677 | - | 19,170,604 |
| Equipment and Vehicles | 1,517,094 | 67,359 | - | 1,584,453 |
| Furniture and Fixtures | 556,277 | 203,772 | - | 760,049 |
| Heavy Equipment | 2,910,211 | 263,540 | - | 3,173,751 |
| Infrastructure | 6,430,774 | 1,097,906 | - | 7,528,680 |
| Total Depreciable Capital Assets | <u>24,898,283</u> | <u>7,319,254</u> | <u>-</u> | <u>32,217,537</u> |
| Less Accumulated Depreciation: | | | | |
| Buildings and Buildings Improvements | (3,059,295) | (337,153) | - | (3,396,448) |
| Equipment and Vehicles | (1,387,924) | (129,835) | - | (1,517,759) |
| Furniture and Fixtures | (403,685) | (78,427) | - | (482,112) |
| Heavy Equipment | (1,635,623) | (134,819) | - | (1,770,442) |
| Infrastructure | (586,961) | (134,314) | - | (721,275) |
| Total Accumulated Depreciation | <u>(7,073,488)</u> | <u>(814,548)</u> | <u>-</u> | <u>(7,888,036)</u> |
| Total Depreciable Capital Assets (Net) | <u>17,824,795</u> | <u>6,504,706</u> | <u>-</u> | <u>24,329,501</u> |
| CAPITAL ASSETS, NET | <u>\$ 31,090,275</u> | <u>\$ 8,045,857</u> | <u>\$ (5,568,251)</u> | <u>\$ 33,567,881</u> |

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

| | AMOUNT |
|---------------------------------|-------------------|
| General Government | \$ 138,473 |
| Public Safety | 48,873 |
| Public Works and Transportation | 350,256 |
| Culture and Recreation | 252,510 |
| Health and Welfare | 8,146 |
| Education | 16,290 |
| Total Depreciation Expenses | <u>\$ 814,548</u> |

10. GENERAL LONG-TERM DEBTS

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 11).

The following is a summary of general and special obligation bonds of the **Municipality** as of June 30, 2012:

During the year, the **Municipality** received the confirmation of an obligation granted by US Department of Agriculture, Rural Development (RD) for the amount of \$199,336 of the original loan of \$500,000, to be used for the improvement of the Community Center of the **Municipality**. The principal and interest are payable semi-annually during 25 years, but the terms will be determined by RD upon completion of the construction.

In addition, on November 2011, the **Municipality** issued special obligation bond of 2012 in the amount of \$210,000 for general construction purpose. The principal and interest at 6.00% for the first year, and 7.50% for the remaining installments are payable semi-annually ranging from \$10,000 to \$20,000 on the 1st days of July and January of each year through July 2026.

| Type of Obligation and Purpose | Maturity Date | Interest Rate | Amount |
|-------------------------------------------------------------|---------------------------|----------------|---------------------|
| General Obligation Bonds - Property Taxes: | | | |
| \$441,000, Series 1990 - General Construction | 2016 | 5.00% | \$ 87,000 |
| \$685,000, Series 2007 - General Construction | 2031 | 7.00% | 625,000 |
| \$655,000, Series 2008 - General Construction | 2031 | 7.50% | 605,000 |
| \$500,000, Series 2012 - General Construction | Undetermined ¹ | 3.75% | 199,336 |
| Total General Obligation Bonds | | | 1,516,336 |
| Special Obligation Bonds - General Revenues: | | | |
| \$1,220,000, Series 2002 - Purchase of Equipment | 2016 | 1.28% to 8.00% | 480,000 |
| Total Special Obligation Bonds - General Revenues | | | 480,000 |
| Special Obligation Bonds - Sales and Use Taxes: | | | |
| \$2,855,000, Series 2008 - General Construction | 2024 | 7.50% | 2,535,000 |
| \$310,000, Series 2008 - Purchase of Equipment | 2014 | 7.50% | 170,000 |
| \$453,000, Series 2011 - Purchase of Equipment | 2015 | 7.50% | 402,000 |
| \$210,000, Series 2012 - General Construction | 2026 | 6.00% to 7.50% | 210,000 |
| Total Special Obligation Bonds - Sales and Use Taxes | | | 3,317,000 |
| Total Special Obligation Bonds | | | 3,797,000 |
| Total General and Special Obligation Bonds | | | \$ 5,313,336 |

¹These terms will be determined by the loan grantor upon completion of the construction activities.

B. Legal Debt Limit and Legal Debt Margin

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

C. Other Long-Term Debts

Borrowing from MRCC

On July 1, 2007, the **Municipality** entered into a repayment agreement with the GDB and MRCC to repay the uncollectible property tax sale authorized by the enacted Law Number 146. The original amount of debt is \$84,149 to be paid during 25 years plus annual interest of 6.22%.

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 \$1,049,742 to be paid during 30 years plus annual interest of 6.1875%.

10. GENERAL LONG-TERM DEBTS – continuation

On November 28, 2001, the **Municipality** entered into a repayment agreement with the GDB and MRCC to pay for the proportional debt to cover the Land Information Management System (LIMS), system established by MRCC with the capacity to maintaining cadaster and photos of all real property of Puerto Rico. The original debt was \$55,763 to be paid during 10 years plus annual interest of 5.95%.

Deferred Credits

This amount represents the unpaid balance of the bond issue cost of the following obligation: \$2,855,000, Series 2008, and \$210,000, Series 2012, both of special obligation bonds.

Christmas Bonus

This amount represents the estimated accrued Christmas bonus accumulated as of June 30, 2012 and payroll related benefits, representing the benefit to employees to be paid during the first week of December 2012.

Compensated Absences

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

Following are the Other Long-Term Debts:

| DESCRIPTION | BALANCE | NEW | RETIREMENTS | BALANCE | AMOUNT'S | AMOUNT'S |
|----------------------|---------------------|-------------------|---------------------|---------------------|------------------------|------------------------|
| | JULY 1, 2011 | | AND ADJUSTMENT | JUNE 30, 2012 | DUE WITHIN ONE YEAR | DUE AFTER NEXT YEAR |
| Law Number 146-MRCC | \$ 70,685 | \$ - | \$ (3,366) | \$ 67,319 | \$ 3,366 | \$ 63,953 |
| Law Number 42-MRCC | 902,891 | - | (21,858) | 881,033 | 23,230 | 857,803 |
| LIMS-MRCC | 3,632 | - | (3,632) | - | - | - |
| Deferred Credits | 7,635 | 4,030 | - | 11,665 | - | 11,665 |
| Christmas Bonus | 185,376 | 196,928 | (185,376) | 196,928 | 196,928 | - |
| Compensated Absences | 2,579,931 | 186,058 | (210,561) | 2,555,428 | 1,987,293 | 568,135 |
| TOTAL | \$ 3,750,150 | \$ 387,016 | \$ (424,793) | \$ 3,712,373 | \$ 2,210,817 | \$ 1,501,556 |

D. Changes in General Long-Term Debts

The following is a summary of changes in long-term debts for the year ended June 30, 2012:

| DESCRIPTION | BALANCE | NEW | RETIREMENTS | BALANCE | AMOUNT'S | AMOUNT'S |
|--------------|---------------------|-------------------|---------------------|---------------------|------------------------|------------------------|
| | JULY 1, 2011 | | AND ADJUSTMENT | JUNE 30, 2012 | DUE WITHIN ONE YEAR | DUE AFTER NEXT YEAR |
| General | \$ 1,448,000 | \$ 199,336 | \$ (131,000) | \$ 1,516,336 | \$ 68,000 | \$ 1,448,336 |
| Special | 3,898,000 | 210,000 | (311,000) | 3,797,000 | 345,000 | 3,452,000 |
| Others Debts | 3,750,150 | 387,016 | (424,793) | 3,712,373 | 2,210,817 | 1,501,556 |
| TOTAL | \$ 9,096,150 | \$ 796,352 | \$ (866,793) | \$ 9,025,709 | \$ 2,623,817 | \$ 6,401,892 |

10. GENERAL LONG-TERM DEBTS – continuation

E. Debt Compliance

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

The annual requirements to amortize the general and special obligations outstanding as of June 30, 2012 are as follows:

| YEAR ENDING JUNE 30, | General Obligation Bonds | | Special Obligation Bonds | | Other Long-Term Obligations | | TOTAL | |
|-------------------------|--------------------------|---------------------|--------------------------|---------------------|-----------------------------|---------------------|---------------------|---------------------|
| | PRINCIPAL PAYMENT | INTEREST PAYMENT | PRINCIPAL PAYMENT | INTEREST PAYMENT | PRINCIPAL PAYMENT | INTEREST PAYMENT | PRINCIPAL | INTEREST |
| 2013 | \$ 68,000 | \$ 35,232 | \$ 345,000 | \$ 186,795 | \$ 2,210,817 | \$ 58,348 | \$ 2,623,817 | \$ 280,375 |
| 2014 | 69,000 | 73,150 | 370,000 | 214,651 | 28,056 | 56,678 | 467,056 | 344,479 |
| 2015 | 70,000 | 69,300 | 394,000 | 188,501 | 29,607 | 54,916 | 493,607 | 312,717 |
| 2016 | 50,000 | 65,100 | 369,000 | 177,626 | 31,256 | 53,058 | 450,256 | 295,784 |
| 2017 | 50,000 | 62,100 | 249,000 | 164,588 | 33,009 | 51,098 | 332,009 | 277,786 |
| 2018-2022 | 320,000 | 271,088 | 1,165,000 | 558,189 | 195,438 | 221,953 | 1,680,438 | 1,051,230 |
| 2023-2027 | 445,000 | 172,565 | 905,000 | 112,688 | 259,053 | 152,561 | 1,609,053 | 437,814 |
| 2028-2032 | 245,000 | 46,025 | - | - | 345,337 | 61,585 | 590,337 | 107,610 |
| Undetermined | 199,336 | - | - | - | 579,800 | - | 779,136 | - |
| TOTAL | \$ 1,516,336 | \$ 794,560 | \$ 3,797,000 | \$ 1,603,038 | \$ 3,712,373 | \$ 710,197 | \$ 9,025,709 | \$ 3,107,795 |

11. DEBT RETIREMENT

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

These property taxes are accumulated by the Municipal Revenue Collection Center in costs of the general obligations bonds issued by the **Municipality** (See Note 10). 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.

12. 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.

12. PROPERTY TAXES – continuation

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 2012 is 8.53% 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 7.50% and 5.50%, respectively, belongs to the **Municipality**. The Commonwealth of Puerto Rico also contributes an annual tax rate of 0.20% of the property tax collected. The remaining percentage is distributed as follows: (a) 6.00% and 4.00%, respectively, represents the **Municipality's** basic tax rate that is appropriated for general purposes and therefore accounted for through the general fund. A portion of such amount is deposited in an equalization fund together with a percentage of the net revenues of the Puerto Rico electronic lottery and a subsidy from the Commonwealth of Puerto Rico. The remaining portion belonging to the **Municipality** of 1.50% 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 reached the maximum statutory tax rate limit for the basic tax while there is no limitation for the ad-valorem tax rate.

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

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

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.

13. 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, 2012, the tax rates were as follows:

- a. 1.50% for financial institutions and savings and loan associations.
- b. 0.40% for all other organizations.

13. 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, 2012. 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.

14. 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, 2012, but pertaining to the current year period.

15. CONSTRUCTION EXCISE TAXES

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

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

- a. All construction will pay 3% of construction excise taxes.
- b. All construction projects carried out by state, federal and municipal governments will pay 4% of construction excise taxes.
- c. All construction projects carried out by not-for-profit organization educational institutions have full exemption to the construction excise taxes.

16. INTERGOVERNMENTAL REVENUES

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

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

17. PENSION PLAN

Description of the Plan

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

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

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

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

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

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

Law Number 305 was enacted on September 24, 1999, amended the Act Number 447 for the purpose of establishing a new program (System 2000). System 2000 became effective on January 1, 2000. Employees participating in the current system (ERS) as of December 31, 1999, may elect either to stay in the defined-benefit plan or transfer to the new program. Persons joining the government on or after January 1, 2000, will only be allowed to become members of System 2000.

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

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

17. PENSION PLAN – continuation

Funding Policy

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

Contribution requirements are established by law and are as follows:

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

Annual Contribution

The **Municipality's** contributions during those years are recognized as total pension expenditures/expenses in the category of administration as follow:

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

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

18. 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.

B. Federal Grants

In the normal course of operations, the **Municipality** receives grants from various Federal and State agencies. The grant programs are subject to audit by agents of the granting authority, the purpose of which is to ensure compliance with conditions precedent to the granting of funds. Any liability for reimbursement which may arise as the result of these audits is not believed to be material.

19. 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, 2012, amounted to approximately \$355,174. 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.

19. COMMITMENTS – continuation

B. Construction

The Municipality had encumbrances at June 30, 2012 for the construction, improvements, or renovation of several municipal facilities in the following funds:

| | Encumbered For | Amount | Reported within Fund Balance Classification |
|------------------------------|-----------------------------------------------|--------------|----------------------------------------------------------|
| General Fund | Solid Waste Disposal | \$ 54,375 | Committed to Waste Disposal |
| | | 70,000 | Committed to Improvement and Construction of Facilities |
| State Roads Improvement Fund | | \$ 3,588,596 | Restricted to Improvement of Streets and Sidewalks |
| Non Major Funds | Improvements to the Community Center | \$ 300,665 | Restricted to Improvement and Construction of Facilities |
| | Improvement of Facilities | 24,000 | Restricted to Improvement and Construction of Facilities |
| | Resurfacing of Streets and Other Improvements | 490,466 | Restricted to Improvement of Streets and Sidewalks |
| | Purchase of Vehicles | 20,000 | Restricted to Capital Outlay - Purchase of Equipment |

C. Other Commitments

At June 30, 2012, the other governmental fund had a deficit of \$370,904. 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.

20. FUND BALANCES RESTATEMENTS

The following reconciles the June 30, 2011 Fund Balance, as previously reported to Beginning Fund Balance, as restated, July 1, 2011 for the various funds:

| | GENERAL FUND | STATE ROADS IMPROVEMENT FUND | OTHER GOVERNMENTAL FUNDS |
|-----------------------------------------------------------------|--------------------|------------------------------------|--------------------------------|
| Fund Balance, as Previously Reported, At June 30, 2011 | \$ 518,904 | \$ - | \$ 1,351,080 |
| Reclassification of Fund Balances | (536,202) | - | 536,202 |
| Reclassification of Major Funds | - | 40,310 | (40,310) |
| Beginning Fund Balance, as Restated, At July 1, 2011 | \$ (17,298) | \$ 40,310 | \$ 1,846,972 |

21. SUBSEQUENT EVENT

On August 21, 2012, the Municipality obtained the approval for the issuance of three bonds; a special obligation bond, Series of 2013 in the amount of \$660,000, another special obligation bond, Series of 2013 in the amount of \$295,000, and a general obligation bond, Series of 2013 in the amount of \$215,000. All three bonds are for general construction and bond issue costs; principal and variable interest at 6%, payable semi-annually on the 1st day of January and July of each year through 2019.

Municipality has evaluated subsequent events through January 23, 2012, 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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF OROCOVIS, PUERTO RICO

REQUIRED SUPPLEMENTARY INFORMATION
BUDGETARY COMPARISON SCHEDULE – GENERAL FUND
FOR THE FISCAL YEAR ENDED JUNE 30, 2012

| | Budget Amounts | | Actual Amounts | Variance with Final Budget |
|------------------------------------------------------------------------|--------------------|--------------------|------------------------------------------|-------------------------------|
| | Original | Final | (Budgetary Basis) (See Notes 1 and 2) | |
| BUDGETARY FUND BALANCE (DEFICIT), AS RESTATED, JULY 1, 2011 | \$ (76,663) | \$ (76,663) | \$ (76,663) | \$ - |
| Resources (Inflows): | | | | |
| Property Taxes | 968,700 | 968,700 | 968,700 | - |
| Volume of Business Taxes | 331,000 | 361,601 | 330,994 | (30,607) |
| Sales and Usage Taxes | 220,100 | 343,789 | 352,171 | 8,382 |
| Intergovernmental Revenues | 8,412,677 | 8,540,236 | 8,588,845 | 48,609 |
| Construction Excise Taxes | 121,000 | 425,202 | 416,957 | (8,245) |
| Rent | 11,200 | 22,626 | 33,851 | 11,225 |
| Miscellaneous | 244,800 | 753,093 | 819,897 | 66,804 |
| Total Resources (Inflows) | 10,309,477 | 11,415,247 | 11,511,415 | 96,168 |
| Amounts Available for Appropriation | 10,232,814 | 11,338,584 | 11,434,752 | 96,168 |
| Charges to Appropriations (Outflows): | | | | |
| Mayor and Municipal Legislature | 652,588 | 929,343 | 914,138 | 15,205 |
| General Government | 4,166,295 | 3,868,826 | 3,859,173 | 9,653 |
| Public Safety | 768,843 | 558,587 | 551,239 | 7,348 |
| Public Works | 1,953,793 | 3,314,343 | 3,307,719 | 6,624 |
| Culture and Recreation | 673,600 | 626,542 | 623,181 | 3,361 |
| Health and Sanitation | 508,636 | 572,089 | 558,935 | 13,154 |
| Solid Waste Disposal | 190,000 | 170,000 | 170,000 | - |
| Human Services and Welfare | 185,325 | 233,420 | 224,336 | 9,084 |
| Public Instruction | 800,000 | 745,363 | 745,363 | - |
| Capital Outlays | 130,293 | 121,630 | 121,458 | 172 |
| Transfers to Other Funds | 280,104 | 275,104 | 254,429 | 20,675 |
| Total Charges to Appropriations | 10,309,477 | 11,415,247 | 11,329,971 | 85,276 |
| BUDGETARY FUND BALANCE (DEFICIT), JUNE 30, 2012 | \$ (76,663) | \$ (76,663) | \$ 104,781 | \$ 181,444 |

1. **Budgetary Reporting**

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

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

| | <u>General Fund</u> |
|------------------------------------------------------------------------------------------------------------------------------------------------|----------------------|
| Sources/Inflows of Resources: | |
| Actual Amounts (Budgetary Basis) "Available for Appropriation" from the Budgetary Comparison Schedule (See Page 48) | \$ 11,434,752 |
| Difference – Budget to GAAP: | |
| GASB 54 Reclassification of Revenue | 11,224 |
| The Fund Balance (Deficit) at the Beginning of Year is a budgetary resource but is not a Current-Year Revenue for financial reporting purposes | <u>76,663</u> |
| Total Revenues as Reported on the Statement of Governmental Funds Revenues, Expenditures and Changes in Fund Balance (See Page 19) | <u>\$ 11,522,639</u> |
| Uses/Outflows of Resources: | |
| Actual Amounts (Budgetary Basis) "Total Charges to Appropriation" from the Budgetary Comparison Schedule (See Page 48) | \$ 11,329,971 |
| Difference – Budget to GAAP: | |
| Non budgetary expenditures (expenditures reclassification GASB 54) | 1,303 |
| Encumbrances for supplies and equipment ordered but not received are reported in the year the order is placed for budgetary reporting purposes | (567,940) |
| Payments of encumbrances of prior year that are expenditures for financial reporting purposes but are not outflows for budgetary purposes | 374,546 |
| Transfers to other funds are outflows of budgetary resources but are not expenditures for financial reporting purposes | <u>(254,429)</u> |
| Total Expenditures as Reported on the Statement of Governmental Funds Revenues, Expenditures and Changes in Fund Balance (See Page 19) | <u>\$ 10,883,451</u> |

END OF THIS SECTION

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

SUPPLEMENTARY INFORMATION REQUIRED BY
 U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
 FINANCIAL DATA SCHEDULE – SECTION 8 HOUSING
 CHOICE VOUCHERS – BALANCE SHEET
 JUNE 30, 2012

COMMONWEALTH OF PUERTO RICO
 MUNICIPALITY OF OROCOVIS, PUERTO RICO

ASSETS:

Current Assets:

| | | |
|------|--|------------|
| Cash | | \$ 106,442 |
|------|--|------------|

Noncurrent Assets:

| | | |
|---------------------------------------------------------------------|--|---------------|
| Furniture, Equipment and Machinery, Net of Accumulated Depreciation | | <u>31,369</u> |
|---------------------------------------------------------------------|--|---------------|

| | | |
|---------------------|--|--------------------------|
| Total Assets | | <u>\$ 137,811</u> |
|---------------------|--|--------------------------|

LIABILITIES AND NET ASSETS:

Liabilities:

Current Liabilities:

| | | |
|------------------|--|----------|
| Accounts Payable | | \$ 5,982 |
|------------------|--|----------|

Net Assets:

| | | |
|----------------------------|----------------|--|
| Invested in Capital Assets | \$ 31,369 | |
| Restricted Net Assets | <u>100,460</u> | |

| | | |
|-------------------|--|-----------------------|
| Net Assets | | <u>131,829</u> |
|-------------------|--|-----------------------|

| | | |
|-----------------------------------------|--|--------------------------|
| Total Liabilities and Net Assets | | <u>\$ 137,811</u> |
|-----------------------------------------|--|--------------------------|

See accompanying Notes to Financial Data Schedule.

SUPPLEMENTARY INFORMATION REQUIRED BY
U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
FINANCIAL DATA SCHEDULE – SECTION 8 HOUSING
CHOICE VOUCHERS – INCOME STATEMENT
FOR THE FISCAL YEAR ENDED JUNE 30, 2012

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF OROCOVIS, PUERTO RICO

REVENUES:

| | |
|--------------------------|-----------------------|
| HUD PHA Operating Grants | \$ 251,426 |
| Other Revenue | <u>2,379</u> |
| Total Revenues | <u>253,805</u> |

EXPENSES:

| | | |
|-----------------------------|--------------|-----------------------|
| Salaries | \$ 22,316 | |
| Office Materials | 2,889 | |
| Housing Assistance Payments | 221,244 | |
| HAP Portability-In | 2,070 | |
| Depreciation | <u>2,045</u> | |
| Total Expenses | | <u>250,564</u> |

Excess of Revenues Over (Under) Expenses \$ 3,241

Net Change in Net Assets:

| | |
|------------------------------------------|--------------------------|
| Beginning Net Assets | \$ 128,588 |
| Excess of Revenues Over (Under) Expenses | <u>3,241</u> |
| Ending Net Assets | <u>\$ 131,829</u> |

1. BASIS OF PRESENTATION

The accompanying Financial Data Schedule (FDS) includes the Section 8 Housing Choice Vouchers federal program activities of the **Municipality of Orocovis, 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 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.

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 Assets are presented in the **Municipality's** Statement of Net Assets. Revenues and Expenses are reported in the Statement of Activities.

END OF NOTES

PART II

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF OROCOVIS, PUERTO RICO**

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

| FEDERAL GRANTOR / PASS THROUGH GRANTOR / PROGRAM OR CLUSTER TITLE | FEDERAL CFDA NUMBER | PASS-THROUGH ENTITY IDENTIFYING NUMBER | FEDERAL EXPENDITURES |
|-----------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------|----------------------------------------------|----------------------------|
| U.S. Department of Agriculture: | | | |
| Community Facilities Loans and Grants..... | 10.766 | | \$ <u>199,335</u> |
| Pass-Through Puerto Rico Department of Education: | | | |
| Child and Adult Care Food Program..... | 10.558 | CCC-252 | <u>704,029</u> |
| Total U. S. Department of Agriculture..... | | | <u>903,364</u> |
| U.S. Department of Housing and Urban Development: | | | |
| Section 8 Housing Choice Vouchers..... | 14.871 | | <u>279,863</u> |
| Pass-Through State – Office of the Commissioner of Municipal Affairs: | | | |
| Community Development Block Grant/States Program (SBGP) and Non Entitlements Grants in Hawaii (Stated Administered Small Cities Program)..... | 14.228 | N/AV | <u>1,113,618</u> |
| Pass-Through Puerto Rico Department of Family: | | | |
| ARRA – Homelessness Prevention and Rapid Re-Housing Program..... | 14.257 | 2009-508DC72001 | <u>136,879</u> |
| Total U.S. Department of Housing and Urban Development.... | | | <u>1,530,360</u> |
| U. S. Department of Energy: | | | |
| Pass-Through Puerto Rico Energy Affairs Administration: | | | |
| ARRA – Energy Efficiency and Conservation Block Grant Program (EECBG)..... | 81.128 | EEA-FOA-0013A | <u>124,560</u> |
| U.S. Department of Health and Human Services: | | | |
| Pass-Through Administration for the Childhood Care and Integral Development: | | | |
| Head Start Program..... | 93.600 | 02-CH-9944/06AD | <u>6,988,285</u> |
| U.S. Department of Homeland Security: | | | |
| Pass-Through Puerto Rico Office for Public Security: | | | |
| Disaster Grants – Public Assistance..... | 97.036 | N/AV | 1,294,301 |
| Homeland Security Grant Program..... | 97.067 | N/AV | <u>58,558</u> |
| Total U. S. Department of Homeland Security..... | | | <u>1,352,859</u> |
| TOTAL EXPENDITURES OF FEDERAL AWARDS | | | <u>\$10,899,428</u> |

See accompanying Notes to Schedule of Expenditures of Federal Awards.

1. BASIS OF PRESENTATION

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

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

3. FEDERAL CFDA NUMBER

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

4. RELATIONSHIP TO FEDERAL FINANCIAL REPORTS

Expenditures of federal awards are reported in the **Municipality's** Statement of Revenues, Expenditures and Changes in Fund Balances – Governmental Fund as follows: Head Start Fund – \$6,988,285 and Other Governmental Funds \$3,911,143.

END OF NOTES



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

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

We have audited the financial statements of the **Municipality of Orocovis, Puerto Rico (Municipality)**, as of and for the fiscal year ended June 30, 2012, and have issued our report thereon dated January 23, 2013. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

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

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

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 no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

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

**To the Honorable Mayor and
Members of the Municipal Legislature
Municipality of Orocovis, Puerto Rico
Page 2**

This report is intended solely for the information and use of the management, Mayor, Municipal Legislature, Office of the Commissioner of Municipal Affairs, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.



CPA Díaz-Martínez, PSC
Certified Public Accountants & Consultants
License Number 12, expires on December 1, 2013

Caguas, Puerto Rico
January 23, 2013

Stamp No. E26827 was affixed to
the original report.





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

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

Compliance

We have audited **Municipality of Orocovis, 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, 2012. **Municipality**'s major federal programs are identified in the Summary of Auditors' Result Section of the accompanying Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the **Municipality**'s management. Our responsibility is to express an opinion on the **Municipality**'s compliance based on our audit.

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

In our opinion, **Municipality** complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the fiscal year ended June 30, 2012. However, the results of our auditing procedures disclosed an instance of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying Schedule of Findings and Questioned Costs as item 2012-III-01.

Internal Control Over Compliance

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

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

**To the Honorable Mayor and
Members of the Municipal Legislature
Municipality of Orocovis, Puerto Rico
Page 2**

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

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

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 2012-III-01 to be significant deficiency.

Municipality's responses to the finding identified in our audit are described in the accompanying Schedule of Findings and Questioned Costs. We did not audit **Municipality's** responses and, accordingly, we express no opinion on the responses.

This report is intended solely for the information and use of the management, the Honorable Mayor and Members of the Municipal Legislature, Office of the Commissioner of Municipal Affairs, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.



CPA Díaz-Martínez, PSC
Certified Public Accountants & Consultants
License Number 12, expires on December 1, 2013

Caguas, Puerto Rico
January 23, 2013

Stamp No. E26828 was affixed to
the original report.



PART III
FINDINGS AND QUESTIONED COSTS

SECTION I – SUMMARY OF AUDITORS' RESULTS

Financial Statements

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

Internal control over financial reporting:

- 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: Unqualified Opinion Qualified Opinion
 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 |
|-------------|-----------------------------------------------------------------------|
| 10.558 | Child and Adult Care Food Program |
| 14.871 | Section 8 Housing Choice Vouchers |
| 93.600 | Head Start Program |
| 81.128 | ARRA – Energy Efficiency and Conservation Block Grant Program (EECBG) |

Dollar threshold used to distinguish between Type A and Type B Programs: \$326,983

Auditee qualified as low-risk auditee? Yes No

SECTION II – FINANCIAL STATEMENT FINDINGS

NO MATTER IS REPORTED.

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

| | |
|---------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| FINDING REFERENCE NUMBER | 2012-III-01 |
| FEDERAL PROGRAM | SECTION 8 HOUSING VOUCHER PROGRAM (CFDA NO. 14.871) U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT |
| AWARD NUMBERS | RQ080 |
| 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 used a utility allowance schedule of 2010 for the reexamination. |
| QUESTIONED COSTS | Not noted. |
| INFORMATION TO PROVIDE PROPER PERSPECTIVE | Municipality did not verify that the current utility allowance schedule was used for the reexamination of each participants file, it is a systemic deficiency. |
| CAUSE | Municipality used a utility allowance schedule that was not the effective for the fiscal year. |
| EFFECT OR POSSIBLE EFFECT | Municipality did not pay the utility allowance amount that was effective for the fiscal year. |
| RECOMMENDATION | We recommend management to implement internal control procedures in order to assure that the effective allowance schedules are used. |
| RESPONSIBLE OFFICIAL'S RESPONSE AND CORRECTIVE ACTION PLANNED | The Municipality reviewed the right amounts for the utilities allowances on the table that supposed to be used for the FY 2011-2012 and made the corrections in the system. |
| IMPLEMENTATION DATE | January 16, 2013 |
| RESPONSIBLE OFFICIAL | Mr. Jesús A. Torres, Accountant |

END OF SCHEDULE

(1) Audit Findings that have been Fully Corrected:

NONE

(2) Audit Findings not Corrected or Partially Corrected:

FISCAL YEAR 2011

| | | |
|------------------|--------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------|
| Finding Number | 2011-III-01 | Davis-Bacon Act No documentation of procedures performed to verify that wages paid are not less than the prevailing wages. |
| CFDA Number | 93.600 93.708 | |
| Questioned Cost | None | |
| Auditee Comments | Pending of final determination of the Administration for the Childhood Care and Integral Development of the Puerto Rico Family Department. | |

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

NONE

(4) Audit findings is no longer valid:

FISCAL YEAR 2009

| | | |
|------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------|
| Finding Number | 2009-III-01 | Cash Management Delay to disburse requested fund since the date they were received. |
| CFDA Number | 14.228 | |
| Questioned Cost | None | |
| Auditee Comments | More than two years has passed without final determination of the Office of the Commissioner of Municipal Affairs. | |
| Finding Number | 2009-III-02 | Davis-Bacon Act No documentation of procedures performed to verify that wages paid are not less than the prevailing wages. |
| CFDA Number | 93.600 | |
| Questioned Cost | None | |
| Auditee Comments | More than two years has passed without final determination of the Administration for the Childhood Care and Integral Development of the Puerto Rico Family Department. | |

continue

(4) Audit findings is no longer valid: (continuation)

| | | |
|-------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Finding Number | 2009-III-03 | Special Test and Provision Head Start Program did not obtain for various Centers, the required licenses issued by the Public Service Commission of Puerto Rico. |
| CFDA Number | 93.600 | |
| Questioned Cost | None | |
| Auditee Comments | More than two years has passed without final determination of the Administration for the Childhood Care and Integral Development of the Puerto Rico Family Department. | |

END OF SCHEDULE