

**MUNICIPALITY OF PATILLAS, PUERTO RICO
SINGLE AUDIT REPORT
JUNE 30, 2012
(INDEPENDENT AUDITOR'S REPORT)**

email: 27 de marzo de 2013

13 APR 12 PM 12:57
2120-6-31
Oficina del Comisario
de Asuntos Municipales

**MUNICIPALITY OF PATILLAS, PUERTO RICO
SINGLE AUDIT REPORT
JUNE 30, 2012**

TABLE OF CONTENTS

	<u>PAGE</u>
Management's Discussion and Analysis	1-9
Independent Auditor's Report	10-12
Basic Financial Statements:	
Government – Wide Financial Statements:	
Statement of Net Assets	13
Statement of Activities	14
Government Fund's Financial Statements:	
Balance sheet - Governmental Funds	15
Statement of Revenues, Expenditures and Changes in Fund Balances Governmental Funds	16
Reconciliation of the Statement of Revenues, Expenditures and Changes in Fund Balances Of Governmental Funds to the Statement of Activities	17
Statement of Revenues, Expenditures and Changes in fund balance Budget and Actual (budget basis) General Fund.....	18
Notes to financial statements	19-52

**PART II - GOVERNMENTAL AUDITING STANDARDS AND
OMB CIRCULAR A-133 REPORTS**

Report on Internal Control Over Financial Reporting and on Compliance and other matters Based on an Audit of the Financial Statements Performed in Accordance with Government Auditing Standards.....	53-54
Report on Compliance with Requirements Applicable to Each Major Program and Internal Control over Compliance in Accordance with OMB Circular A-133	55-57
Schedule of Expenditures of Federal Awards.	58-59
Notes to Schedule of Federal Financial Award.....	60
Schedule of Findings and Questioned Costs.....	61-67
Summary Schedule of Prior Audit Findings	68
Corrective Action Plan	69



ESTADO LIBRE ASOCIADO DE PUERTO RICO
GOBIERNO MUNICIPAL DE PATILLAS
OFICINA DE FINANZAS
TEL. 787-839-4120 EXT. 238
FAX: 787-839-0500

MANAGEMENT'S DISCUSSION AND ANALYSIS

The Management's Discussion and analysis (MD&A) of the Municipality of Patillas financial performance provides an overview of the Municipality's financial activities for the fiscal year ended June 30, 2012. MD & A should be read in conjunction with the transmittal letter on page 9 and the Municipality's financial statements, which begin on page 13. The discussion and analysis includes comparative data for prior year as this information is available for the fiscal year ended June 30, 2012. This MD & A is prepared in order to comply with such pronouncement and, to provide the financial statements users with major information.

FINANCIAL HIGHLIGHTS

- The Net assets of the Municipality exceeded its liabilities at the close of the current fiscal year by \$17,657,010 net assets increased by \$1,842,561 when compared with prior year.
- Revenues were \$2,476,946 more than last year, while expenses were \$2,946,037 more than last year as reported in the Statement of Activities.
- The Municipality had reported in the General Fund a deficiency of revenues over expenditures amounting to \$2,660,933 in the accompanying statement of revenues.
- Loans principal payments were \$870,076 during fiscal year 2011-12.
- The actual revenues were \$7,992,139 and the expenditures were \$10,326,683 creating an excess of \$2,334,544 under the in the Budgetary Schedule mainly due to unfavorable variances in revenues, (Sales of property not realized).
- The Municipality government fund reported combined ending fund balances of \$2,335,721 in the accompanying statement of revenues, expenditures.
- The Municipality has reported a net undesignated fund balance for the general fund amounting to \$ 6001,248.

MUNICIPALITY OF PATILLAS MANAGEMENT'S DISCUSSION AND ANALYSIS

New Requirements for the Financial Reporting

The new approach on the preparation of the Municipality's financial statements emphasizes on a government wide (consolidated) view of its financial operations. Nevertheless major individual funds are presented and evaluated in all of its details. Simultaneous implementation of both of these perspectives allows user to address relevant questions about the municipality's performance and provides a basis for comparisons and evaluation of services quality.

Because of the implementation of these new reporting standards, much of the information will not be easily comparable with prior year data. However, in future years, comparisons will be more meaningful and will provide a better understanding of the municipality's financial position and results of its operations.

The Property Tax revenue represents 11% of total revenues of the municipality during the last five years. The Municipal Revenue Collection Center (CRIM) of the Commonwealth of Puerto Rico is responsible for the assessment of all real and personal property located within the **Municipality of Patillas** and for the levy, administration and collection of the corresponding taxes.

Financial Statements Components

The basic financial statement consist of government wide financial statements, the major individual funds financial statement, and notes to the financial statements that provides more details.

Governmental-wide financial statements - The government-wide financial statements which begin on page 13 of this report are designed to provide users with a broad overview of the Municipality's finances, in a manner similar to a private-sector business. The government wide statements provide short and long term information about the municipality's status as a whole.

The Statement of Net Assets reports information of the Municipality as a whole. Increase or decrease of net assets may serve as an indicator of whether the municipality's financial position is improving or deteriorating. Those statements include all assets and liabilities using the accrual basis of accounting, which is similar to the accounting used by most private sector companies. All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

The statement of Activities is focused on both the gross and net cost of various activities, which are supported by the Municipality's property tax, municipal licenses tax and other revenues. It is intended to summarize and simplify the user's analysis of the costs of governmental services. The governmental activities reflect basic services, including police, public works, solid waste disposal, community services, and general administration. Property tax, municipal license tax, state and federal appropriations finance most of the services.

MUNICIPALITY OF PATILLAS MANAGEMENT'S DISCUSSION AND ANALYSIS

The Statement of Net Assets and the statement of activities, on page 13-14, report the Municipality net assets and changes in them. One can analyze of the Municipality's net assets, as the difference between assets and liabilities, as one way to measure the Municipality's financial position. Over time increase decreases in the Municipality's net assets are one indicator of whether its financial health is improving or deteriorating. However, other non-financial factors should be considered, such as changes in the Municipality's property tax base, and the condition of roads, to assess the overall health of the Municipality's of Patillas.

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The Major Governmental Funds presentation, on pages provides detailed information about the most significant funds, not the Municipality as a whole. The Municipality uses fund accounting to ensure and demonstrate compliance with financial related legal requirements. The Municipality's basic services are reported in governmental funds, which focus on how money flows into and out of those funds and the balances left at year-end that are available for spending. These funds are reported using an accounting method called modified accrual accounting, which measures cash and all other financial assets that can readily be converted to cash. The Governmental funds statement provides a detailed short-term view of the Municipality general governmental operations and the basic services it provides. Governmental funds information help you determine whether there are more or fewer financial resources that can be spent in the near future to finance Municipality programs. We describe the relationship between governmental activities and governmental funds in reconciliation besides the fund 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 statement.

Infrastructure Assets

The Municipality implemented the major model portions of GASB statement 34 during the current fiscal years. Historically, the governmental larger group of assets have not been reported nor depreciated in governmental financial statement. The new statement required that this asset be evaluated and reported within the Governmental column of the Governmental Wide Statement.

Additionally, the government must elect to either depreciate these assets over their estimated useful life or develop a system of assets management designated to maintain the service delivered potentially to near perpetuity. If the government develops the assets management system, which periodically, by category, measures and demonstrate its maintenance system, which periodically, by category, measures and demonstrate its maintenance of locally established level of services standards, the government may record its cost of maintenance in lieu of depreciation. The information about the condition and maintenance of condition of the government infrastructure assets should assist financial statements users in evaluating a local government and its performance over time.

**MUNICIPALITY OF PATILLAS
MANAGEMENT'S DISCUSSION AND ANALYSIS**

Government-Wide Financial Analysis

Statement of Net Assets

The Statement of Net Assets reports information of the Municipality as a whole. Increase or decrease of net assets may serve as an indicator of whether municipality's financial position is improving or deteriorating. In the case of the Municipality primary government assets exceeded liabilities by \$17,657,010 the close of the recent fiscal year compared to \$13,949,558 at the end of previous year, as restated and showed in the following condensed Statement of Net Assets of the Primary Government.

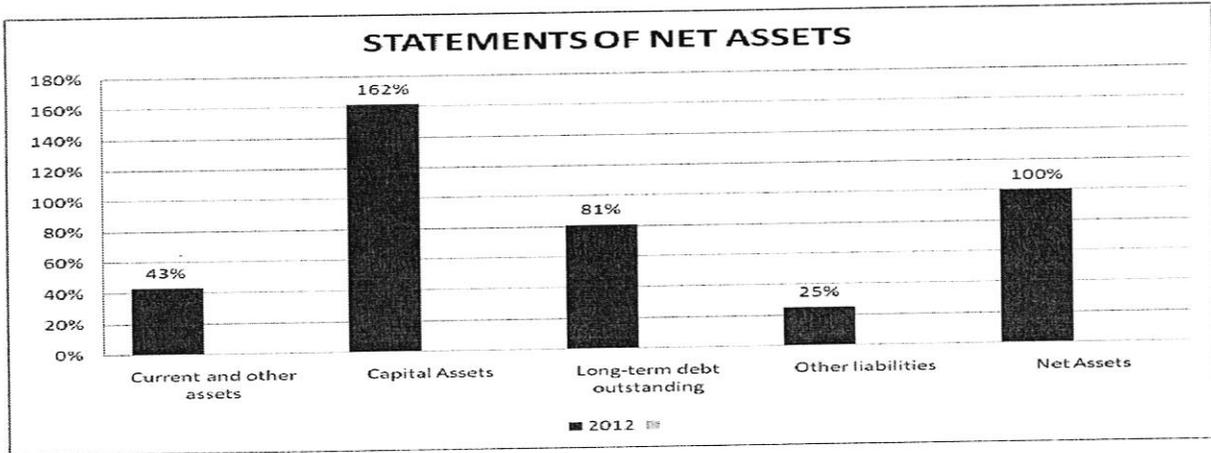
**Statements of Net Assets
As of June 30, 2012 and 2011**

	2012	2011	Changes	%
Current and other assets	\$ 7,557,725	\$ 8,451,724	\$ (893,999)	-11%
Capital assets net	28,525,619	25,328,296	3,197,323	13%
Total assets	36,083,344	33,780,020	2,303,324	0.07
			-	
Current and other liabilities	4,275,838	3,852,982	422,856	11%
Long-term liabilities	14,150,496	14,112,589	37,907	0%
Total liabilities	18,426,334	17,965,571	460,763	3%
Net assets:			-	
Invested in capital assets, net of related debt	21,164,869	17,366,786	3,798,083	22%
Debt service	1,398,514	837,596	560,918	67%
Other activities	2,631,661	1,338,027	1,293,634	97%
Capital project activity	3,312,788	3,835,720	(522,932)	-14%
Committed	1,032,446	825,810	206,636	25%
Unassigned (deficit)	(11,883,268)	(8,389,490)	(3,493,778)	42%
Total net assets	\$ 17,657,010	\$ 15,814,449	\$ 1,842,561	12%

The decrease of \$893,999 in current net asset was mainly due to increase of cash and investment of \$1.3 million. The account Capital assets increased by \$3.7 million principally by additions to construction in progress by \$ 3.5 million at the same time created increased in the net investment in capital asset of \$3.7 million.

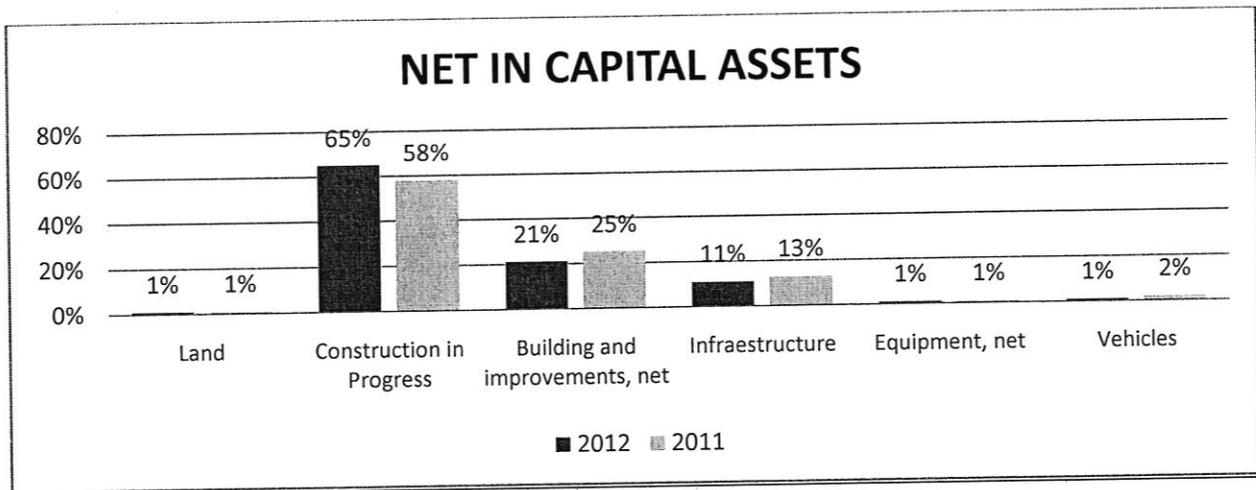
Current liabilities increase by \$442,856 percent caused by a decrease of accounts payable by \$330,308 and a decrease government entities by \$144,961. Long-term liabilities decrease by \$37,907.

**MUNICIPALITY OF PATILLAS
MANAGEMENT'S DISCUSSION AND ANALYSIS**



Increase (Decrease) Net in Capital Assets was as follows:

	2012	%	2011	%	Change
Land	\$ 192,199	1%	\$ 192,199	1%	\$ -
Construction in progress	18,299,602	65%	14,793,921	58%	3,505,681
Building and improvements, net	6,068,259	21%	6,353,416	25%	(285,157)
Infrastructure	3,218,798	11%	3,272,537	13%	(53,739)
Equipment, net	392,570	1%	284,524	1%	108,046
Vehicles	154,191	1%	431,699	2%	(277,508)
Total Net Capital Asset	\$ 28,325,619		\$ 25,328,296		\$ 2,997,323



Construction in progress represent 50 percent and 65 percent of total asset and net capital assets respectively. Building improvements represents 21 percent of total asset and 17 percent and net capital asset. The Increase in Construction in progress by \$3.5 million when compared with prior year includes.

**MUNICIPALITY OF PATILLAS
MANAGEMENT'S DISCUSSION AND ANALYSIS**

The following reflects the condensed Statement of Activities of the Primary Government:

**Statements of Activities
For the year ended June 30, 2012 and 2011
Changes in Net Assets**

	2012	2011	Changes	%
General Revenues:				
Property tax	\$ 1,799,067	\$ 2,024,062	\$ (224,995)	-11%
Municipal Licenses tax	492,423	470,407	22,016	5%
Intergovernmental revenue	8,045,025	6,935,252	1,109,773	16%
Rent	60,943	39,985	20,958	52%
Interest	9,942	9,846	96	1%
Other revenue	19,128	115,185	(96,057)	-83%
Municipal sales tax	918,814	851,329	67,485	8%
Program revenues:				
Capital grant	1,285,814	1,187,846	97,968	8%
Operating grant	2,983,431	1,503,729	1,479,702	98%
Total Revenues	15,614,587	13,137,641	2,476,946	19%
Expenditures:			-	
General Government	5,433,012	4,452,707	980,305	22%
Public safety	953,027	3,311,209	(2,358,182)	-71%
Public work	4,700,301	715,219	3,985,082	557%
Health	379,166	370,339	8,827	2%
Education and training	882,749	940,158	(57,409)	-6%
Culture and recreation	1,244,930	1,233,178	11,752	1%
Interest and fiscal charges	439,290	315,767	123,523	39%
Charges for services	(260,449)	(512,588)	252,139	100%
Total expenditures	13,772,026	10,825,989	2,946,037	27%
Changes in net assets	\$ 1,842,561	\$ 2,311,652	(469,091)	-20%

**MUNICIPALITY OF PATILLAS
MANAGEMENT'S DISCUSSION AND ANALYSIS**

The Statement of Activities reflects for fiscal year 2012, the net effect of revenues derived from several programs plus current operating revenues. Total revenues compared to the total expenses, amounted to an increase of \$2,476,946 in the Municipality's net assets. Approximately 20 percent of the Municipality's total revenue came from taxes, while 27 percent resulted from Federal grants and 51 percent resulted from Intergovernmental Revenues. The Municipality's expenses cover a range of services like health, public safety, sanitation, recreation and sports, education, housing, transportation, welfare, construction and improvements. The largest expenses were for general government, public works, education and training and culture and recreation. With this analysis, the readers have comparative information with the percentage of change in revenues and expenses from prior year to current year.

A brief review of the Statements of Activities of the Municipality at June 30, 2012, shows that total expenses incurred to afford the cost of all functions and programs amounted to \$14,032,475. Upon examining the sources of revenues for the financing of the programs, the Statement reflects the following; \$2,983,431 from operating grants and contributions; and \$1,285,814 from capital grants and contributions obtained from other sources. General revenues for the year amounted to \$11,345,342. There was a change in net assets \$1,842,561 that represents 16 percent of total revenues and an increase of 19 percent when compared to prior year. Expenses increase by \$2,946,037 or 27 percent when compared to prior year.

FINANCIAL ANALYSIS OF THE GOVERNMENTAL FUNDS

The following reflects the condensed Balance Sheet of the Governmental Funds:

**Governmental Funds
Balance Sheets
June 30, 2012 and 2011**

	2012	2011	Changes	%
Assets:				
Cash	\$ 1,541,070	\$ 2,847,880	\$ (1,306,810)	-46%
Restricted Cash	5,302,579	5,284,353	18,226	0%
Accounts Receivable	3,368,158	3,612,680	(244,522)	-7%
Total Assets	\$ 10,211,807	\$ 11,744,913	\$ (1,533,106)	-13%
Liabilities and Fund Balance				
Liabilities:				
Total Liabilities	\$ 7,856,086	\$ 7,076,265	\$ 779,821	11%
Funds Balances	2,355,721	4,668,648	(2,312,927)	-50%
Total liabilities and Fund Balances	\$ 10,211,807	\$ 11,744,913	\$ (2,283,145)	-19%

The Fund Financial Statement is another important component of the Municipality's financial statements. A fund is a grouping of related accounts used to maintain accountability and controls over economic resources of the Municipality that have been segregated for specific activities. The

**MUNICIPALITY OF PATILLAS
MANAGEMENT'S DISCUSSION AND ANALYSIS**

The Municipal fund type of accounting is used to demonstrate compliance with related legal requirements. Information offered thru this Statement is limited to the Municipality's most significant funds and is particularly related to the local government only instead of the government as a whole. Government funds are used to account for essentially the same functions as those reported as governmental activities.

During 2012 the municipality had \$3.4 million cash restricted; in the Bond issued Fund and Debt service \$1.8 million. The debt service fund increased by \$116,316. Deferred revenues decreased by \$27,994.

**Statements of Revenues, Expenditures and Changes in Fund Balances
Years Ended June 30, 2012 and 2011**

	2012	2011	Changes	%
Revenues:				
Property taxes	\$ 1,799,067	\$ 2,024,062	\$ (224,995)	-11%
Volume of business tax	492,423	470,407	22,016	5%
Intergovernmental revenue	8,045,025	6,935,252	1,109,773	16%
Federal grants	4,269,245	2,601,705	1,667,540	64%
Sales Tax	918,814	851,329	67,485	8%
Other	350,462	677,604	(327,142)	-48%
Total Revenues	\$ 15,875,036	\$ 13,560,359	\$ 2,314,677	17%
Expenditures and Fund Balance				
Expenditures:				
General Government	\$ 5,386,284	\$ 4,335,905	\$ 1,050,379	24%
Public safety and public work	5,385,482	3,699,257	1,686,225	46%
Education and training and culture	2,124,580	2,139,425	(14,845)	-1%
Capital outlays	3,515,400	3,261,126	254,274	8%
Other	378,762	480,171	(101,409)	-21%
Bonds (principal and interest)	1,309,366	1,022,767	286,599	28%
Total Expenditures	\$ 18,099,874	\$ 14,938,651	\$ 3,161,223	21%
Prior period Adjustment				
Excess of revenues (expenditures)				
Over expenditures (revenues)	\$ (2,224,838)	\$ (1,378,292)	\$ (846,546)	61%
Fund Balance, ending	\$ 2,355,721	\$ 2,914,019	\$ (558,298)	-19%

The most significant changes of this statement were as follows:

- (1) Revenues from property tax decreased by \$224,995 due to decrease in property tax in collection. The increase in Intergovernmental revenue by \$1,109,773 Revenue from volume business tax declaration increase by \$22,016 on funds received when compared with prior year, reflected in sales reported in the municipal tax declaration increase approximately by 8 percent in many taxpayer. Other revenues decrease by \$327,142 million, principally for eventual income.

Expenditures increase by approximately \$3.1 million when compared to prior year. The general, public safety and public work expenditures increased by \$2.7 million, Capital outlays increase by \$254,274, except for other expense decreased by \$101,409.



ESTADO LIBRE ASOCIADO DE PUERTO RICO
GOBIERNO MUNICIPAL DE PATILLAS
OFICINA DE FINANZAS
TEL. 787-839-4120 EXT. 238
FAX: 787-839-0500

MUNICIPALITY OF PATILLAS MANAGEMENT'S DISCUSSION AND ANALYSIS

Economic Factors and Next Year 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 Mayor exercises the executive power and the legislative which has 14 members, exercises the legislative power.

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

The Budget for Revenues was \$11 million for the general fund, total revenues decreased by \$3 million when compared the budgeted revenues to the actual revenues. The other revenue decreased by \$ 2.6 million and Municipal sales tax by \$309,929. The actual expenditure was \$1.3 million less than budgeted expenditures. General Government reflected increase by \$1.1 when compared Budget Expenditures to actual expenditures. Excess of revenues under expenditures reflect a decrease by \$1.7 million, mentioned in this paragraph

The Municipality has finished during the year the Reconstruction of the La Felicita Bridge and improvements in Bo. Mulas, Bo. Apeadero, Bo. Mamey and Bo. Marín.

Contacting the Municipality's Financial Management

The Municipality's financial statements are designed to present users with a general overview of the Municipality's finances and to show the accountability for the money it receives. If you have questions about the report, or need additional financial information, please contact us at the Municipality of Patillas, PO Box 698, Patillas, and Puerto Rico 00723.

Finance Director, PO Box 698, Patillas, PR 00723.
Telephone (787)839-4120 Fax: (787) 839-9546 E-mail: lianetteon@gmail.com

JUAN A. FELICIANO CHARNECO
Certified Public Accountant

151 Calle Miguel Salas
Arecibo, PR 00612

Tel: (787) 879-4433
Fax: (787) 880-1402

INDEPENDENT AUDITOR'S REPORT

To the Mayor and Municipal Council of
the Municipality of Patillas
Patillas, Puerto Rico

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the **Municipality of Patillas** Puerto Rico, ("the Municipality") as of and for the year ended June 30, 2012, which collectively comprise the **Municipality's** basic financial statements, as listed in the accompanying table of contents. These financial statements are the responsibility of the Municipality's management. Our responsibility is to express opinions on these financial statements based on my audit. We did not audit the financial statement of the Esmeralda Del Sur which is shown as discretely presented component unit. That statement was audited by other auditors whose reports has been furnished to us, and my opinion, insofar as it relates to the amount included for Esmeralda del Sur, is based solely on the report of the other auditors.

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 of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not the purpose of expressing an opinion on the effectiveness of the Municipality internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the report of other auditors provide a reasonable basis for our opinions.

In our opinion, based on our report and the report of the other auditors, the financial statements referred to above present fairly, in all material respects, the financial position of the governmental activities, each major fund and the aggregate remaining fund information of the **Municipality of Patillas**, Puerto Rico, as of June 30, 2012, and the respective changes in financial position, and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 15, 2013 on my consideration of the **Municipality of Patillas**, Puerto Rico internal control over financial reporting and on my tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the result of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Governmental Auditing Standards and should be considered in assessing the results of my audit.

Accounting principles generally accepted in the United States of America require that the *management's discussion and analysis* and budgetary comparison information on pages 1 through 9 and page 18 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Municipality of Patillas, Puerto Rico, financial statements as a whole. The introductory section, combining and individual nonmajor fund financial statements, and statistical section, are presented for purposes of additional analysis and are not required part of the financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations, and is also not a required part of the financial statements. The combining and individual nonmajor fund financial statements and the schedule of expenditures of federal awards are the

responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other 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. The introductory and statistical sections have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we do not express an opinion or provide any assurance on them.

Arecibo, Puerto Rico
March 15, 2013

The stamp number 2661163
was affixed to the
original of this report.



Juan A. Feliciano Charneco
CPA JUAN A. FELICIANO CHARNECO
License No. 1263
Expires December 1, 2013

MUNICIPALITY OF PATILLAS, PUERTO RICO
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2012

19. RESTATEMENT OF 2012 FINANCIAL STATEMENTS

During the fiscal year ended June 30, 2012 **the Municipality** notes that certain liabilities had been overstated or understated as well as other differences related with adjustments to capital assets and reclassification of certain fund balances. As a result the net assets at June 30, 2012, as previously reported, had been decreased by \$(136,751) and the general fund balance of various funds at June 30, 2012, as previously reported, had been increased by \$834,975 in the debt service fund.

	General fund	Bond issue fund	Homeland Security	Debt Service	Other Funds
Beginning balance at					
June 30, 2011	\$ (3,203,564)	\$ 3,581,912	\$ 130,561	\$ 837,596	\$ 1,397,180
Accounts payable prior year	(136,751)	(834,251)	150,000	235,444	670,964
Beginning balance, as restated June 30, 2011	\$ (3,340,315)	\$ 2,747,661	\$ 280,561	\$ 1,073,040	\$ 2,068,144

20. SUBSEQUENT EVENTS

During July 2012 the Municipality pays operational debts for the amounts of \$3,145,000. In October 2012 received \$1,700,000 from a court demand used to pay operational debts.

MUNICIPALITY OF PATILLAS, PUERTO RICO
STATEMENT OF NET ASSETS
JUNE 30, 2012

<u>ASSETS</u>	Primary Government Governmental Activities	Component Unit Esmeralda Del Sur
Cash and investments	\$ 1,541,070	\$ 184,830
Cash with fiscal agent and restricted deposit	5,302,579	1,301,142
Accounts receivable other	-	19,069
Accounts receivable from federal government	41,660	-
Accounts receivable from government	672,416	-
Capital assets, net of accumulated depreciation	28,525,619	1,320,555
Other assets	-	28,961
Total assets	\$ 36,083,344	\$ 2,854,557
<u>LIABILITIES</u>		
Liabilities:		
Accounts payable and accrued liabilities	\$ 2,150,979	\$ 36,922
Due to government entity	1,892,717	-
Deferred revenue (volume business tax)	232,142	-
Noncurrent liabilities:		
Due within one year	926,166	142,685
Due in more than one year	13,224,330	57,909
Mortgages payable	-	735,608
Total liabilities	18,426,334	973,124
<u>NET ASSETS</u>		
Invested in capital assets, net of related debt	21,164,869	442,262
Restricted for:		
Debt service	1,398,514	1,301,142
Capital project activity	3,312,788	-
Other activities	2,631,661	-
Committed	1,032,446	-
Unassigned (Deficit)	(11,883,268)	138,029
Total net assets	17,657,010	1,881,433
Total Liabilities and net Assets	\$ 36,083,344	\$ 2,854,557

See notes to financial statements.

**MUNICIPALITY OF PATILLAS, PUERTO RICO
STATEMENT OF ACTIVITIES
FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

Functions/Programs	Program Revenues			Net (Expenses) Revenues and Changes in net assets	
	Charges for Services	Capital Grants and Contributions	Operating Grants and Contributions	Primary Government	Component Unit
EXPENDITURES:					
General government	\$ 5,433,012	\$ (1,285,814)	\$ (545,178)	\$ 3,341,571	-
Public safety	953,027	-	-	953,027	-
Public works	4,700,301	-	(1,569,420)	3,130,881	-
Health	379,166	-	-	379,166	-
Culture and recreation	1,244,930	-	-	1,244,930	-
Education and training	882,749	-	(868,833)	13,916	-
Interest on long -term debt	439,290	-	-	439,290	-
Total governmental activities	\$ 14,032,475	\$ (1,285,814)	\$ (2,983,431)	\$ 9,502,781	-
Component units:					
Esmeralda del Sur	432,456	-	-	-	432,456
Total component unit	\$ 432,456	-	-	-	\$ 432,456
GENERAL REVENUES:					
Property taxes				1,799,067	-
Municipal licenses tax				492,423	-
Intergovernmental revenues				8,045,025	-
Rent of properties				60,943	535,663
Interest revenues				9,942	-
Other revenues				19,128	1,247
Municipal sales tax				918,814	-
Financial				-	32,417
Total general revenues				11,345,342	569,327
Changes in net assets				1,842,561	136,871
Net assets at beginning of year				13,949,558	1,744,562
Prior period adjustment (Note 18)				1,864,891	-
Net assets at end of year				\$ 17,657,010	\$ 1,881,433

See notes to financial statements.

**MUNICIPALITY OF PATILLAS, PUERTO RICO
BALANCE SHEET - GOVERNMENTAL FUNDS
JUNE 30, 2012**

<u>ASSETS</u>	General Fund	Bonds Issue Fund	HUD Programs	Head Start Programs	Homeland Security Programs	Debt Service Fund	Other Funds	Total Governmental Funds
Cash and investments	\$ 330,778	\$ -	\$ 176,045	\$ 3,966	\$ 964,607	\$ -	\$ 65,674	\$ 1,541,070
Cash with fiscal agent	-	3,493,823	-	-	-	1,808,756	-	5,302,579
Accounts receivable from government	156,492	-	-	-	-	515,924	-	672,416
Accounts receivable from federal government	-	-	25,664	15,996	-	-	-	41,660
Due from other funds	159,430	-	-	-	150,000	-	2,344,652	2,654,082
Total assets and other debits	\$ 646,700	\$ 3,493,823	\$ 201,709	\$ 19,962	\$ 1,114,607	\$ 2,324,680	\$ 2,410,326	\$ 10,211,807

LIABILITIES AND FUND BALANCES

Liabilities:								
Accounts payable and accrued liabilities	\$ 2,088,162	\$ -	\$ -	\$ 16,302	\$ -	\$ 926,166	\$ -	\$ 3,030,630
Due to special revenue and general fund	2,388,412	-	26,871	3,629	26,175	-	208,995	2,654,082
Due to government entities	1,892,717	-	-	-	-	-	-	1,892,717
Deferred revenue (volume business tax)	232,142	-	-	-	-	-	-	232,142
Accrued employee benefits	46,515	-	-	-	-	-	-	46,515
Total liabilities	6,647,948	-	26,871	19,931	26,175	926,166	208,995	7,856,086

Fund balances:

Restricted for:								
Debt service	-	3,241,400	-	-	-	1,398,514	-	1,398,514
Capital project activity	-	71,388	-	-	-	-	-	3,312,788
Other activities	-	103,450	31	31	844,321	-	1,683,859	2,631,661
Committed	18,440	252,423	-	-	244,111	-	517,472	1,032,446
Unassigned	(6,019,688)	-	-	-	-	-	-	(6,019,688)
Total fund balances	(6,001,248)	3,493,823	174,838	31	1,088,432	1,398,514	2,201,331	2,355,721
Total liabilities and fund balance	\$ 646,700	\$ 3,493,823	\$ 201,709	\$ 19,962	\$ 1,114,607	\$ 2,324,680	\$ 2,410,326	\$ 10,211,807

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

TOTAL FUND BALANCE - GOVERNMENTAL FUNDS

Amounts reported for governmental activities in the statement of net assets are different because:

Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds

Long-term liabilities, including bonds payable, are not due and payable in the current period and, therefore, are not reported in the funds:

Accrued compensated absences		\$ 600,330	
Bonds payable		12,624,000	
Total Long-Term Debt Liabilities		\$ 13,224,330	
TOTAL NET ASSETS OF GOVERNMENTAL ACTIVITIES			(13,224,330)
			\$ 17,657,010

See notes to financial statements.

MUNICIPALITY OF PATILLAS, PUERTO RICO
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES - GOVERNMENTAL FUNDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2012

	General Fund	Bonds issue Fund	HUD Programs	Head Start Programs	Homeland Security Programs	Debt Service Fund	Other Funds	Total Governmental Funds
REVENUES:								
Property taxes	\$ 1,347,053	\$ -	\$ -	\$ -	\$ -	\$ 452,014	\$ -	\$ 1,799,067
Municipal license tax	492,423	-	-	-	-	-	-	492,423
Licenses, permits, fines and sales tax	260,449	-	-	-	-	-	-	260,449
Intergovernmental revenues	5,637,798	-	-	-	-	-	2,407,227	8,045,025
Rent of properties	60,943	-	-	-	-	-	-	60,943
Interest income	9,942	-	-	-	-	-	-	9,942
Other revenues	18,928	-	200	-	-	637,507	-	19,128
Municipal sales tax	281,307	-	-	-	1,569,420	-	545,178	918,814
Federal financial award	-	-	1,285,814	868,833	1,569,420	-	-	4,269,245
Total revenues	8,108,843	-	1,285,814	869,033	1,569,420	1,089,521	2,952,405	15,875,036

EXPENDITURES:

Current:

General government	4,043,635	-	702,524	-	89,840	-	550,285	5,386,284
Public safety	950,986	-	-	-	-	-	-	950,986
Public works	4,434,496	-	-	-	-	-	-	4,434,496
Health	378,762	-	-	-	-	-	-	378,762
Capital outlays	9,719	-	565,039	-	671,709	-	2,268,933	3,515,400
Culture and recreation	1,241,831	-	-	-	-	-	-	1,241,831
Education and training	-	-	-	882,749	-	-	-	882,749
Debt service:								
Principal retirement	-	-	-	-	-	870,076	-	870,076
Interest and fiscal charges	-	-	-	-	-	439,290	-	439,290
Total expenditures	11,059,429	-	1,267,563	882,749	761,549	1,309,366	2,819,218	18,099,874
Excess of revenues over (under) expenditures	(2,950,586)	-	18,251	(13,716)	807,871	(219,845)	133,187	(2,224,838)

OTHER FINANCING SOURCES (USES):

Transfer in (out) to debt service fund	(545,322)	-	-	-	-	545,322	-	-
Transfer in from Bond issued fund	834,975	(834,975)	-	-	-	-	-	-
Bond Expenditure	-	(88,089)	-	-	-	-	-	(88,089)
Total other financing sources (uses)	289,653	(923,064)	-	-	-	545,322	-	(88,089)
Excess of revenues over (under) expenditures and other uses and other sources	(2,660,933)	(923,064)	18,251	(13,716)	807,871	325,477	133,187	(2,312,927)
Net change in fund balances	(2,660,933)	(923,064)	18,251	(13,716)	807,871	325,477	133,187	(2,312,927)
Fund balance June 30, 2011	(3,203,564)	3,581,912	156,587	13,747	130,561	837,596	1,397,180	2,914,019
Prior period adjustment (Note 19)	(136,751)	834,975	-	-	150,000	235,441	670,964	1,754,629
Beginning balance restated	(3,340,315)	834,975	156,587	13,747	280,561	1,073,037	2,068,144	4,668,648
Fund balance June 30, 2012	(6,001,248)	3,493,823	174,838	31	1,088,432	1,398,514	2,201,331	2,355,721

See notes to financial statements.

**MUNICIPALITY OF PATILLAS
RECONCILIATION OF THE STATEMENT OF REVENUES,
EXPENDITURES, AND CHANGES IN FUND BALANCES OF
GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES
JUNE 30, 2012**

Net change in fund balance - total governmental funds \$ (2,312,927)

Amounts reported for governmental activities in the statement of activities
are different because:

Governmental funds report capital outlays as expenditures. However,
in the statement of activities the cost of those assets is allocated
over their estimated useful lives and reported as depreciation expense.

Expenditures for capital assets	3,515,400	
Less: current year depreciation	<u>(318,077)</u>	
		3,197,323

The issuance of long-term debt provides current financial resources
to governmental funds, while the repayment of the principal of
of long-term debt consumes the current financial resources of
governmental funds. Neither transaction, however, has any effect
on net assets.

Principal payments	870,076	
Bond Expenditure	<u>88,089</u>	

	958,165
Change in net assets of governmental activities	<u>\$ 1,842,561</u>

See notes to financial statements.

MUNICIPALITY OF PATILLAS, PUERTO RICO
BUDGETORY COMPARISION SCHEDULE GENERAL FUND (BUDGET BASIS)
GENERAL FUND AND DEBT SERVICE
FOR THE FISCAL YEAR ENDED JUNE 30, 2012

	Budgeted Amounts		Adjusted Actual Note 1	Variance Favorable (Unfavorable)
	Original	Final		
REVENUES:				
Property taxes	\$ 298,686	\$ 298,686	\$ 298,686	\$ -
Municipal license tax	500,000	500,000	492,423	(7,577)
Intergovernmental revenues	5,534,701	5,534,701	5,637,798	103,097
Licenses, permits and fines	402,000	402,000	260,449	(141,551)
Municipal sales tax	591,236	591,236	281,307	(309,929)
Rent of properties	100,000	100,000	60,943	(39,057)
Interest income	51,000	51,000	9,942	(41,058)
Other revenues	2,623,669	2,623,669	18,928	(2,604,741)
Other sources	960,324	960,324	931,663	(28,661)
Total revenues	\$ 11,061,616	\$ 11,061,616	\$ 7,992,139	\$ (3,069,477)
EXPENDITURES:				
Current:				
General government	\$ 3,477,058	\$ 4,745,175	\$ 3,595,910	\$ 1,149,265
Public safety	1,192,580	956,775	950,985	5,790
Public Works	3,916,442	3,667,772	3,613,873	53,899
Health	441,714	421,509	378,762	42,747
Culture and recreation	1,391,795	1,281,819	1,241,831	39,988
Transfer to debt service	590,650	590,650	545,322	45,328
Total expenditures	\$ 11,010,239	\$ 11,663,700	\$ 10,326,683	\$ 1,337,017
Excess of revenues over (under) expenditures		\$ (602,084)	\$ (2,334,544)	\$ (1,732,460)
Explanation of differences:				
Sources/inflows of resources:				
Actual amounts (budgetary basis) "available for appropriation" from the budgetary comparison schedule				\$ 7,992,139
Transfers from other funds are inflows of budgetary resources but are not revenues for financial reporting purposes.				116,704
Revenue not accrued for financial purpose only				
Total revenues as reported on the statement of revenue, expenditure, and changes in fund balances				\$ 8,108,843
Uses/outflow of resources				
Actual amounts (budgetary basis) "total charges to appropriations" from the budgetary comparison schedule				\$ 10,326,683
Differences - budget to GAAP:				
Non budgeted expenditures				1,278,068
Transfer to debt service				(545,322)
Total expenditures as reported on the statement of revenue, expenditures and change in fund balances				\$ 11,059,429

See notes to budgetary comparison schedule.

MUNICIPALITY OF PATILLAS, PUERTO RICO
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2012

GENERAL ORGANIZATION

The **Municipality of Patillas (The Municipality)** was founded in 1811. 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 Puerto Rico. The legislative body consists of fourteen (14) assemblymen also elected in the general elections of Puerto Rico for a four-year period.

The Municipality provides services such as: health, public safety, sanitation, recreation and sports, education, housing, transportation, welfare, construction and/or improvements of highways and streets, and other general and administrative services.

The financial statements of **the Municipality** have been prepared in conformity with generally accepted accounting principles (GAAP) as applicable to governmental entities. The Governmental Accounting Standards Board (GASB) is the primary standard-setting body for establishing governmental accounting and financial reporting principles. The GASB periodically updates its existing Governmental Accounting and Financial Reporting Standards, which along with subsequent GASB Pronouncement (Statements and Interpretations,) institute GAAP for governmental units. A summary of **the Municipality's** significant accounting policies consistently applied in the preparation of the accompanying basic financial statements follows:

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a. Reporting Entity

The Municipality's financial statements include the operations of all departments and separate legal entities for which **the Municipality** is financially accountable or for which exclusion would leave the financial statements misleading or incomplete.

In June 1999, the GASB issued Statement No. 34 *Basic Financial Statements and Management Discussion and Analysis for State and Local Governments*. This statement establishes new financial reporting requirements for state and local governments. It requires new information and restructures much of the information that governments have reported in the past. Comparability with reports issued in prior years is affected. In June 2001, the GASB issued Statement No. 37 *Basic Financial Statements and Management Discussion and Analysis for State and Local Governments Omnibus*, which in part addressed the Management Discussion and Analysis (MD&A) requirements, Program Revenue Classifications and Major Fund criteria requirements in the reporting model in Statement No. 34.

The Municipality implemented this Standard for the fiscal year ended June 30, 2004.

MUNICIPALITY OF PATILLAS, PUERTO RICO
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2012

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

b. Financial Reporting Entity

In evaluating how to define the Municipality for financial reporting purposes, management has considered all potential component units. The decision to include a potential component unit in the reporting entity was made by applying the provisions of Statement No. 14, *and GASB Statement No. 39, Determining Whether Certain Organizations are Component Units – Amendment of GASB Statement No. 14 (GASB No. 39)* to determine its financial reporting entity.

The Municipality's management has considered all potential component units (whether governmental, not-for-profit, or profit-oriented) for which it may be financially accountable, and other legally separate organizations for which the Municipality is not financially accountable but the nature and significance of their relationship with the Municipality may be such that exclusion of their basic financial statements from those of the Municipality would cause the accompanying basic financial statements to be misleading or incomplete.

"The Financial Reporting Entity" of the GASB. The basic, but not the only criterion for including a potential component unit within the reporting entity is if elected officials of a primary government appoints a voting majority of the entity's governing body, and if either one of the following conditions exists: the primary government can impose its will on the other entity or the potential exist for the other entity to (1) provide specific financial to or (2) impose specific financial burdens on the primary government. A second criterion used in evaluating potential component units is if the nature and significance of the relationship between the entity and a primary government are such that to exclude the entity from the financial reporting entity would render the financial statements misleading or incomplete. GAAP details two methods of presentation: 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 or discrete presentation of the component unit's financial data in columns separate from the Municipality's balances and transactions.

The reporting entity is composed of the primary government and its component unit, which is included to ensure the financial statements, is not misleading.

Discretely Presented Component Units

The following discretely presented component unit is in the basic financial statement because of the nature of the services they provide and the Municipality's ability to impose its will.

MUNICIPALITY OF PATILLAS, PUERTO RICO
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2012

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Municipality of Patillas Component Unit – Esmeralda Del Sur

Esmeralda Del Sur (the Project) is a housing development project consisting of land, and twelve one-story concrete building and other improvements owned by the Municipality of Patillas. The Project leases its 100 rental units to and/or low and moderate income individuals in the Patilla's area. Project Esmeralda Del Sur is located at "Calle los Colegios, Patillas, PR 00723".

The Project is governed by board of directors that are appointed by the Municipality's Legislative Assembly. The mayor of the Municipality is a permanent member of the board of directors.

The following is relevant information extracted from the financial statements of the Project.

Summary of significant accounting policies:

The following summarizes the major accounting policies judged by management to be the most appropriate in the circumstances to present fairly the Project's financial position, results of operations and cash flows in conformity with generally accepted accounting principles.

Federally subsidized rent income – The Project is under financing from Rural Housing Service (RHS) under Section 515 of the Housing Act of 1949. The properties are operated subject to Section 8 Housing Assistance Payments agreement with the U.S. Department of Housing and Urban Development (HUD), and a portion of the Project's rental income is received from HUD. The agreement was effective on April 1, 1979, with an initial term of five years and extended at the project's option for additional five years term and seven additional five years renewal option through the year 2019 to make housing assistance payments. HUD has agreed to pay the Project the difference between the contract rent, as defined in the agreement, and that portion of rent payable by qualified tenants. In addition, HUD has agreed to pay a portion of the contract rent to the project during certain vacancy periods.

Cash and Restricted Deposits

Under the term of the HAP contract the Project is required to set aside specified amounts for the replacements of property and other project expenditures approved by HUD. HUD restricted deposits, which approximate \$1,301,142 at June 30, 2012, are held in separate account and generally are not available for operating purpose.

The Project maintains a restricted cash accounts fir insurance escrow. In additions, all tenant security deposits are deposited into a separate bank account and held in trust for the tenants until they vacate the property. Any amounts not returned to the tenant due to lease violations are transferred to the Project's general operating accounts. Restricted funds are held in separate accounts and are not available for operating purpose.

MUNICIPALITY OF PATILLAS, PUERTO RICO
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2012

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continuation)

Mortgage Payable

Consists of a 9% (with an effective subsidy rate of 8%) mortgage note used for construction of the projects buildings, payable in monthly installments of \$16,757, including interest, until 2017, collateralized with land and building.

The principal maturities of the mortgage in each of the next five years are:

Year ending June 30	Principal	Interest
2013	\$ 142,686	\$ 58,394
2014	156,071	45,009
2015	170,711	30,368
2016	186,725	14,354
2017	222,110	970
	\$ 878,303	\$ 149,095

Pollution remediation obligation

Based on comprehensive Asbestos-Containing Material (ACM) survey engaged by the project's management agent, it was determined that the project's buildings contain asbestos materials. These materials need to be removed in accordance with Puerto Rico Environmental Quality Board (EQB) regulation with the use of proper engineering controls.

At June 30, 2012 the project has accrued its best estimates of its obligation regarding the removal of asbestos materials, which is presented under the pollution remediation obligation caption in the accompanying balance sheet. The estimated liability of \$48,500 was obtained from the project's comprehensive asbestos-containing materials (ACM) survey. It is reasonably possible that the recorded estimate of the obligation may change in the near term.

Management fees

During the year ended June 30, 2012 the management agent's compensation is based in an amount equal to twenty-nine dollars (\$29) per unit per month. The management agent is Housing Promoters, Inc.

Complete financial statements for the individual component unit may be obtained from their administrative office located at "Calle los Colegios, Patillas, PR 00723".

MUNICIPALITY OF PATILLAS, PUERTO RICO
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2012

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continuation)

c. Basic Financial Statements-GASB Statement No. 34

The basic financial statements include both government-wide and fund financial statements. While the previous model emphasized fund types (the total of all funds of a particular type), in the new reporting model the focus is on major individual funds (within the fund financial statements). Both the government-wide and fund financial statements categorize activities as governmental activities. In the government-wide Statement of Net Assets the governmental activities (a) are presented on a consolidated basis in one column, and (b) are reflected, on a full accrual, economic resource basis, which incorporates long-term assets and receivables as well as long-term debt and obligations.

The Government-wide Statement of Activities reflects both the gross and net cost per functional category. The Statement of Activities reduces gross expenses (including depreciation) by related operating grants and contributions. The operating grants include operating-specific grants.

This government-wide focus is more on the sustainability of **the Municipality** as an entity and the change in aggregate economic position resulting from the activities of the fiscal period.

The fund financial statements are, in substance, very similar to the financial statements presented in the previous model. Emphasis here is on the major funds in the governmental category. Non-major funds are aggregated into a single column.

The governmental funds financial statements are presented on a current financial resource measurement focus and modified accrual basis of accounting. This is the manner in which these funds are normally budgeted. This presentation is deemed most appropriate to (a) demonstrate legal and covenant compliance, (b) demonstrate the sources and use of liquid resources, and (c) demonstrate how **the Municipality** actual experience conforms to the budget or fiscal plan. Since the governmental fund statements are presented on a different measurement focus and basis of accounting than the government-wide statement, a reconciliation is presented on the fund statement, which briefly explains the adjustments necessary to transform the fund based financial statements into the governmental column of the government-wide presentation.

MUNICIPALITY OF PATILLAS, PUERTO RICO
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2012

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continuation)

d. Basis of Presentation

The new model as defined in Statement No. 34 establishes criteria (percentage of the assets, liabilities, revenues or expenditures/expenses of either fund category or the governmental and enterprise combined) for the determination of major funds. **The Municipality** reports the following major funds on **Fund Financial Statements**:

Major Funds

General Fund – Always a major fund. The general fund is the main operating fund of **the Municipality**. It is used to account for all financial resources except those required to be accounted for in another funds.

Bond Issue Fund – Bond Issue fund are used to account for the proceeds of specific revenue sources that are legally restricted to expenditures for specified.

Homeland Security Programs – Special revenue fund for revenue from the grant are used to account for the proceeds of specific revenue sources that are legally restricted to expenditures for specified.

HUD Programs Fund – This fund accounts for revenues sources for the development of viable urban communities, decent housing suitable living environment, rental assistance to help very low-income families afford decent, safe and sanitary housing by encouraging property owners to rehabilitate substandard housing and lease the units with rental subsidies to low income families.

Debt Service Fund – Debt service fund is used to account for the accumulation of resources for, and the payment of, general long-term debt principal and interest.

Head Start – Program Funds – The special revenue fund of Head Start is a major fund used by **the Municipality** to account for revenues derived from the grant that is legally restricted by outside parties for use on specific purpose. The uses and limitations of this revenue fund are specified by municipal ordinances of federal and state statutes.

However, resources restricted to expenditure for purposes normally financed from the general fund are reported in **the Municipality's** general fund provided that all applicable legal requirements are appropriately satisfied. In this case, a special revenue fund to account for such kind of transactions will be used only if legally mandated.

Other Funds (not major funds) – Special revenue funds are used to account for the proceeds of specific revenues sources that are legally restricted to expenditures for specified purposes. Capital projects fund is used to account for the financial resources for the acquisition of personal property and/or construction of major improvements, which are not financed by other funds.

MUNICIPALITY OF PATILLAS, PUERTO RICO
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2012

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continuation)

e. Basis of Accounting

The accounts of **the Municipality** are organized on the basis of funds, each of which is considered to be a separate accounting entity. **The Municipality** has created various types of funds. Each fund is accounted for by a separate set of self-balancing accounts, which include its assets, liabilities, fund balances, and revenues and expenditures/expenses, as applicable. The individual funds accounts for the governmental resources allocated to **the Municipality** for the purpose of carrying on specific activities in accordance with laws, regulations, or other restrictions.

Measurement Focus, Basis of Accounting

Government-wide Financial Statements – The government wide financial statements are reported using the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of when the related cash flows take place. Non-exchange transactions, in which **the Municipality** gives (or receives) value without directly receiving (or giving) equal value in exchange, include grants. Revenue from grants is recognized in the fiscal year in which all eligibility requirements have been satisfied.

Governmental Funds Financial Statement – Governmental funds are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Under this method, revenues are recognized when measurable and available. “Available” means collectible within the current period or 90 days after the end of the period to use them to pay liabilities of the current period. Miscellaneous revenues are recorded when collected. Revenues collected in advance of the fiscal year to which they apply are recorded as deferred revenues and recognized as revenues in the year to which they apply. Expenditures are generally recognized when the related fund liability is incurred. General capital asset acquisitions are reported as expenditures in governmental funds.

MUNICIPALITY OF PATILLAS, PUERTO RICO
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2012

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continuation)

Governmental Fund Types / Governmental Activities – Governmental funds are those through which most governmental functions of **the Municipality** are financed. The acquisition, use, and balances of **the Municipality's** expendable financial resources and the related liabilities are accounted for through governmental funds. The measurement focus is upon determination of changes in financial position, rather than upon net income determination.

Licenses and permits, charges for services, fines and forfeits and miscellaneous revenues (except investment earnings) are recorded as revenues when received. Investment earnings (interest) are recorded as earned since they are measurable and available.

The principal revenue sources considered susceptible to accrual include property taxes, municipal license taxes, intergovernmental grants and contributions, interest on deposits, and certain charges for services. These principal revenue sources meet both measurability and availability criteria in the accompanying FFFS, except for amounts recorded as deferred revenues.

All revenues, expenses, gains losses and assets resulting from non-exchange transactions are recorded in a similar manner to the GWFS, using the previously discussed criteria set forth by GASB No. 33 for non-exchange transactions, but subject to and limited by the availability criteria discussed above. Accordingly, property tax and municipal license tax receivables are also generally recorded in the fiscal year when an enforceable legal claim has arisen while property tax and municipal license tax revenues (net of amounts considered not collectible) are also generally recorded in the fiscal year when resources are required to be used for the first fiscal year that the use of the resources is permitted. Receivables and revenues from federal and state grants and contributions, donations and entitlements are also generally recorded when all eligibility requirements imposed by the provider have been met (generally, as qualifying reimbursable expenditures are incurred for expenditure-driven grants).

Interests on deposits are recorded when earned since these revenues are considered both measurable and available at June 30, 2012.

f. Encumbrances

Governmental funds employ encumbrances accounting. Under the encumbrance system, all purchase orders; contracts and other commitments for the expenditure of funds are recorded in order to reserve that portion of the applicable appropriation. Under generally accepted accounting principles, encumbrances outstanding at year-end are reported as reservations of fund balances and they constitute neither expenditures, nor liabilities. Encumbrances constitute the equivalent of expenditures for budgetary purposes only, and accordingly, are reported with expenditures in all budgetary basis statements.

MUNICIPALITY OF PATILLAS, PUERTO RICO
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2012

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continuation)

g. Budgetary Data

The Municipality follows the following procedures, which are in accordance with the municipal law; in establishing the budgetary date reflected in the basic financial statements.

- (1) On or prior to May 15, the Mayor submits to the Municipal Assembly a proposed budget for the fiscal year commencing the following July 1st. The proposed budget includes estimated expenditures and their financing sources.
- (2) The budget document is available for public inspection prior to its approval by the Municipal Assembly.
- (3) Prior to July 1st, the annual budget is legally enacted through passage of the annual appropriation ordinance.
- (4) Subsequent to the enactment of the annual appropriation ordinance, the Municipal Assembly has the authority to make necessary adjustments to the budget.

The budget is prepared following the modified accrual basis of accounting except for the encumbrances, as described below:

The actual results of operations, presented in the Statement of Revenues, Expenditures and Changes in Fund Balances-Budget and Actual-General Fund, are reflected in conformity with the budgetary accounting of the Municipality for a better comparison with the budget information.

Amendments to the budget, and budgetary transfers related to personal expenditures, require the approval of the Municipal Assembly. Non-capital encumbrances lapse at the end of the next fiscal year. During the fiscal year, the Municipality readjusted its original budget of the General Fund Balance by \$602,084.

Since the budgetary basis differs from generally accepted accounting principles (GAAP), actual amounts for the general fund and debt service fund in the accompanying Statement of Revenues and Expenditures-Budget and Actual are presented on the budgetary basis to enhance comparability. The principal differences are as follows:

- (1) Encumbrances are recorded as expenditures under the budgetary basis and as reservations of fund balance under the GAAP basis.
- (2) The property tax advances are presented as revenue in the budgetary basis and as other financing sources in the GAAP basis.
- (3) The Municipality receives certain revenues as contributions from governmental entities, legislative and private parties, which are not included therein nor are the related expenditures.
- (4) Certain debt issuance to acquire personal property is reflected in the general fund and is restricted for that purpose

MUNICIPALITY OF PATILLAS, PUERTO RICO
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2012

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continuation)

The Municipality has not legally adopted a budget for the Head Start special revenue and capital projects funds. Accordingly, it has not presented an annual comparison of budget and actual for these major funds.

Legal Compliance

Article 7.003, Law No. 81 of August 31, 1991, amended require that Mayor provide to Municipal Legislature an annual balanced budget indicating: 1) interest, amortization and retirement public debt, 2) statutory obligations, 3) judicial claims payments, 4) any amount to cover prior year's deficit, 5) contract commitments and operational expenditures. For annual interest and principal debt amortization, CRIM provides annual estimated resources that will be obtained of additional special property tax (municipal) collections. **The Municipality's** management shows budgetary financial statements in general and debt service funds in compliance with state law and which are based in annual activity. The legal level of budgetary control is at the individual department level for general fund (Mayor and Legislature funds) expenditures, and annual principal and interest due for debt service fund.

h. Deposits

Substantially all cash balances are commingled in a general checking account and several special purpose bank accounts, except for cash and investments restricted by law. Each fund records its equity interest in the pooled cash balance. The available cash balance in the general checking account beyond immediate needs is invested in interest-bearing deposits. Generally, cash is deposited in interest-bearing bank accounts. Investment earnings are credited to the respective fund.

i. Inventories

The general fund purchases office and printing supplies, gasoline, oil, medicines and other items. The cost of purchases is recorded as expenditures and the inventory is not recorded in the basis financial statements since amount is insignificant.

MUNICIPALITY OF PATILLAS, PUERTO RICO
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2012

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continuation)

j. Capital Assets

Fund Financial Statements

The capital assets acquired are recorded as expenditures at cost in the governmental funds.

Government Wide Financial Statement

Purchased capital assets are recorded at cost. Donated capital assets are recorded at their estimated fair value a time they are received by **the Municipality** and are capitalized in the Statement of net Assets. Major renewals and betterment are capitalized: replacement, maintenance and repairs, which do not improve or extend the life of the respective assets, are charged to operations.

Depreciation is provided over the estimated useful life of the respective assets on straight-line basis.

k. Vacation and Sick Leave and Other Compensated Absences

Municipal employees are granted 30 days of vacation and 18 days of sick leave annually. Vacation leave may be accumulated up to a maximum of 60 days and sick leave up to a maximum of 90 days. In the event of employee resignation, the employee is paid for accumulated vacation days up to the maximum allowed. 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 or more of service who are entitled to sick leave pay to the maximum allowed. The Municipality is required to pay excess sick leave over 90 days on or before March 31 of the accumulated excess at December 31, of prior year. Employees' maximum allowed accumulated vacation, with the employer's share of payroll taxes, is accounted in for the Statement of Net Asset.

l. Insurance

The Municipality has insurance coverage for its public facilities and equipment, primarily to provide protection in case of disaster and other losses. Also, principal officials of **the Municipality** are covered under various surety bonds. The Secretary of the Department of the Treasury of the Commonwealth of Puerto Rico is the designated agency to obtain the necessary insurance coverage for **the Municipality**.

MUNICIPALITY OF PATILLAS, PUERTO RICO
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2012

1. **SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continuation)**

m. **Restricted Assets**

Investments and Certificates

Certain proceeds of the Municipality revenue bonds as well as certain resources set aside for their repayment are classified as restricted assets on the balance sheet because their use is limited by applicable bond covenants. The "revenue bond" maintenance account is used to report those rental proceeds that are restricted for use in maintenance of the properties. The "revenue bond fund account" is used to segregate resources accumulated for debt service payments over the next twelve months. The "Debt Service Account" is used to report resources set aside to make up potential future deficiencies in the "revenue bond fund account".

Cash with fiscal agent

The cash with fiscal agent pertaining to the debt service represents property tax collections retained by the Government Development Bank for Puerto Rico and another financial institution restricted for the payment of **Municipality's** debt service (See Note 2) and unused proceeds from bonds and notes issued principally for the acquisition or construction of permanent improvements are accounted in the capital project fund. In debt service fund are unsecured and collateralized, as no collateral is required by governmental banks.

n. **Fund Balance**

During year ended June 30, 2012, **the Municipality** implemented GASB Statement No. 54, Fund Balance Reporting and Governmental Type Definitions ("GASB 54"). The objective of GASB 54 is to enhance the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied and by clarifying the existing governmental fund type definitions. GASB 54 establishes fund balance classifications that comprise a hierarchy based primarily on the extent to which a government is bound to observe constraints imposed upon the use of the resources reported in the governmental funds. The implementation of this statement had no impact on the total fund balances for **the Municipality's** governmental funds.

MUNICIPALITY OF PATILLAS, PUERTO RICO
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2012

The Municipality classifies governmental fund balances as follows:

- **Nonspendable**– includes amounts that inherently cannot be spent either because it is not in spendable form (i.e., prepaid, inventories, long-term portions of loans receivable, etc.) or because of legal or contractual requirements (i.e., principal of an endowment, etc.).
- **Restricted** – includes amounts that are constrained by specific purposes which are externally imposed by (a) other governments through laws and regulations, (b) grantors or contributions through agreements, (c) creditors through debt covenants or other contracts, or (d) imposed by law through constitutional provisions or enabling legislation.
- **Committed** – includes amounts that are constrained for specific purposes that are internally imposed by the government through formal actions made by **the Municipality's** legislative body, which is the highest level of decision making authority, before the end of the reporting period. Those committed amounts cannot be used for any other purpose unless the government removes or changes the specified use by taking the same type of action it employed to previously commit those mounts.
- **Assigned** – includes amounts that are intended to be used for specific purposes that are neither consider restricted nor committed; in addition, such assignments are made before the report issuance date.
- **Unassigned** – include amounts that do not qualify to be accounted for and reported in any of the other fund balance categories. This classification represents the amount of fund balance that has not been assigned to other funds and that has not been restricted, committed, or assigned to specific purposes within the General Fund. The General Fund should be the only fund that reports a positive unassigned fund balance amount. In other government funds, if expenditures incurred for specific purposes exceeded the amounts that are restricted, committed, or assigned to those purposes, it may be necessary to report a negative unassigned fund balance.

The Municipality generally uses restricted amounts first when both restricted and unrestricted (committed, assigned, and unassigned) fund balance is available unless there are legal documents, contracts, or agreements that prohibit doing such. Additionally, **the Municipality** generally would first use committed, then assigned, and lastly unassigned amounts of unrestricted fund balance when expenditures are made.

MUNICIPALITY OF PATILLAS, PUERTO RICO
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2012

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continuation)

0. Claims and Judgments

The estimated amount of the liability for claims and judgments, which is due on demand, such as from adjudicated or settled claims, is recorded in the general fund and in the Statement of Net Assets.

p. Use of Estimates

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

q. Totals Column (Memorandum Only) Governmental Funds Statement

The total data under this column is presented only to facilitate financial analysis. Data in these columns do not present financial position or results of operations in conformity with generally accepted accounting principles. Such data is not comparable to a consolidation, since Interfund eliminations have not been made.

MUNICIPALITY OF PATILLAS, PUERTO RICO
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2012

2. PROPERTY TAXES

The Municipal Revenue Collection Center (CRIM) of the Commonwealth of Puerto Rico is responsible for the assessment of all real and personal property located within the **Municipality of Patillas** and for the levy, administration and collection of the corresponding taxes.

The property tax is levied each year on the assessed value of the property at the beginning of the calendar year. Assessed values of real property are established at the estimated current value existing in the year 1957 and of personal property at the current value at the date of the assessment.

Real property taxes are billed by the CRIM and are due in two equal installments in July and January following the assessment date. Personal property taxes are self-assessed and are due in May 15, when the property tax return is required to be filed.

The tax rate per annum is 10.33% for real property and 8.33% for personal property of which 8.33% and 1.83%, respectively, belongs to the Commonwealth of Puerto Rico and 4.25% of both percents belong to **the Municipality**. From the portion belonging to **the Municipality**, 3% represents **the Municipality's** basic rate, which is appropriated for general purpose and, therefore, accounted for through the general fund. The remaining portion belonging to **the Municipality** of 1.25% represents the "ad-valorem" tax withheld by the CRIM as fiscal agent, and restricted for debt service, which is accounted for through the debt service fund (See note 2). **The Municipality** has reached the maximum statutory tax rate limit for the basic tax while there is no limitation for the ad-valorem tax rate.

The Municipality has reached the maximum statutory tax rate limit for the basic tax while there is no limitation for the ad-valorem tax rate.

Complete real property tax exoneration is granted by the Commonwealth of Puerto Rico on the first \$15,000 of the assessed valuation of owner occupied residential units. However, **the Municipality** receives the full amount levied, except for residential units assessed at less than \$3,500, on which a complete exemption is granted. Veterans have additional exemption from taxes of \$5,000 of the assessed value of real property. The Department of Treasury instead of the property taxpayer became the source of payment in these cases.

Complete exemption from personal taxes up to an assessment of \$50,000 is granted to retailers with an annual volume of net sales under \$150,000.

MUNICIPALITY OF PATILLAS, PUERTO RICO
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2012

2. PROPERTY TAXES (Continuation)

The CRIM reports annually to the Municipality the estimated basic property tax and the tax to be used for the debt service, which will be collected in the fiscal year. The basic tax is advanced to **the Municipality** during such fiscal year. It is the practice to amortize these advances through the subsequent collection by the CRIM of the basic tax from the taxpayers.

The basic property tax advances from the CRIM are recorded in the general fund as other financing sources. As this tax is collected and reported by the CRIM, it is recorded in the general fund as revenue. The property tax received from the Department of Treasury, which is related to the exoneration granted by the Commonwealth of Puerto Rico is reflected as revenue in the general fund.

Since the collection of property taxes from the taxpayers is under the administration of the CRIM, **the Municipality** recognized as an expenditure the operational expenses allocated by the CRIM to **the Municipality**, which amounted to \$44,143 during 2012.

The following is a summary of the property tax advances that resulted in an Accounts Receivable, to the year ended June 30, 2012. The resulting receivable is presented in the general fund for Fund Financial Statement and is presented as revenue in both Financial Statements.

Accounts Receivable:

Amortization through collections of property taxes by the CRIM	
07-01-11 - 06-30-12	\$ 5,661,271
Advance received, 07-01-11 - 06-30-12	(5,544,567)
Accounts Receivable - 2012	\$ 116,704

MUNICIPALITY OF PATILLAS, PUERTO RICO
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2012

3. DEPOSITS

The Municipality's cash and investments at June 30, 2012, were entirely covered by the Federal Depository Insurance Corporation by collateral provided by the banks and held by the Department of the Treasury pursuant to applicable laws and regulations. Cash with fiscal agent is maintained in interest-bearing accounts in the Government Development Bank for Puerto Rico and is collateralized by the Commonwealth of Puerto Rico.

Puerto Rico laws authorize governmental entities to invest in direct obligations or obligations guaranteed by the federal government or the Commonwealth of Puerto Rico. The Municipality is also allowed to invest in bank acceptances, other bank obligations and certificates of deposit in financial institutions authorized to do business under the federal and Commonwealth laws. During the year, the Municipality invested its funds in interest-bearing bank accounts, and short-term certificates of deposit if due date is not more than 90 days, the certificate considered as cash equivalents.

4. CONCENTRATION OF CREDIT RISK

The Municipality maintains its cash account in local commercial banks, whose accounts are insured by the Federal Deposit Insurance Corporation (FDIC) up to \$250,000. Deposits in excess of \$250,000 are collateralized by the bank securities to property safeguard such funds. Nevertheless, management believes that concentration of credit risk is limited because balances are deposited with high standing financial institutions.

As of June 30, 2012, the Municipality's custodial credit risk was approximately \$5.2 million, which is the bank balance of cash deposited at the Government Development Bank for Puerto Rico. These deposits are exempt from the collateral requirements established by the Commonwealth.

Custodial Credit Risk

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. In compliance with the laws and regulations of the Commonwealth of Puerto Rico, the Municipality has adopted, as its custodial credit risk policy, the *Statement of Uniform Investment Guidelines for the Municipalities of the Commonwealth of Puerto Rico, issued by the Government Development Bank for Puerto Rico*. Accordingly, the Municipality is only allowed to invest in obligations of the Commonwealth of Puerto Rico, obligations of the United States of America, certificates of deposit, commercial paper, bankers' acceptances or in pools of obligations of the Municipalities of Puerto Rico, which are managed by GDB. According to the aforementioned investment guidelines, the Municipality is not allowed to invest in marketable securities or any other type of investments (debt securities) for which credit risk exposure may be significant.

MUNICIPALITY OF PATILLAS, PUERTO RICO
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2012

Consequently, at June 30, 2012 and for the fiscal year then ended, the Municipality invested only in certificates of deposit in commercial banks, which are insured by the Federal Deposit Insurance Corporation (FDIC), generally up to a maximum of \$250,000 per depositor. 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.

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 and certificates of deposit in interest bearing accounts generating interest at prevailing market rates as required by the *Statement of Uniform Investment Guidelines for the Municipalities of the Commonwealth of Puerto Rico*, issued by the Government Development Bank for Puerto Rico (the adopted policy of the Municipality). At June 30, 2012, the interest rate risk associated with the Municipality's cash and cash equivalent is considered low since the investment portfolio of the Municipality consists of certificates of deposit and do not include debt securities or any type of investments that could be affected by changes in interest rates.

Custodial credit risk — In the case of deposits, this is the risk that in the event of a bank failure, the Municipality's deposits may not be recovered. Pursuant to the *Statement of Investment Guidelines for the Government of the Commonwealth of Puerto Rico*, the balances deposited in commercial banks by the Municipality are insured by the Federal Deposit Insurance Corporation (FDIC), generally up to a maximum of \$250,000 per depositor. In addition, public funds deposited in commercial banks by the Municipality are fully collateralized for the amounts deposited in excess of the federal depository insurance. All securities pledged as collateral are held in the Municipality's name by the agents of the Commonwealth's Secretary of Treasury. Deposits of GDB are uninsured and **uncollateralized**. However, no losses related to defaults by GDB on deposit transactions have been incurred by the Municipality through June 30, 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.

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.

MUNICIPALITY OF PATILLAS, PUERTO RICO
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2012

5. MUNICIPAL LICENSE TAXES

The volume of business tax 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 under the Industrial Incentives Acts of Puerto Rico. All taxpayers are required to file their declarations by April 15 of each year.

The tax rates are as follow:

1% for financial institutions
for all other organizations 0.5%

Taxes are payable in two equal semiannual installments on July 1 and January 1 following the levy date. If they are paid before their maturity, the taxpayer is granted certain discounts.

The deferred revenue of the general fund correspond to the business tax levied received from the next fiscal year.

The minimum gross revenue to file the Volume of Business Tax Declaration is \$5,000 and the maximum tax payable is \$25. The date to file the Volume of Business Tax Declaration is April 15. The Municipality grants a 5% discount, if the taxes are paid on or before April 15. Otherwise, 50% of taxes payable must be paid within the first 15 days of each semester beginning with the first semester ending December 31.

The **Municipality** recognized an account receivable for the estimated municipal license taxes to be collected during the first two months of next year, but corresponding to current year. Municipal license taxes collected prior to June 30, 2012 but pertaining to the next fiscal year is recorded as deferred revenues.

MUNICIPALITY OF PATILLAS, PUERTO RICO
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2012

6. INTERFUND TRANSACTIONS

Due From/To Other Funds (Fund Financial Statement)

Interfund receivables and payables generally reflect temporary loans, billings for services provided and recovery of expenditures. The balances are as follows:

Funds	Due From	Due To
General	\$ 159,430	\$ 2,388,412
HUD	-	26,871
Head Start	-	3,629
Homeland Security	150,000	26,175
Other funds	2,344,652	208,995
TOTAL	\$ 2,654,082	\$ 2,654,082

For the most part, the effect of interfund activity has been removed from the Statement of Net Assets (Government Wide Financial Statement).

7. INTERGOVERNMENTAL REVENUES

Sources of intergovernmental revenue consist primarily of governmental payments from the Commonwealth of Puerto Rico and in "lieu of tax" payments from certain "quasipublic" corporations, such as the Puerto Rico Electric Power Authority.

Grants and subsidies received from the Commonwealth of Puerto Rico include, among others, a general subsidy for capital improvements. Almost all these intergovernmental revenues are accounted for in the general fund.

8. DUE TO GOVERNMENTAL ENTITIES

As of June 30, 2012 balances due to governmental entities of the general fund consists of the following:

Governmental Entities	Current
Name	Due to
Puerto Rico Water and Sewer Authority	\$ 667,531
Puerto Rico Retirement System	69,878
Puerto Rico Department of Labor	40,235
General Administration Services	223,668
Medic Plan	19,436
Puerto Rico Association System	49,790
Internal Revenue Service	136,343
Puerto Rico Department of Treasury	685,836
TOTAL	\$ 1,892,717

MUNICIPALITY OF PATILLAS, PUERTO RICO
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2012

9. CAPITAL ASSETS

Include those changes pursuant to the implementation of GASB Statement No. 34, follows. Land and construction in progress are not subject to depreciation.

Capital assets activity for the year ended June 30, 2012 was as follows:

	Balance 6/30/2011	Additions	Retire- ments	Balance 6/30/2012
Governmental activities:				
Capital assets, not being depreciated:				
Land	\$ 192,199	\$ -	\$ -	192,199
Construction in Progress	14,793,921	3,505,681	-	18,299,602
Total capital assets not being depreciated	<u>14,986,120</u>	<u>3,505,681</u>	<u>-</u>	<u>18,491,801</u>
Capital assets, being depreciated				
Buildings and building improvements	10,736,950	-	-	10,736,950
Infrastructure	3,414,895	-	-	3,414,895
Equipment	2,206,344	9,719	-	2,216,063
Vehicles	2,957,306	-	-	2,957,306
Total capital assets being depreciated	<u>19,315,495</u>	<u>9,719</u>	<u>-</u>	<u>19,325,214</u>
Less: accumulated depreciation for:				
Buildings and building improvements	4,383,534	-	85,157	4,468,691
Infrastructure	142,358	-	53,739	196,097
Equipment	1,681,693	-	141,800	1,823,493
Vehicles	2,765,734	-	37,381	2,803,115
Total accumulated depreciation	<u>8,973,319</u>	<u>-</u>	<u>318,077</u>	<u>9,291,396</u>
Total capital assets being depreciated, net	<u>10,342,176</u>	<u>9,719</u>	<u>(318,077)</u>	<u>10,033,818</u>
Governmental activities capital assets, net	<u>\$ 25,328,296</u>	<u>\$ 3,515,400</u>	<u>\$ (318,077)</u>	<u>\$ 28,525,619</u>

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

Governmental activities:	
General government	\$ 46,728
Public works	265,805
Public safety	2,041
Culture and recreation	3,099
Health	404
Total depreciation expense governmental activities	\$ 318,077

MUNICIPALITY OF PATILLAS, PUERTO RICO
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2012

9. CAPITAL ASSETS (Continuation)

Government Wide Financial Statements

Capital assets purchased are carried at historical costs. Contributed assets are recorded at fair value as of the date donated. Additions, Improvements and other capital outlays that significantly extend the useful life of an asset are capitalized. Other costs incurred for repairs and maintenance is expensed as incurred. Depreciation on capital assets is calculated using the straight-line method over the following estimated useful lives:

Vehicles, Heavy Equipment	5-25	\$300
Furniture and Fixture	5-10	\$300
Computer and Electronic Equipment	5	\$300
Buildings	50	\$ 1
Infrastructure	60	\$ 1
Improvements	20-40	\$ 1

In addition, the Municipality assigned a 10% residual value on most Capital Assets.

Fund Financial Statements

The Municipality charged costs of capitalizable outlays as expenditures categories in the Governmental Fund Financial Statements.

10. CHANGES IN GENERAL LONG-TERM DEBT

General in General Long – Term Debt

The principal long-term obligation of the Municipality is obligation bonds issue to pay governmental debts and accounts payable. The Municipality's long-term debt retirements are appropriated and paid from resources accumulated in the debt service fund.

The following is a summary of bonds of the Municipality of Patillas for year ended June 30, 2012.

Description	Beginning Balance	Adjustments	Reductions	Ending Balance
General Obligations Bonds	\$13,619,060	\$520,076	\$870,076	\$13,269,000

MUNICIPALITY OF PATILLAS, PUERTO RICO
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2012

General Obligation Bonds:

Description	Balance 06-30-2012	Due within One Year
Bonds Series 2002 \$255,000 payable in annual installments of \$5,000 to \$20,000 until 2026; with interest ranging from 2.7% to 5.6%	\$ 200,000	\$ 10,000
Bonds Series 2002 \$2,740,000 payable in annual installments of \$70,000 to \$215,000 until 2026; with interest ranging from 2.7% to 5.6%	2,115,000	85,000
Bonds Series 2007 \$410,000 payable in annual installments of \$5,000 to \$10,000 until 2031; with interest ranging from 1.53% to 7.5%	380,000	10,000
Bonds Series 2007 \$100,000 payable in annual installments of \$5,000 to \$10,000 until 2021; with interest ranging from 1.53% to 7.5%	75,000	5,000
Bonds Series 2008 \$375,000 payable in annual installments of \$5,000 to \$30,000 until 2032; with interest of 1.53% to 7.5%	360,000	5,000
Bonds Series 1997 \$400,000 payable in annual installments of \$20,000 to \$40,000 until 2016; with interest ranging from 1.5%	155,000	25,000
Bonds Series 2005 \$259,000 payable in annual installments of \$35,000 to \$42,000 until 2013; with interest of 4.5% to 7.81%	42,000	42,000
SUB TOTAL	\$ 3,327,000	\$ 182,000

MUNICIPALITY OF PATILLAS, PUERTO RICO
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2012

10. CHANGES IN GENERAL LONG-TERM DEBT (Continuation)

Operational Bonds: (Continuation)

Description	Balance 06-30-2012	Due within One Year
Bonds Series 2006 \$975,000 payable in annual installments of \$115,000 to \$170,000 until 2013; with interest of 1.53% to 7.0%	\$ 330,000	\$ 160,000
Bonds Series 2007 \$484,000 payable in annual installments of \$5,000 to \$10,000 until 2031; with interest of 1.53% to 7.5%	357,000	41,000
Bonds Series 2009 \$705,000 payable in annual installments of \$80,000 to \$425,000 until 2016; with interest of 4.75% to 7.5%	540,000	95,000
Bonds Series 2009 \$895,000 payable in annual installments of \$100,000 to \$160,000 until 2016; with interest of 4.75% to 7.5%	685,000	120,000
SUB TOTAL	1,912,000	416,000

General Obligation Bonds:

Description	Balance 06-30-2012	Due within One Year
Bonds Series 2011 \$3,460,000 payable in annual installments of \$55,000 increase to \$5,000 each year until 2035; with interest of 6% to 7%	\$ 3,405,000	\$ 60,000
Bonds Series 2008 \$4,850,000 payable in annual installments of \$70,000 to \$4,340,000 until 2015; with interest of 1.53 to 5.4%	4,625,000	90,000
SUB TOTAL	8,030,000	150,000
TOTAL	\$ 13,269,000	\$ 748,000

MUNICIPALITY OF PATILLAS, PUERTO RICO
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2012

10. CHANGES IN GENERAL LONG-TERM DEBT (Continuation)

The annual debt requirements for the bonded debt outstanding as June 30, 2012 are as follows:

Year Ending	Principal	Interest	Total
2013	\$ 748,000	\$ 837,211	\$ 1,585,211
2014	754,000	786,451	1,540,451
2015	617,000	742,792	1,359,792
2016	651,000	658,268	1,309,268
2017	709,000	637,312	1,346,312
Subsequent years	9,790,000	5,937,675	15,727,675
TOTAL	\$ 13,269,000	\$ 9,599,709	\$ 22,868,709

The Municipality is required to limit the amount of general obligation debt to 10% of the total assessment of property located within the **Municipality**, for bonds to be repaid with the proceeds of property tax restricted for debt services. Other obligations include compensated absences; LIMS refinance debt, claims and judgments.

➤ **DEBT SERVICE FUND**

The revenues of the debt service fund arise from the additional property tax and are recognized when collected and informed by the CRIM (See Note 2). The CRIM retains these collections for the payment of principal and interest of bonds and notes issued by the Municipality. Interest income is for the payment of interest or special obligations notes and property taxes are for the debt service requirements of the general obligations bonds and notes.

Principal and interest on these obligations are paid by the Government Development Bank for Puerto Rico from funds obtained from the Following:

Property taxes	\$ 452,014
General funds	545,322
Municipal sales tax	637,507
TOTAL	\$ 1,634,843

Expenditures for the year 2011-2012 were as follows:

Principal	\$ 870,076
Interest	439,290
TOTAL	\$ 1,309,366

MUNICIPALITY OF PATILLAS, PUERTO RICO
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2012

12. RETIREMENT PLAN

Plan Description

Regular employees of the Municipality contribute to a cost sharing multiple-employer defined benefit retirement plan, administered by the Employee' Retirement System of the Government of Puerto Rico and its instrumentalities (ERS). ERS covers all regular full time public employees working for the central government, public corporations and the municipalities of Puerto Rico. The system provides retirements pensions, death and disability benefits. Retirement benefits depend upon age at retirement and number of years of credited service. Disability retirement benefits are available to members for occupational and non-occupational disabilities. Benefits vest after ten years of plan participation. The system was created under Act 447, approved on May 15, 1951, "Retirement Pensions, Disability and Death Benefits", as amended, and became effective on January 1, 1952. ERS issues a publicly financial report that includes financial statements and required supplementary information of the Plan, which may be obtained from the ERS at GPO Box 42005, San Juan Puerto Rico 00940.

The annual retirement benefits for those regular full-time employees hired on or before March 31, 1990 or those attaining permanent status before that date (Old Plan) and for those hired or attaining permanent status on or after April 1, 1990 (New Plan) are as follows:

OLD PLAN (LAW 447)

Eligibility

Pension Benefits

Age 55 and 30 years
Of service

75% of average highest compensation
during any years of credited service

Under 55 and 30 years
Of service

65% of average highest compensation
during any 3 years of credit service

Participants in the System who retire prior to 30 years of credited service are entitled to an annual retirement benefit equal to 1.5% of the highest compensation in any 3 years of credited service for each year of service up to 20 years, and 2% for each year in excess of 20 years.

No benefit is payable if the participant receives a refund of his accumulated contributions.

Additional information of ERS is provided in its financial statements for the year ended June 30, 2012 a copy of which can be obtained from the ERS, Minillas Station, PO Box 42003, San Juan, PR 00940.

MUNICIPALITY OF PATILLAS, PUERTO RICO
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2012

12. RETIREMENT PLAN (Continuation)

NEW PLAN (REFORMA 2000)

Eligibility

Age 65 with 10 years
of service

Pension Benefits

1.5% of average compensation during
the final 5 years of credited services
multiplied by the numbers of years
credited service

For both plans, the employees are vested when attaining ten years of plan participation. Disability and death benefits are available with certain limitations and all annuities in pay status will be increased every three years by 3% subject to the approval by the Legislature of Puerto Rico.

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

Funding Policy

The Act 447, as amended, is the authority under which obligations to contribute to the Plan by the Plan members, employer and other contributing entities are established or may be amended. The required contributions made by **the Municipality** were based on percentages established by the Administrator of the System. Such percentages were not based on actuarial studies as required by generally accepted accounting principles. An actuarial computation of the annual contribution applicable to **the Municipality** has not been prepared. Accordingly, the amounts by which the actual contributions differ from the required actuarial contributions are not known.

MUNICIPALITY OF PATILLAS, PUERTO RICO
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2012

12. RETIREMENT PLAN (Continuation)

Contribution Requirements

The Municipality's total payroll for the fiscal year 2012 amounted to approximately \$6,497,641. Common wealth legislation requires employees to contribute 5.775% of gross salaries up to \$6,600 plus 8.275% of the gross salary in excess of \$6,600. Municipality is required to contribute 9.275% of gross salary annually during year 2012. Municipality is required and actual contribution under Act 447 and Reform 2000 were \$88,065 and \$180,756 respectively.

Actuarial Valuation

As of June 30, 2011, the ERS has an unfunded accrual liability of approximately \$17.1 billion, representing a 9.7% funding ratio. This information is not available by each participating government agency or municipalities.

Net assets of the system consist principally of investments in stocks and bonds and loans to participants. The projected unit credit actuarial cost method was used for the actuarial calculation. Significant assumptions were as follows:

a) Interest rate	6.4 % a year
b) Salary increases	3.0% year
c) Pre-retirement Mortality	For General Employees and Mayors, RP-2000 Employee Mortality Rates for males and females projected on a generational basis using Scale AA. For members covered under Act 127, RP-2000 Employee Mortality Rates with blue collar adjustments for males and females, projected on a generational basis using Scale AA.
Post-retirement Health Mortality	Gender-specific mortality rates were developed based on a study of plan's experience from 2003 to 2007. Sample rates shown below are as of 2005 and are thereafter projected on a generational basis using Scale AA.
Post-retirement Disabled Mortality	RP 2000 Disabled Annuitant Mortality Rates, without projection.

MUNICIPALITY OF PATILLAS, PUERTO RICO
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2012

12. RETIREMENT PLAN (Continuation)

Actuarial Valuation (Continued)

d) Termination

Withdrawal rates vary by employee category.

e) Disability

Rates are based on the six month elimination period rates in the 1987 Commissioners Group Disability Table, adjusted as set forth in the table below. Rates of disability cease to apply once a member is eligible for the 75% of the Highest Salary maximum benefit.

Adjustment to 1987 CGDT		
Act	Members Covered under Act 127	Other Members
447	100%	75%
1	100%	75%
2000	100% if more than 10 years from retirement eligibility. 300% if at or past retirement eligibility. Interpolated from 100% to 300% in the 10 years leading up to retirement eligibility.	75%

100% of disabilities occurring while in active service are assumed to be occupational for members covered under Act 127. For other members, 90% of disabilities occurring while in active service are assumed to be occupational and 10% are assumed to be non-occupational.

MUNICIPALITY OF PATILLAS, PUERTO RICO
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2012

12. RETIREMENT PLAN (Continuation)

Actuarial Valuation (Continued)

f) Retirement

Rates of retirement vary by employment category, Act, and by age and years of Creditable Service.

Act 447 General Employees (Includes General Hazardous Employees)			
Age	Service Condition		
	10 years	25 years	30 years
45 to 49			10.0%
50 to 53			15.0
54			20.0
55 to 57		10.0%	20.0
58	5.0%	10.0	20.0
59 to 64	10.0	15.0	20.0
65 to 69	15.0	15.0	20.0
70	100.0	100.0	100.0

System 2000 General Employees		
Age	Non-hazardous	Hazardous
60 to 66	15.0%	12.0%
67	100.0	100.0

Act 447 Police & Fire			
Age	Service Condition		
	10 years	25 years	30 years
45 to 48			10.0%
49			15.0
50		7.0%	15.0
51 to 56		15.0	20.0
57		20.0	30.0
58	2.5%	20.0	100.0
59 to 64	10.0	25.0	
65 to 69	10.0	30.0	
70	100.0	100.0	

MUNICIPALITY OF PATILLAS, PUERTO RICO
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2012

12. RETIREMENT PLAN (Continuation)

Actuarial Valuation (Continued)

System 2000 Police & Fire			
Age	Service Condition		
	10 years	25 years	30 years
45 to 48			9.0%
49			13.5
50		6.3%	13.5
51 to 56		13.5	18.0
57		18.0	27.0
58	2.25%	18.0	27.0
59 to 64	9.0	22.5	27.0
65 to 69	9.0	27.0	31.5
70	100.0	100.0	100.0

- g) Proportion of participants with spouses 50% of participants assumed to be married at retirement, with females assumed to be four years younger than males.
- h) Number of employees electing high contributions 15% of retiring employees assumed to pay retroactive contributions at retirement.
- i) Cost-of-living adjustments 3% every third year

Accordingly, the pension expense for fiscal year 2012 was approximately \$268,821 that represented 100% of the contributions required by funding policies of the Plan.

13. LONG TERM LIABILITIES

Compensated Absences

The liability for compensated absences was recorded in the Government-wide financial statements. The balance consists of unpaid, accumulated annual and sick leave balances. The liability has been calculated using the vesting method, in which sick leave amounts for both employees who currently are eligible to receive termination payments and other employees who are expected to become eligible in the future to receive such payments upon termination are included.

The changes in Compensated absences for the year ended June 30, 2012 are as follows:

Governmental activity	June 30, 2011	Net decrease	June 30, 2012	Due within One year
Compensated Absences	\$ 733,091	(\$86,246)	\$646,845	\$46,515

MUNICIPALITY OF PATILLAS, PUERTO RICO
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2012

14. LEASES

Operating Leases

The Municipality has several short-term operating lease agreements covering some of **the Municipality's** premises and equipment. Most of the agreements are renewed annually. Total rental expenditures for the year ended June 30, 2012, were approximately \$114,465 included in all funds.

15. CLAIMS AND CONTINGENCIES

Contingencies

As pr Act No. 72 of September 7, 1993, Act of the Health Insurance of PR Administration", (HIA) should negotiate with the municipalities a contribution from the operational budget for the medical services covered by the Health Care Reform.

On July 1, 1997, there was an amendment to Act No. 72 in which it was established that the balance due to HIA from October 1994 to June 30, 1997 would be earned on the additional lottery games. During the year the Municipality pay to Health Insurance of PR Administration \$255,102.

Federal Programs

The Municipality participates in a number of federal financial assistance programs. Although the Municipality's grant programs have been audited in accordance with the provisions of the Single Audit Act of 1984, as amended, these programs are still subject to financial and compliance audits and resolution of previously identified questioned costs. These grants are also subject to audit on behalf of the grantors to assure compliance with grant provisions. If expenditures are disallowed due to noncompliance with grant program requirements, **the Municipality** may be required to reimburse the grantor agency. Accordingly, the Administrations compliance with applicable grant requirements will be established at some future date. Nevertheless, **the Municipality's** management expects the amount of expenditures, which may be disallowed by the granting agencies from such audits, to be immaterial.

Comptroller's Office Audits

The Municipality of Patillas, Puerto Rico, has been audited by the Comptroller's Office of the Commonwealth of Puerto Rico. The Comptroller's Office has issued a final report related to the financial operations of the Municipality for a period before the single audit. These audit reports do not cover any findings subsequently disclosed to Municipality operations by the Comptroller's Office.

MUNICIPALITY OF PATILLAS, PUERTO RICO
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2012

16. MUNICIPAL SALES TAX

Pursuant to the provisions of the Law number 80 of July 29, 2007 and effective August 1, 2007, the citizenship contribution was uniformly established in 1.5% of which 1% will be collected by the Municipalities and the remaining .5% will be collected by the Treasury Department of the Commonwealth of Puerto Rico. Also, this Law uniformed the use of the contribution of 1.5% in the following activities: solid waste disposal costs, recycle, public works and improvements, health services and security services.

The Municipalities of Puerto Rico are responsible to collect 1% of the corresponding tax with the same exemptions and limitations that the portion collected by Treasury Department. The Act provides and optional surtax on the un-processed food. This surtax must be approved by the Municipal Legislature. The Treasury Department is responsible to create the Municipal Development Fund (.02%), the Municipal Redemption Fund (.02%) and the Municipal Improvements Fund (.01%0 with the remaining 0.5%. The Municipality collected \$281,307 during the year ended June 30, 2012.

17. CONTINGENCIES, LIABILITIES FOR CLAIMS AND JUDGMENTS AND OTHER

Contingencies and claims and judgments against the Municipality

The **Municipality** is a defendant in a number of lawsuits arising principally from claims against the **Municipality** for alleged improper actions. It is management's opinion, based on the advice of the legal counsel, that the probable claims against the **Municipality** are covered by insurance at June 30, 2012; the financial condition of the **Municipality** is not adjusted.

MUNICIPALITY OF PATILLAS, PUERTO RICO
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2012

19. RESTATEMENT OF 2012 FINANCIAL STATEMENTS

During the fiscal year ended June 30, 2012 **the Municipality** notes that certain liabilities had been overstated or understated as well as other differences related with adjustments to capital assets and reclassification of certain fund balances. As a result the net assets at June 30, 2012, as previously reported, had been decreased by \$(136,751) and the general fund balance of various funds at June 30, 2012, as previously reported, had been increased by \$834,975 in the debt service fund.

	General fund	Bond issue fund	Homeland Security	Debt Service	Other Funds
Beginning balance at					
June 30, 2011	\$ (3,203,564)	\$ 3,581,912	\$ 130,561	\$ 837,596	\$ 1,397,180
Accounts payable prior year	(136,751)	(834,251)	150,000	235,444	670,964
Beginning balance, as					
restated June 30, 2011	\$ (3,340,315)	\$ 2,747,661	\$ 280,561	\$ 1,073,040	\$ 2,068,144

20. SUBSEQUENT EVENTS

During July 2012 the Municipality pays operational debts for the amounts of \$3,145,000. In October 2012 received \$1,700,000 from a court demand used to pay operational debts.

JUAN A. FELICIANO CHARNECO
Certified Public Accountant

151 Calle Miguel Salas
Arecibo, PR 00612

Tel: (787) 879-4433
Fax: (787) 880-1402

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

To the Mayor and Municipal Council of
The Municipality of Patillas
Patillas, Puerto Rico

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of Municipality of Patillas, Puerto Rico, (the "Municipality") as of and for the year ended June 30, 2012 and has issued my report thereon dated March 15, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

Management of Municipality of Patillas 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 my auditing procedures for the purpose of expressing my opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Municipality of Patillas 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 a 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 the 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 that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above. However, we identified certain deficiencies in internal control over financial reporting, described in the accompanying Schedule of Findings and Questioned Cost that we consider to be significant deficiency is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Municipality's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of non compliance or other matters that are required to be reported under Government Auditing Standards, and which are described in the accompanying Schedule of Findings and Questioned Costs as items 12A and 12B.

We noted certain matters that I reported to management of Municipality of Patillas, Puerto Rico in a separate letter dated March 15, 2013.

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

This report is intended solely for the information of the management, Municipal Council 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.

Arecibo, Puerto Rico
March 15, 2013

The stamp number 2661164
was affixed to the
original of this report



Juan A. Feliciano Charneco
CPA JUAN A. FELICIANO CHARNECO
License No. 1263
Expires December 1, 2013

JUAN A. FELICIANO CHARNECO
Certified Public Accountant

151 Calle Miguel Salas
Arecibo, PR 00612

Tel: (787) 879-4433
Fax: (787) 880-1402

**REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO
EACH MAJOR PROGRAM AND INTERNAL CONTROL OVER COMPLIANCE
IN ACCORDANCE WITH OMB-CIRCULAR A-133**

Independent Auditor's Report

To the Mayor and Municipal Council of
the Municipality of Patillas
Patillas, Puerto Rico

Compliance

We have audited the compliance of the Municipality of Patillas, Puerto Rico, (the "Municipality") with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that could have a direct and material effect on to each of its major federal programs for the year ended June 30, 2012. The Municipality major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the "Municipality" management. Our responsibility is to express an opinion on of Municipality compliance based on my audit.

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

In our opinion, the Municipality of Patillas complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2012. However, the results of our auditing procedures disclosed instances of noncompliance with OMB Circular A-133 and which is described in the accompanying schedule of findings and questioned cost as item 2012-02.

Internal Control over Compliance

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

A deficiency in an entity's 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 and would not necessarily identify all deficiencies in the entity's internal control that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

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

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

Arecibo, Puerto Rico
March 15, 2013

The stamp number 2661165
was affixed to the
original of this report



Juan A. Feliciano Charneco
CPA JUAN A. FELICIANO CHARNECO
License No. 1263
Expires December 1, 2013

MUNICIPALITY OF PATILLAS, PUERTO RICO
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2012

Federal Grantor / Pass-through Grantor Program Title	Federal CFDA Number	Pass-through Grantors Number	Federal Expenditures
<u>U.S. Department of Housing and Urban Development</u>			
<u>Direct Program:</u>			
Department of Housing and Urban Development Public and Indian Housing Section 8 - Housing Choice Voucher	14.871	RQ46-EO-57-001/002	\$ 270,422
<u>Direct Program:</u>			
ARRA - Homeless Prevention & Rapid Re-housing Program	14.257	N/A	143,124
Passed-through Commonwealth of Puerto Rico Commissioners Office of Municipal Affairs Community Planning and Development Community Development Block Grant (State Program)	14.228	2010	865,217
<u>Total U.S. Department of Housing and Urban Development</u>			<u>1,278,763</u>
<u>U.S. Department of Health and Human Services:</u>			
<u>Direct Program:</u>			
Head Start	93.600	02CH9911/05	839,014
Passed-through Commonwealth of Puerto Rico Governors Office for the Care and Integral Development of Children: Department of the Families of Puerto Rico Child Care Mandatory Matching Fund of the Child Care and Development Fund	93.596	G0703PRCCDF	41,701
<u>Total U.S. Department of Health and Human Services</u>			<u>880,715</u>

See notes to the schedule of expenditures of federal awards.

MUNICIPALITY OF PATILLAS, PUERTO RICO
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2012

Federal Grantor / Pass-through Grantor Program Title	Federal CFDA Number	Pass-through Grantors Number	Federal Expenditures
<u>U.S. Department of Agriculture</u>			
Passed-through Commonwealth of Puerto Rico Governors Office			
Department of Education of Puerto Rico			
Child and Adult Care Food Program	10.558	PI-HS-06-02(CCC-198)	442,295
<u>Total U.S. Department of Agriculture</u>			442,295
<u>U.S. Department of Homeland Security</u>			
Public Assistance Grant			
Passed-through Commonwealth of Puerto Rico Governors Office			
Authorized Representative to FEMA (GAR)			
Disaster Grant Public Assistance	97.036	N/A	761,549
<u>Total U.S. Department of Homeland Security</u>			761,549
<u>U.S Department of Energy</u>			
Passed-through Commonwealth of Puerto Rico Governors Offices			
Energy Affairs Administration			
ARRA- Energy Efficiency and Conservation Block Grant Program	81.128	N/A	130,578
Total U.S Department of Energy			130,578
TOTAL FEDERAL ASSISTANCE			\$ 3,493,900

See notes to the schedule of expenditures of federal awards.

MUNICIPALITY OF PATILLAS, PUERTO RICO
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL FINANCIAL AWARDS
FOR THE FISCAL YEAR THEN ENDED JUNE 30, 2012

(1) GENERAL

The accompanying schedule of expenditures of federal awards includes the federal grant activity of Municipality of Patillas, Puerto Rico and is presented on the modified accrual basis of accounting. The reporting entity is defined in Note 1 to the financial statements of the Municipality. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations.

(2) MAJOR FEDERAL AWARDS

The Community Development Block Grants, Housing Assistance Payments Programs, Health and Human Services Programs, Homeland Security Programs and **American Recovery and Reinvestment Act Program** represent the major federal financial awards of the Municipality. Major federal awards represent 94% of total expenditures.

(3) FEDERAL CFDA NUMBER

The CFDA numbers included in this schedule were determined based on the program name review of grant contract information and the office of management and budget catalog of Federal Domestic Assistance.

(4) RELATIONSHIP TO GENERAL PURPOSE FINANCIAL STATEMENTS

Federal financial assistance expenditures are reported in the Municipality of Patillas, Puerto Rico Combined Statement of Revenues, Expenditures and Change in Fund Balances All Governmental and Types as follow:

Description	Hud Programs	Head Start Programs	Homeland Security Programs	Other funds	Total
Federal Programs Expenditures	\$ 1,278,763	\$ 880,715	\$ 761,549	\$ 572,873	\$ 3,493,900
State & Municipal Expenditures	-	-	-	2,246,345	2,246,345
TOTAL	\$ 1,278,763	\$ 880,715	\$ 761,549	\$ 2,819,218	\$ 5,740,245

**MUNICIPALITY OF PATILLAS
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2012**

SECTION I – SUMMARY OF AUDITOR’S RESULTS

Part I - Financial Statements

1. Type of auditor’s report issued: Unqualified
2. Internal control over financial reporting:
- Material weakness (es) identified? _____ Yes X No
- Significant deficiency (s) identified not considered
to be material weaknesses? _____ Yes X No
None reported
3. Noncompliance material to financial statements noted? _____ Yes X No

Part II - Federal Awards

1. Internal control over major programs:
- Material weakness (es) identified? _____ Yes X No
- Significant deficiency (s) identified not
Considered being material weaknesses? _____ Yes X No
2. Type of auditor’s report issued on compliance
for major programs Unqualified
3. Any audit findings disclosed that are required to be
Reported in accordance with Circular A-133,
Section .510(a) are reported X Yes _____ No

**MUNICIPALITY OF PATILLAS
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2012**

Identification of Major Programs

CFDA Number(s)	Name of Federal Program or Cluster
14.228	Community Development Grant (State Program)
14.871	Section 8 Housing Choice Voucher
93.600	Head Start
97.036	Disaster Grant - Public Assistance
14.257	ARRA - Homeless Prevention & Rapid Re-housing Program
81.128	ARRA - Energy Efficiency and Conservation Block Grant Program
10.558	Child and Adult Care Food Program

Dollar threshold used to distinguish
Between type A and type B Programs

\$300,000

Auditee qualified as low-risk audit

 X Yes No

B – Financial Statements Findings

No matters were reported regarding reportable conditions, material weaknesses, and instances of non-compliance related to the financial statements that are required to be reported in accordance with paragraph 5.18 through 5.20 of Governmental Auditing Standards.

C – Federal Award Findings and Questioned Cost

Federal Program Information

**MUNICIPALITY OF PATILLAS
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2012
(continued)**

**Program: Accounting and Finance Department
General Fund
Year ended June 30, 2012**

Ref. No.	Finding / Noncompliance	Questioned Cost
2012-01	<p><u>Statement of Condition and Criteria</u> The Municipality is operating by a decrease in revenues during the year accordingly by the criteria established by the Standards of Financial Management Systems for Regulations for Municipal Administration; and with GASB codifications 1700, with requirements stated in OMB Circular A-133.</p> <p><u>Cause</u> The Municipality has significant deficiencies in its accounting and financial management systems and financial reporting practices caused by the government operations as related to budgets for the General Fund.</p> <p><u>Effect</u> The lack of budget may affect the Municipality results: a) To provide services to citizens without affecting them. b) To determine compliance with finance the related legal and contractual provisions.</p> <p><u>Auditors Recommendation</u> The Municipality should revise and evaluate in a monthly basis revenues and disbursements to adjust disbursements to the revenues receipt to comply with Budget requirements of Municipal Law number 81 of August 30, 1991 as amended. Evaluate the impact in the revenues of the change in construction tax and the increase of the real and personal taxes.</p> <p><u>Municipality Response</u> The Municipality will evaluate the actual administrative procedures being followed. The Municipality management took serious measures to minimize the impact of this condition and expect to correct in the near future. Revenues budget were reduced by the Puerto Rico economic conditions, in addition several disaster events affected directly the Municipality, but we have continued providing the services needed by the citizens using the operational funds. We expected to obtain an operational loan to reduce the deficit situation.</p>	-0-

**MUNICIPALITY OF PATILLAS
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2012
(continued)**

**Department of Homeland Security
CFDA No. 97.036
Grant No. Disaster Grant Public Assistance
Year ended June 30, 2012**

Ref. No.	Finding / Noncompliance	Questioned Cost
-----	-----	-----
2012-02	<p><u>Statement of Condition and Criteria</u> It was noted in my test of compliance that the Municipality's financial management system did comply with the cash management requirements established by the United States Treasury. According to these requirements the Municipality had to establish procedures to minimize the time elapsing between the transfer of funds from the Governor's Office Authorized Representative to FEMA (GAR) and the disbursements by the Municipality. It was noted during my audit that Municipality held cash balances over \$5,000 for periods longer than 3 days.</p> <p><u>Cause</u> The Municipality did not comply with the Cash Management Requirements of the Department of Treasury of the United States as per Title 44 of CFR, part 13.20 (cc) (7).</p> <p><u>Effect</u> The Municipality did not maintain adequate procedures for the Administration of cash.</p> <p><u>Auditor's Recommendation</u> The Municipality should establish adequate procedures in order to control in a more effective manner the need and use of the federal funds and establish internal procedures to minimize the time elapsed to disburse the funds receive.</p> <p><u>Municipality Response:</u> The Municipality recognizes the importance of minimizing the time to disburse funds transferred from FEMA, but the FEMA funds are approved and received in accordance from the authorized representative, are disburse in the time required.</p>	-0-

MUNICIPALITY OF PATILLAS
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2012
(continued)

FINDINGS FINANCIAL STATEMENTS AUDIT

a. Finding 12-A

The Municipality realized transfer from the Joint Resolution of the Puerto Rico Legislature account to the payroll during 2011-12 amounting to \$1,455,666 million. In addition, the Municipality made disbursements from payroll account in order to reimburse the funds used from the other governmental fund. Those transactions were not recorded on accounting books and debt balance cannot be clearly determine, (included only in report 4-a).

Criteria

The Article 8 of the Resource Allocation for the Realization of Permanent Works, Acquisition of Equipment. Purchase of material and other social interest activities Act (Law 179 of August 16, 2002) requires municipalities to utilize funds from state grants only for the intended purpose established by the Joint Resolution of the Puerto Rico Legislature and may not expend these in any activity not specifically and categorically addressed in the legislative grant. The use of funds from state grants in activities other than those mentioned in the Joint Resolution requires the prior approval of the Puerto Rico Legislature.

Cause

The bank transfers were authorized by the Finance Director. These transfers were made to compensate cash deficiency the Municipality was facing to pay current operating obligations. The Finance Director performed these transfers in violation of state law.

Recommendation

The Municipality should avoid this practice in order to comply with the laws.

MUNICIPALITY OF PATILLAS
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2012
(continued)

FINDINGS FINANCIAL STATEMENTS AUDIT

b. Finding 12-B

Analytical review procedures performed as a part of the audit revealed that the budget compared to actual; indicates that the Municipality overstates budgeted revenues. This has the effect in the budget process that causes also an inflated level of expenditures. Because the higher revenues are not realized and expenditures are not adjusted, an operating deficit results.

We strongly recommend take the following steps to realistically budget for its operations:

- Management should immediately undertake a thorough review and comparison of the budget to current actual fiscal year revenues and expenses.
- Total expense budgeted should then be based on the total estimated revenue less a certain margin to add to fund balances at year-end or at minimum to break even for the year.
- The year budgeted revenue should be based on actual amounts earned in year through year, which result in the development of a more conservative and realistic budget.
- Any new or additional revenues sources being developed should be budgeted only when they are realized.
- Development and practice of a formal process of comparing the periodic budget to actual revenues and expenses by the management, with timely revisions as needed, should be commence.

MUNICIPALITY OF PATILLAS
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2012
(continued)

Criteria

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

Cause

The Municipality did not follow adequate budgeting procedures for establishing reasonable estimates.

Recommendation

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

**MUNICIPALITY OF PATILLAS
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
FOR THE YEAR ENDED JUNE 30, 2012**

2011 – Finding No.1: U.S. Department of Housing and Urban Development
Public and Indian Housing
Section 8 – Voucher
CFDA No. 14.871
Year ended June 30, 2012
Finding was corrected

2011 – Finding No. 2: U.S. Department of Housing and Urban Development
Public and Indian Housing
Home Land Security
CFDA No. 97.036
Year ended June 30, 2012
Finding reported again