

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

**MUNICIPIO DE PEÑUELAS
AUDITORÍA 2013-2014
30 DE JUNIO DE 2014**

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

SINGLE AUDIT REPORT

For the Fiscal Year Ended June 30, 2014
(With Independent Auditors' Report Thereon)

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

**Basic Financial Statements and
Supplemental Schedule
Single Audit Report
June 30, 2014**

**MUNICIPALITY OF PEÑUELAS
COMMONWEALTH OF PUERTO RICO**

**SINGLE AUDIT REPORT
FISCAL YEAR ENDED JUNE 30, 2014**

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PEDRO C. ORTIZ LEDEE
CERTIFIED PUBLIC ACCOUNTANT

INDEPENDENT AUDITOR'S REPORT

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

Report on the Financial Statements

I have audited the accompanying financial statements of each major fund, and the aggregate remaining fund information of the Municipality of **Peñuelas**, Puerto Rico (Municipality), as of and for the fiscal year ended June 30, 2014, and the related notes to the financial statements. I was engaged to audit the financial statements of the governmental activities. These financial statements collectively comprise the Municipality's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

My responsibility is to express opinions on these financial statements based on my audit. I conducted my audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that I plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement. Because of the matter described in the "Basis for Disclaimer of Opinion on Governmental Activities" paragraph, however, I was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the governmental activities.

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

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinions.

INDEPENDENT AUDITOR'S REPORT (CONTINUED)

Basis for Disclaimer of Opinion on Governmental Activities

The Municipality did not maintain a complete, updated and accurate capital assets subsidiary ledger, in order to obtain sufficient and competent evidential matter related to the capital assets reported in the accompanying statement of net position for \$41,488,186, net of accumulated depreciation of \$22,850,893. The Municipality's records do not permit the application of other auditing procedures to the capital assets.

Disclaimer of Opinion

Because of the significance of the matter described in the "Basis for Disclaimer of Opinion on Governmental Activities" paragraph, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the governmental activities. Accordingly, I do not express an opinion on the financial position of the governmental activities of the Municipality at June 30, 2014, or the changes in financial position, thereof for the year then ended.

Unmodified Opinions

In my opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of each major fund, and the aggregate remaining fund information of the Municipality, as of June 30, 2014, and the respective changes in financial position thereof for the fiscal year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and budgetary comparison information on pages 4 through 18 and 69 through 71 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. I 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 my inquiries, the basic financial statements, and other knowledge I obtained during my audit of the basic financial statements. I do not express an opinion or provide any assurance on the information because the limited procedures do not provide me with sufficient evidence to express an opinion or provide any assurance.

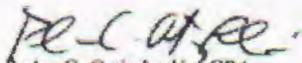
Other Information

My audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Municipality's basic financial statements. The 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. Because of the significance of the matter described in the "Basis for Disclaimer of Opinion on Governmental Activities" paragraph, it is inappropriate to and I do not express an opinion on the supplementary information referred to above.

INDEPENDENT AUDITOR'S REPORT (CONTINUED)

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, I have also issued my report dated March 29, 2015, on my consideration of the Municipality's internal control over financial reporting and on my tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of my testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Municipality's internal control over financial reporting and compliance.


Pedro C. Ortiz Ledee, CPA
License Number 5200

Guayama, Puerto Rico
March 29, 2015



**MUNICIPALITY OF PEÑUELAS
COMMONWEALTH OF PUERTO RICO**

**MANAGEMENT DISCUSSION AND ANALYSIS
FISCAL YEAR ENDED JUNE 30, 2014**

As management of the Municipality of Peñuelas (the Municipality), we offer readers the following discussion and analysis of the Municipality's financial activities reported in the accompanying basic financial statements as of and for the fiscal year ended June 30, 2014. We encourage readers to consider the information presented here in conjunction with additional information that is furnished in the accompanying financial statements, which follow this narrative.

Besides, this document includes comparative data with prior year as this information was available for the fiscal year ended on June 30, 2014. This MD & A is prepared in order to comply with the Governmental Accounting Standards Board (GASB) Statement No. 34, "Basic Financial Statements – and Management's Discussion and Analysis-for State and Local Governments." and, among other purposes, to provide the financial statements users with the following major information:

- a broader basis in focusing important issues;
- acknowledgement of an overview of the Municipality's financial activities;
- provides for an evaluation of its financial condition as of the end of fiscal year 2013-2014 compared with prior year results;
- identification of uses of funds in the financing of the Municipality's variety of activities and;
- asses management's ability to handle budgetary functions.

FINANCIAL HIGHLIGHTS

Government-Wide Highlights:

- The Municipality's total assets amounted to \$60,931,878 at June 30, 2014, of which \$41,488,186 (68%) consist of capital assets (net of accumulated depreciation and amortization of \$22,850,893), \$13,023,531 (21%) consist of cash and cash equivalents, \$5,664,142 (9%) consist of cash with fiscal agent (which are restricted principally for capital projects and debt service) and \$756,019 (1%) consist of accounts receivable.
- The Municipality's total liabilities amounted to \$34,367,491 at June 30, 2014, of which \$23,796,000 (69%) consist of bonds and notes payable, \$1,189,071 (4%) consist of accounts payable, accrued liabilities and due to governmental activities, \$2,351,236 (7%) consist of accrued compensated absences, \$4,772,354 (14%) consist of unearned revenues, and \$1,937,832 (6%) consist of other long-term debts.
- The Municipality's total assets exceeded its liabilities (net position) by \$26,564,387 at June 30, 2014.
- The Municipality's total revenues amounted to \$28,703,328 for the fiscal year ended June 30, 2014, of which \$15,076,947 (53%) arose from taxes, \$13,172,170 (46%) arose from intergovernmental

**MUNICIPALITY OF PEÑUELAS
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**MANAGEMENT DISCUSSION AND ANALYSIS
FISCAL YEAR ENDED JUNE 30, 2014**

- grants and contributions, and \$454,211 (2%) arose from charges from services, miscellaneous revenues and interest on deposits.
- The Municipality's total expenses amounted to \$28,605,467 for the fiscal year ended June 30, 2014, of which \$19,138,156 (67%) were incurred in providing direct services and benefits to citizens in relation to public works, health and welfare, public safety, culture and recreation, community development, and education. In addition, the Municipality incurred in \$924,508 (3%) of its total expenses, in interests related to its long-term obligations, and \$8,542,803 (30%) in general government activities to support the Municipality's functions and programs. The Municipality's total expenses include depreciation and amortization of capital assets in the amount of \$2,126,047 for the fiscal year ended June 30, 2014.
- The Municipality's total net position increased by \$97,861 during the fiscal year ended June 30, 2014.

Governmental Funds' Highlights:

- The total fund balances of governmental funds amounted to \$12,176,269 at June 30, 2014, of which \$6,681,942 are restricted and assigned, while \$5,494,327 are presented as unassigned fund.
- The fund balances of governmental funds decreased by (\$1,069,207) during the fiscal year ended June 30, 2014, principally due to an increase of expenses in several special revenue funds.

OVERVIEW OF THE BASIC FINANCIAL STATEMENTS

The purpose of financial reporting is to provide external users of basic financial statements with information that will help them to make decisions or draw conclusions about the Municipality. There are many external parties that use the basic financial statements of the Municipality; however, these parties do not always have the same specific objectives. In order to address the needs of as many parties as reasonably possible, the Municipality, in accordance with required financial reporting standards, presents this Management's Discussion and Analysis (MD&A) as an introduction to the accompanying basic financial statements. This narrative represents an overview and analysis of the financial activities of the Municipality for the fiscal year ended June 30, 2014. Because this MD&A is designed to focus on the current year activities, resulting changes and currently known facts, we encourage readers to consider the information presented in this MD&A in conjunction with the additional information furnished in the accompanying basic financial statements.

The Municipality's basic financial statements include three components: (1) government-wide financial statements (GWFS), (2) fund financial statements (FFS), and (3) notes to the basic financial statements (NBFS). This report also contains additional required information in addition to the basic financial statements themselves. These components are described below.

**MUNICIPALITY OF PEÑUELAS
COMMONWEALTH OF PUERTO RICO**

**MANAGEMENT DISCUSSION AND ANALYSIS
FISCAL YEAR ENDED JUNE 30, 2014**

The basic financial statements focus on: (1) the Municipality as a whole (government-wide financial reporting) and, (2) the Municipality's major individual governmental funds. Both perspectives allow the users to address relevant questions, broaden a basis for comparison (year to year or government to government) and enhance the Municipality's accountability. The components of the basic financial statements are described below.

a) Government-Wide Financial Statements

The GWFS are composed of: (1) the statements of net position (SNP) and (2) the statement of activities (SA). These financial statements can be found immediately following this MD&A. GWFS are designed to provide readers with a broad overview of the Municipality's operations as a whole in a manner similar to private-sector businesses. These statements provide short-term and long-term information about the Municipality's financial position, which assist the Municipality's management to determine the economic condition at June 30, 2014. The GWFS are prepared using methods that are similar to those used by most private businesses.

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

1. Statement of Net Position

The purpose of SNP is to attempt to report all assets owned and all liabilities owed by the Municipality. The Municipality reports of all of its assets when it acquires ownership over the assets and reports all of its liabilities when they are incurred. For example, the Municipality reports buildings and infrastructure as assets, even though they are not available to pay the obligations incurred by the Municipality. On the other hand, the Municipality reports liabilities, such as claims and judgments, bonds and notes payable, obligations under capital leases, compensated absences and certain accounts payable and accrued liabilities, even though these liabilities might not be paid until several fiscal years into the future.

The difference between the Municipality's total assets plus deferred outflows of resources and total liabilities plus deferred inflows of resources reported in SNP is presented as *net position*, which is similar to the total owners' equity reported by a commercial enterprise in its financial statements. Although the purpose of the Municipality is not to accumulate net position, as this amount increases or decreases over time, such amount represents a useful indicator of whether the financial position of the Municipality is either improving or deteriorating, respectively.

2. Statement of Activities

The SA presents information showing how the Municipality's net position changed during the fiscal year ended June 30, 2014, by presenting all of the Municipality's revenues and expenses. As previously discussed, the items reported in SA are measured in a manner similar to the

**MUNICIPALITY OF PEÑUELAS
COMMONWEALTH OF PUERTO RICO**

**MANAGEMENT DISCUSSION AND ANALYSIS
FISCAL YEAR ENDED JUNE 30, 2014**

approach used by a commercial enterprise in that revenues are recognized when earned or established criteria are satisfied, and expenses are recorded when incurred by the Municipality. Consequently, revenues are reported even when they may not be collected for several months after the end of the fiscal year and expenses are recorded even though they may not have used cash during the current year.

Although SA looks different from a commercial enterprise's income statement, the difference is only in format, not substance. Whereas the bottom line in a commercial enterprise represents its net income, the Municipality reports an amount described as *net change in net position*, which is essentially the same concept.

The focus of SA is on the *net cost* of various activities provided by the Municipality. The statement begins with a column that identifies the cost of each of the Municipality's major functions. Another column identifies the revenues that are specifically related to the classified governmental functions. The difference between the expenses and revenues related to specific functions/programs identifies the extent to which each function of the Municipality draws from general revenues or is self-financing through fees, intergovernmental aid, and other sources of resources.

This statement also presents a comparison between direct expenses and program revenues for each function of the Municipality.

GWFS and FFS present all of the Municipality's governmental activities, which are supported mostly by taxes, intergovernmental revenues (such as federal and state grants and contributions), and charge for services. All services normally associated with the Municipality fall into this category, including culture, recreation and education; general government; health and sanitation; public safety; welfare and housing assistance; and urban and economic development.

b) Fund Financial Statements

The Municipality's FFS consist of: (1) the balance sheet – governmental funds and (2) the statement of revenues, expenditures and changes in fund balances – governmental funds. These financial statements report the financial position, the results of operations of the Municipality's governmental funds, with an emphasis on the Municipality's major governmental funds.

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 Municipality, like most other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. Each fund is considered an independent fiscal entity accounted for within a set of self-balancing accounts that comprise its assets, deferred outflows of resources, liabilities, deferred inflows of resources, fund equity, revenue, and expenditures. Fund accounting segregates funds according to their intended purpose and is used to aid management in demonstrating compliance with legal, financial and contractual provisions. All of the funds of the Municipality can be divided into two categories: governmental funds and proprietary funds.

**MUNICIPALITY OF PEÑUELAS
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**MANAGEMENT DISCUSSION AND ANALYSIS
FISCAL YEAR ENDED JUNE 30, 2014**

1. Governmental funds

Governmental funds are used to account for most of the services provided by the Municipality. These funds are used to account for essentially the same functions reported as governmental activities in the GWFS. Unlike GWFS, the focus of governmental funds in the FFS is directed to specific activities of the Municipality rather than the Municipality as a whole; therefore, governmental funds in FFS report the Municipality's operations in more detail than the GWFS.

Governmental funds in FFS provide a detailed short-term view of the Municipality's finances that assist in determining whether there will be adequate financial resources available to meet the current needs of the Municipality, which is, evaluating the Municipality's near-term financing requirements. For financial reporting purposes, the Municipality classifies its governmental funds within the following types: (1) General Fund, (2) Head Start- Special Programs Fund, (3) Capital Improvements Fund, (4) Debt Service Fund and (5) Other Governmental Funds.

Governmental funds FFS are prepared on an accounting basis that is significantly different from that used to prepare GWFS. In general, governmental funds FFS focus on near-term inflows and outflows of expendable financial resources, consequently, they measure and account for cash and other assets that can easily be converted to cash. For example, amounts reported on the balance sheet include capital assets within a very short period of time, but do not include capital assets such as land and buildings. Governmental fund liabilities generally include amounts that normally are going to be paid within a short period after the end of the fiscal year. The difference between a fund's total assets plus deferred outflows of resources and total liabilities plus deferred inflows of resources is reported as the fund balance or deficit, and generally indicates the amount that can be used to finance the next fiscal year's activities. Likewise, the operating statement for governmental funds reports only those revenues and expenditures that were collected in cash or paid with cash, respectively, during the current fiscal year or very shortly after the end of the fiscal year.

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

The Municipality has four major governmental funds. Each major fund is presented in a separate column in the balance sheet – governmental funds and the statement of revenues, expenditures and changes in fund balances – governmental funds (1) General Fund, (2) Head Start- Special Programs Fund, (3) Capital Improvements Fund, (4) Debt Service Fund.

**MUNICIPALITY OF PEÑUELAS
COMMONWEALTH OF PUERTO RICO**

**MANAGEMENT DISCUSSION AND ANALYSIS
FISCAL YEAR ENDED JUNE 30, 2014**

c) Notes to Basic Financial Statements

The NBFS provide additional information that is essential for a full understanding of the data provided in the GWFS and FFS. The NBFS can be found immediately following the basic financial statements.

d) Other Supplementary Information

The basic financial statements are followed by a section of other supplementary information consisting of budgetary comparison schedule – general fund.

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**MUNICIPALITY OF PEÑUELAS
COMMONWEALTH OF PUERTO RICO**

**MANAGEMENT DISCUSSION AND ANALYSIS
FISCAL YEAR ENDED JUNE 30, 2014**

FINANCIAL ANALYSIS OF GOVERNMENT-WIDE FINANCIAL STATEMENTS

The Municipality's overall financial position and operations at June 30, 2014 and 2013 are summarized as follows, based on the information included in the accompanying statement of net position:

	<u>Governmental Activities</u>	
	<u>2014</u>	<u>2013</u>
Assets:		
Current assets	\$ 19,443,692	\$ 22,128,257
Non-current assets:		
Capital assets	41,488,186	41,625,628
Total assets	<u>60,931,878</u>	<u>63,753,885</u>
Liabilities:		
Current liabilities, excluding long-term obligations	7,267,423	8,077,781
Long-term obligations:		
Due within one year	1,655,871	1,409,789
Due after one year	25,444,197	27,799,789
Total liabilities	<u>34,367,491</u>	<u>37,287,359</u>
Net Position		
Invested in capital assets, net of related debt	23,068,186	22,285,628
Restricted	7,636,779	9,045,272
Unrestricted (deficit)	(4,140,578)	(4,864,374)
Total net position	<u>\$ 26,564,387</u>	<u>\$ 26,466,526</u>

At June 30, 2014, the Municipality's current assets, amounting to \$19,443,692 are mainly composed of cash and cash equivalents (\$13,023,531), cash with fiscal agent (\$5,664,142), and intergovernmental grants and contributions receivable (\$756,019).

The cash represents resources, except for the amounts presented in the General Fund, that legally designated for: (1) the payment of debt service, (2) the acquisition, construction and improvement of major capital assets, and (3) the operations of federally and state funded grant programs. Cash also consists of unspent proceeds of bonds issued for acquisition, construction and improvement of major capital assets.

**MUNICIPALITY OF PEÑUELAS
COMMONWEALTH OF PUERTO RICO**

**MANAGEMENT DISCUSSION AND ANALYSIS
FISCAL YEAR ENDED JUNE 30, 2014**

The Municipality's non-current assets, amounting to \$41,488,186 at June 30, 2014, are substantially composed of capital assets, with a cost basis of \$64,339,079, which are reported net of accumulated depreciation and amortization of \$22,850,893.

At June 30, 2014, the Municipality's current liabilities amounting to \$7,267,423 are mainly composed of unearned revenues (\$4,772,354), accounts payable and accrued liabilities (\$989,633), interest payable (\$320,998), and intergovernmental payables (\$199,438). Unearned revenues principally consist, of municipal license taxes and intergovernmental grants and contributions related to state and federally funded grant programs.

The Municipality's non-current liabilities, amounting to \$27,100,068 at June 30, 2014, are mainly composed of portion due within one year of bonds and notes payable (\$1,655,871), and the portion due after one year of bonds and notes payable (\$25,444,197).

As noted earlier, net position may serve over time as a useful indicator of the Municipality's financial position. The assets of the Municipality exceeded liabilities by \$26,564,387 at June 30, 2014. The most significant portion of net position (\$23,068,186) reflects the Municipality's investment in capital assets (e.g. land, buildings, machinery, equipment, furniture, fixtures, infrastructure, etc.), net of all related debt still outstanding that was issued to acquire, construct or improve those assets. The Municipality uses these capital assets to provide services to its citizens; consequently, these assets are not available for future spending. Although the Municipality's investment in capital assets is reported net of the outstanding related debt, the resources needed to repay that debt must be provided by other sources, since capital assets cannot be used to liquidate these liabilities. The another significant portion of net position (\$7,636,779) at June 30, 2014, represents resources that are restricted for debt service payments and to finance the operations of federal and state funded programs.

The remaining component of total net position consists of unrestricted net liabilities amounting to (\$4,140,578) at June 30, 2014. These unrestricted net liabilities are the consequence of previous budgets that did not provide sufficient funding for incurred long-term obligations, such as bonds and notes payable, compensated absences, etc. Historically, a significant portion of such obligations has been budgeted on a pay-as-you-go basis.

The total net position of the Municipality increased by \$97,861 for the fiscal year ended June 30, 2014. Such increase is due to the excess of total revenues (\$28,703,328), over total expenses (\$28,605,467), including depreciation and amortization of capital assets of (\$2,126,047) for the fiscal year ended June 30, 2014.

**MUNICIPALITY OF PEÑUELAS
COMMONWEALTH OF PUERTO RICO**

**MANAGEMENT DISCUSSION AND ANALYSIS
FISCAL YEAR ENDED JUNE 30, 2014**

The following is a condensed presentation of the Municipality's results of operations as reported in the statement of activities for the fiscal years ended June 30, 2014 and 2013:

	Governmental activities	
	2014	2013
Program revenues:		
Program-specific operating grants and contributions	\$5,696,543	\$5,711,885
Program-specific capital grants and contributions	1,771,764	1,475,936
Charges for services	17,090	13,315
Total program revenues	7,485,397	7,201,136
General revenues:		
Property taxes	4,932,768	5,129,229
Municipal license taxes	8,737,976	9,707,031
Sales and use taxes	998,343	1,021,768
Interest and investment earnings	38,718	87,222
Unrestricted grants and contributions	5,703,863	4,926,399
Construction excise taxes	407,860	510,390
Other general revenues (various sources)	398,403	65,604
Total general revenues	21,217,931	21,447,643
Total revenues	28,703,328	28,648,779
Program expenses:		
General government	8,542,803	7,869,474
Public works	6,122,979	6,465,643
Health and welfare	7,569,599	5,197,645
Public safety	1,160,334	1,257,888
Culture and recreation	3,397,042	5,204,221
Economic development	-	1,317
Education	256,665	375,948
Community development	631,537	113,521
Interest on long-term obligations	924,508	892,808
Total expenses	28,605,467	27,378,465
Net increase (decrease) in net position	97,861	1,270,314
Net position, at beginning of fiscal year	26,466,526	25,196,212
Net position, at end of fiscal year	\$26,564,387	\$26,466,526

**MUNICIPALITY OF PEÑUELAS
COMMONWEALTH OF PUERTO RICO**

**MANAGEMENT DISCUSSION AND ANALYSIS
FISCAL YEAR ENDED JUNE 30, 2014**

As previously mentioned, the Municipality's total net position increased by \$97,861 during the current fiscal year. Approximately 53% (\$15,076,947) of the Municipality's total revenues for the current fiscal year came from property, municipal license, construction excise and sales and use taxes, while 46% (\$13,172,170) resulted from restricted and unrestricted capital and operating grants and contributions. Charges for services and other revenues, amounting to \$454,211, provided 2% of the total revenues for the current fiscal year.

The Municipality's expenses cover a wide range of services. The largest expenses of the Municipality for the fiscal year ended June 30, 2014 were related to: (1) general administrative and operating costs (\$8,542,803), which were classified as "general government" and accounted for 30% of total expenses, (2) public safety (\$1,160,334), which accounted for 4% of total expenses, (3) public works (\$6,122,979), which accounted for 21% of total expense, (4) health and welfare (\$7,569,599), which accounted for 26% percent of total expenses (5) culture and recreation (\$3,397,042), which accounted for 12% of total expenses, and (6) education, community development and interest on long-term obligation (\$1,812,710), which accounted for 6% of total expenses. These expenses include depreciation of capital assets in the amount of (\$2,126,047), for the fiscal year ended June 30, 2014.

FINANCIAL ANALYSIS OF GOVERNMENTAL ACTIVITIES

Analysis of Financial Position of Governmental Funds

As discussed earlier, the Municipality uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. The focus of the Municipality's governmental funds is to provide information on near-term inflows, outflows, and balances of expendable resources. Such information is useful in assessing the Municipality's compliance with finance-related legal requirements. Specifically, unreserved fund balance may serve as a useful measure of the Municipality's net resources available for spending at the end of the fiscal year.

At June 30, 2014, the total assets of governmental funds amounted to \$20,577,431, which consisted principally of: (1) cash and cash equivalents of \$13,023,531 (63%), (2) cash in fiscal agent of \$5,664,142 (27%), (3) property and sales taxes, intergovernmental, and other receivables of \$756,019 (4%), (5) due from other funds of \$1,133,739 (6%). Such assets include cash, cash equivalents and receivables that are principally used for debt service, capital projects, encumbrances and other specific purposes.

At June 30, 2014, the total liabilities of governmental funds amounted to \$8,401,162, which consisted principally of: (1) unearned revenues of \$ 4,772,354 (57%), (2) accounts payable and accrued liabilities and another payables of \$989,633 (12%), (3) intergovernmental accounts payable of \$199,438 (2%), (4) matured bonds and interests due and payable of \$1,305,998 (16%) and (5) due to other funds of \$1,133,739 (13%).

The total fund balances of governmental funds amounted to \$12,176,269 at June 30, 2014, of which \$6,681,942 are restricted and assigned, while \$5,494,327 represent unassigned fund balance. The fund balances of governmental funds decreased by (\$1,069,207) during the fiscal year ended June 30, 2014, principally due to a significant increase of expenses of in several special revenue funds.

**MUNICIPALITY OF PEÑUELAS
COMMONWEALTH OF PUERTO RICO**

**MANAGEMENT DISCUSSION AND ANALYSIS
FISCAL YEAR ENDED JUNE 30, 2014**

The following table presents the condensed financial position of governmental funds at June 30, 2014 and 2013:

	<u>2014</u>	<u>2013</u>
Assets:		
Total assets - major governmental funds	\$19,116,457	\$21,190,706
Total assets - other governmental funds	1,460,974	1,944,675
Combined total assets	<u>20,577,431</u>	<u>23,135,381</u>
Liabilities:		
Total liabilities - major governmental funds	7,766,731	9,431,911
Total liabilities - other governmental funds	634,431	457,994
Combined total liabilities	<u>8,401,162</u>	<u>9,889,905</u>
Fund balances (deficits):		
Restricted – major governmental funds	5,828,503	6,655,497
Committed – major governmental funds	-	75,788
Assigned – major governmental funds	26,896	98,094
Restricted, committed and assigned – other governmental funds	826,543	1,410,893
Unassigned	5,494,327	5,005,204
Combined total fund balances	<u>12,176,269</u>	<u>13,245,476</u>
Total liabilities and fund balances	<u>\$20,577,431</u>	<u>\$23,135,381</u>

**MUNICIPALITY OF PEÑUELAS
COMMONWEALTH OF PUERTO RICO**

**MANAGEMENT DISCUSSION AND ANALYSIS
FISCAL YEAR ENDED JUNE 30, 2014**

Major Governmental Funds

General fund (GF) – The GF is the principal operating fund of the Municipality. The GF's total assets amounted to \$11,000,287 at June 30, 2014. Such assets consist principally of: (1) Cash in commercial banks (\$9,794,031), (2) receivables of (\$69,250), and (3) short-term amounts due from other funds (\$1,133,739).

The GF's total liabilities amounted to \$5,475,797 at June 30, 2014. Such liabilities are composed mainly of: (1) unearned revenues (\$4,682,485), and (2) accounts payable, accrued liabilities and amounts due to other governments (\$793,312).

At the end of the current fiscal year, restricted and assigned fund balances amounts to \$3,267 and \$26,896, respectively. Unassigned fund balance of the GF amounted to \$5,494,327, while total fund balance reached \$5,524,490.

Head Start- Special Programs Fund (SRHS)- The SRF-HS's total assets amounted to \$824,923 at June 30, 2014, which consist mainly of cash (\$781,226), and intergovernmental receivable (\$43,697). The SRF-HS's total liabilities amounted to \$824,923 at June 30, 2014.

Capital Improvement Fund (CIP)- The CIP's total assets amounted to \$3,717,189 at June 30, 2014, which consist of cash with fiscal agent (\$2,141,932), and cash in commercial bank (\$1,575,257). The CIP's total liabilities amounted to \$160,013 at June 30, 2014, which are composed mainly of accounts payable. At the end of the current fiscal year, the CIP's had total restricted fund balances amounted to \$3,557,176.

Debt service fund (DSF)- The DSF's total assets amounted to \$3,574,058 at June 30, 2014, which consist mainly of cash in fiscal agent (\$3,462,970) and property and tax receivables amounting (\$111,088). The DSF's total liabilities amounted to \$1,305,998 at June 30, 2014, which are mainly composed of: (1) matured bonds due and payable (\$985,000), and (2) matured interest due and payable (\$320,998). At the end of the current fiscal year, DSF's total fund balance reached \$2,268,060.

Other governmental funds (OGF)- The OGF's total assets amounted to \$1,460,974 at June 30, 2014, which consist mainly of cash and cash equivalents (\$873,017), cash in fiscal agent of (\$55,973), and receivables from intergovernmental grants and contributions (\$531,984). The OGF's total liabilities amounted to \$634,431 at June 30, 2014, which are mainly composed of unearned revenues (\$5,092), accounts payable (\$130,861) and short-term amounts due to other funds (\$498,478). At the end of the current fiscal year, OGF's total fund balance reached \$826,543.

**MUNICIPALITY OF PEÑUELAS
COMMONWEALTH OF PUERTO RICO**

**MANAGEMENT DISCUSSION AND ANALYSIS
FISCAL YEAR ENDED JUNE 30, 2014**

Analysis of Operating Results of Governmental Funds

Major Governmental Funds

General fund – The total fund balance of the GF increased by \$416,641 during current fiscal year, principally due to a significant increase in intergovernmental revenues. Total revenues, expenditures and other financing sources (net) amounted to \$19,581,848, \$19,747,757, and \$582,550, respectively, for the fiscal year ended June 30, 2014.

Approximately 69% (\$13,424,584) of the GF's total revenues for the current fiscal year came from property, municipal license, construction excise and sales and use taxes, while 29% (\$5,703,863) resulted from intergovernmental grants and contributions. Interest revenues, charges for services and miscellaneous revenues, amounting to \$453,401, provided 2% of the total revenues for the current fiscal year. Transfers from other governmental funds amounts to \$950,439.

The largest expenses of the GF for the fiscal year ended June 30, 2014 were related to: (1) general administrative and operating costs (\$8,158,716), which were classified as "general government" and accounted for 41% of total expenses, (2) public safety (\$1,129,432), which accounted for 6% of total expenses, (3) public works (\$5,957,464), which accounted for 30% percent of total expenses, (4) health and welfare (\$1,671,420), which accounted for 8% of total expenses, (5) culture and recreation (\$2,578,199), which accounted for 13% of total expenses and (6) education (\$252,526) which accounts 1% of total expenses. Transfer to other governmental funds amounts to (\$367,889).

Head Start- Special Programs Fund (SRF-HSP) –Total revenues for the fiscal year ended June 30, 2014 were \$4,300,797.

Total expenditures amounted to \$4,300,797 for the fiscal year ended June 30, 2014. SRF-HSP's total expenditures for the current fiscal year came from health and welfare.

Capital Improvements Funds (CIP)- The total fund balance of the CIP increased by \$197,246 during current fiscal year. Total expenditures amounted to \$395,987 for the fiscal year ended June 30, 2014.

CIP's total expenditures for the current fiscal year came from culture and recreation (\$98,615), and public works (\$297,372).

Debt service fund (DSF) – The total fund balance of the DSF decreased by (1,022,956) during current fiscal year. Total revenues, expenditures and other financing sources (net) amounted to \$1,653,173, \$2,199,508 and (\$476,621), respectively, for the fiscal year ended June 30, 2014.

Approximately 66% (\$1,092,158) of DSF's total revenues for the current fiscal year came from restricted property taxes, while 34% (\$560,205) came from restricted sales and use taxes and interest. DSF's total expenditures for the current fiscal year came from principal and interests on bonds payable (\$2,199,508) and transfers to other funds of \$844,510.

**MUNICIPALITY OF PEÑUELAS
COMMONWEALTH OF PUERTO RICO**

**MANAGEMENT DISCUSSION AND ANALYSIS
FISCAL YEAR ENDED JUNE 30, 2014**

Other governmental funds (OGF) – The total fund balance of the OGF decreased by (\$660,138) during current fiscal year. Total revenues and expenditures amounted to \$2,574,277, and \$3,128,486, respectively, for the fiscal year ended June 30, 2014. Approximately 21% (\$545,754) of OGF's total revenues for the current fiscal year came from intergovernmental grants, \$2,018,510 (78%) from federal grants and \$10,013 (1%) from others revenues.

The largest expenses of the OGF for the fiscal year ended June 30, 2014 were related to: (1) public works (\$1,130,900), which accounted for 36% of total expenses, (2) health and welfare (\$1,536,959), which accounted for 49% of total expenses, and (3) community development (\$448,054), which accounted for 14% of total expenses.

BUDGETARY HIGHLIGHTS

a) General Fund

The final budget of the general fund for the fiscal year ended June 30, 2014 amounted to \$19,811,974. Over the course of the fiscal year, the Municipality revised the GF's budget in order to include increases and decreases in revenues that were identified during the course of the fiscal year based on current developments that positively affected the Municipality's finances. The laws and regulations of the Commonwealth mandate a balanced budget.

The total actual revenues (budgetary basis) of the general fund for the fiscal year ended June 30, 2014 were \$19,358,502, which is (\$453,472) lower than the budgeted revenues. In addition, the total actual expenditures (budgetary basis) of the general fund for the fiscal year ended June 30, 2014 were \$19,338,763, which is (\$10,264), higher than the budgeted expenditures.

The most significant fluctuations in actual revenues occurred in municipal licenses taxes which had actual revenues that were \$1,714,740 lower than budgeted. This fluctuation arise because a significant reduction of sales volume reported by the tax payer that provide fuel oil to the Puerto Rican Power Authority in the Municipality of Peñuelas.

Also, the most significant fluctuations in actual expenditures and encumbrances occurred in general government, which had actual expenditures and encumbrances that were \$467,688 higher than budgeted, and public works and culture an recreation, which had actual expenditures and encumbrances that were \$169,758 and \$145,418 lower than budgeted, respectively.

CAPITAL ASSETS AND DEBT ADMINISTRATION

a) Capital Assets

The Municipality has invested \$64,339,079 in capital assets used in governmental activities, which have an accumulated depreciation and amortization of \$22,850,893 at June 30, 2014. The net capital assets of governmental activities increased during the current fiscal year due to the current fiscal

**MUNICIPALITY OF PEÑUELAS
COMMONWEALTH OF PUERTO RICO**

**MANAGEMENT DISCUSSION AND ANALYSIS
FISCAL YEAR ENDED JUNE 30, 2014**

year's capital additions \$1,988,605, which were partially offset by the depreciation and amortization expense (\$2,126,047) for the same period.

b) Debt Administration

The Municipality finances a significant portion of its construction activities through bond and note issuances, and through state and federal grants. The proceeds from bond issuances designated for construction activities are committed in its entirety for such purposes and cannot be used for any other purposes.

At June 30, 2014, the Municipality's total bonded debt amounted to \$23,796,000, consisting of bonds payable. Such debt is backed by the full faith and credit of the Municipality. The following is a summary of the debt activity for the fiscal year ended June 30, 2014:

- Bonds payable decreased by (\$1,095,000) by the effect of total principal payments on bonds made during the current fiscal year.
- The Municipality has also certain outstanding notes payable due to CRIM (\$1,937,832). Such notes payable increased by \$310,177 during the current fiscal year mainly due to a new note payable made during the same period.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

The Municipality relies primarily on property and municipal taxes as well as federal and state grants to carry out the governmental activities. Historically, property and municipal taxes have been very predictable with increases of approximately five percent. Federal and State grant revenues may vary if new grants are available but the revenue also is very predictable. Those factors were considered when preparing the Municipality's budget for the fiscal year 2014-2015.

REQUEST FOR INFORMATION

This financial report is designed to provide a general overview of the Municipality's finances for all of the Municipality's citizens, taxpayers, customers, investors and creditors. This financial report seeks to demonstrate the Municipality's accountability for the money it receives. Questions concerning any of the information provided in this report or requests for additional information should be addressed to the Municipality of Peñuelas, Department of Finance.

Commonwealth of Puerto Rico
Municipality of Peñuelas
Statement of Net Position
June 30, 2014

	Governmental Activities
Assets	
Cash and cash equivalents	\$ 13,023,531
Cash with fiscal agent	5,664,142
Accounts receivable:	
Property tax	20,816
Municipal licenses tax	-
Sales tax	123,212
Intergovernmental	575,681
Other	36,310
Capital assets	
Land, improvements, and construction in progress	659,123
Other capital assets, net of depreciation	40,829,063
Total capital assets	41,488,186
Total assets	60,931,878
Liabilities	
Accounts payable and accrued liabilities	989,633
Due to other governmental entities	199,438
Unearned revenues:	
Municipal license tax	4,682,485
Federal grant revenues	89,869
Mature bonds due and payable	985,000
Interest payable	320,998
Noncurrent liabilities:	
Due within one year	1,655,871
Due in more than one year	25,444,197
Total liabilities	34,367,491
Net Position	
Invested in capital assets, net of related debt	23,068,186
Restricted for:	
Capital projects	3,557,176
Debt service	3,253,060
Other purposes	826,543
Unrestricted (deficit)	(4,140,578)
Total net position	\$ 26,564,387

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

Commonwealth of Puerto Rico
Municipality of Peñuelas
Statement of Activities
For the Year Ended June 30, 2014

Functions/Programs	Expenses	Program Revenues			Net (Expense) Revenue and Changes in Net Position
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Governmental Activities
General government	\$ 8,542,803	\$ -	\$ -	\$ -	\$ (8,542,803)
Public safety	1,160,334	-	-	-	(1,160,334)
Public works	6,122,979	17,090	-	1,323,720	(4,782,169)
Health and welfare	7,569,599	-	5,674,021	-	(1,895,578)
Culture and recreation	3,397,042	-	22,522	-	(3,374,520)
Community development	631,537	-	-	448,044	(183,493)
Education	256,665	-	-	-	(256,665)
Interest on long-term debt	924,508	-	-	-	(924,508)
Total governmental activities	\$ 28,605,467	\$ 17,090	\$ 5,696,543	\$ 1,771,764	(21,120,070)
General revenues and special items:					
Property tax					4,932,768
Municipal license tax					8,737,976
Sales tax					998,343
Construction excise tax					407,860
Grants and contributions not restricted to specific programs					5,703,863
Interest and investment earnings					38,718
Miscellaneous					398,403
Total general revenues					21,217,931
Change in net position					97,861
Net position - beginning					26,466,526
Net position - ending					\$ 26,564,387

Commonwealth of Puerto Rico
Municipality of Peñuelas
Balance Sheet
Governmental Funds
June 30, 2014

	General Fund	Head Start - Special Programs Fund	Capital Improvements Fund	Debt Service Fund	Other Governmental Funds	Total Governmental Funds
Assets and Deferred Outflows of Resources						
Cash and cash equivalents	\$ 9,794,031	\$ 781,226	\$ 1,575,257	\$ -	873,017	\$ 13,023,531
Cash with fiscal agent	3,267	-	2,141,932	3,462,970	55,973	5,664,142
Accounts receivable:						
Property tax	-	-	-	20,816	-	20,816
Sales tax	32,940	-	-	90,272	-	123,212
Intergovernmental	-	43,697	-	-	531,984	575,681
Other	36,310	-	-	-	-	36,310
Due from other funds	1,133,739	-	-	-	-	1,133,739
Total assets	11,000,287	824,923	3,717,189	3,574,058	1,460,974	20,577,431
Deferred Outflows of Resources	-	-	-	-	-	-
Total assets and deferred outflows of resources	\$ 11,000,287	\$ 824,923	\$ 3,717,189	\$ 3,574,058	\$ 1,460,974	\$ 20,577,431
Liabilities, Deferred Inflows of Resources and Fund Balances						
Liabilities :						
Accounts payable and accrued liabilities	\$ 593,874	\$ 157,946	\$ 106,952	\$ -	\$ 130,861	\$ 989,633
Due to other governmental entities	199,438	-	-	-	-	199,438
Due to other funds	-	582,200	53,061	-	498,478	1,133,739
Unearned revenues:						
Municipal license tax	4,682,485	-	-	-	-	4,682,485
Federal grant revenues	-	84,777	-	-	5,092	89,869
Mature bonds due and payable	-	-	-	985,000	-	985,000
Interest Payable	-	-	-	320,998	-	320,998
Total liabilities	5,475,797	824,923	160,013	1,305,998	634,431	8,401,162
Deferred Inflows of Resources	-	-	-	-	-	-
Fund balances:						
Restricted	3,267	-	3,557,176	2,268,060	826,543	6,655,046
Assigned	26,896	-	-	-	-	26,896
Unassigned	5,494,327	-	-	-	-	5,494,327
Total fund balances	5,524,490	-	3,557,176	2,268,060	826,543	12,176,269
Total liabilities, deferred inflows of resources and fund balances	\$ 11,000,287	\$ 824,923	\$ 3,717,189	\$ 3,574,058	\$ 1,460,974	\$ 20,577,431

**MUNICIPALITY OF PEÑUELAS
COMMONWEALTH OF PUERTO RICO**

**RECONCILIATION OF THE BALANCE SHEET – GOVERNMENTAL FUNDS TO THE
STATEMENT OF NET POSITION
YEAR ENDED JUNE 30, 2014**

The amounts of governmental reported in the statement of net position are different to the amounts reported in the balance sheet- governmental funds for the following reasons:

The fund balances reported in the balance sheet - governmental funds	\$ 12,176,269
Add (deduct):	
Capital assets used in governmental activities are not considered available financial resources at fiscal year-end, therefore, are not reported in the governmental funds. This is the carrying amount of capital assets, net of accumulated depreciation and amortization of \$22,850,893 at June 30, 2014	41,488,186
The following liabilities are not due (mature) in the current period, therefore, are not reported in the governmental funds:	
Bonds and notes payable	(22,811,000)
CRIM- Act. No. 42	(981,317)
CRIM- Act. No. 146	(416,951)
CRIM- Fiscal Year 2012-2013 Final Settlement	(229,387)
CRIM- Fiscal Year 2013-2014 Final Settlement	(310,177)
Compensated Absences	<u>(2,351,236)</u>
Net position as reported in the accompanying statement of net position	<u>\$ 26,564,387</u>

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

Commonwealth of Puerto Rico
Municipality of Peñuelas
Statement of Revenues, Expenditures and Changes in Fund Balances
Governmental Funds
For the Year Ended June 30, 2014

	General Fund	Head Start - Special Programs Fund	Capital Improvements Fund	Debt Service Fund	Other Governmental Funds	Total Governmental Funds
Revenues						
Property tax	\$ 3,840,610	\$ -	\$ -	\$ 1,092,158	\$ -	\$ 4,932,768
Municipal license tax	8,737,976	-	-	-	-	8,737,976
Sales tax	438,138	-	-	560,205	-	998,343
Construction excise tax	407,860	-	-	-	-	407,860
Charges for services	17,090	-	-	-	-	17,090
Intergovernmental	5,703,863	-	593,233	-	545,754	6,842,850
Rent of property	125,990	-	-	-	-	125,990
Interest	37,908	-	-	810	-	38,718
Federal grants	-	4,300,797	-	-	2,018,510	6,319,307
Miscellaneous	272,413	-	-	-	10,013	282,426
Total revenues	19,581,848	4,300,797	593,233	1,653,173	2,574,277	28,703,328
Expenditures						
Current:						
General government	8,158,716	-	-	-	7,492	8,166,208
Public safety	1,129,432	-	-	-	-	1,129,432
Public works	5,957,464	-	297,372	-	1,130,900	7,385,736
Health and welfare	1,671,420	4,300,797	-	-	1,536,959	7,509,176
Culture and recreation	2,578,199	-	98,615	-	942	2,677,756
Economic development	-	-	-	-	-	-
Community development	-	-	-	-	448,054	448,054
Education	252,526	-	-	-	4,139	256,665
Debt service:						
Principal	-	-	-	1,275,000	-	1,275,000
Interest	-	-	-	924,508	-	924,508
Total expenditures	19,747,757	4,300,797	395,987	2,199,508	3,128,486	29,772,535
Excess (deficiency) of revenues over (under) expenditures	(165,909)	-	197,246	(546,335)	(554,209)	(1,069,207)
Other financing sources (uses)						
Transfers in	950,439	-	-	367,889	-	1,318,328
Transfers out	(367,889)	-	-	(844,510)	(105,929)	(1,318,328)
Total other financing sources (uses)	582,550	-	-	(476,621)	(105,929)	-
Net change in fund balances	416,641	-	197,246	(1,022,956)	(660,138)	(1,069,207)
Fund balance, beginning	5,107,849	-	3,359,930	3,291,016	1,486,681	13,245,476
Fund balance, ending	\$ 5,524,490	\$ -	\$ 3,557,176	\$ 2,268,060	\$ 826,543	\$ 12,176,269

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06/03/2015

**MUNICIPALITY OF PEÑUELAS
COMMONWEALTH OF PUERTO RICO**

**RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES,
AND CHANGES IN FUND BALANCES OF
GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES
YEAR ENDED JUNE 30, 2014**

Net Change in Fund Balances - Total Governmental Funds	\$ (1,069,207)
<p>Amounts reported for governmental activities in the Statement of Activities are different because:</p>	
<p>Governmental Funds report capital outlays as expenditures. However, in the Government-Wide Statement of Activities and Changes in Net Position, the cost of those assets is allocated over their estimated useful lives as depreciation expense. This is the amount of capital assets recorded in the current period.</p>	1,988,605
<p>Depreciation expense on capital assets is reported in the Government-Wide Statements of Activities and Change in Net Position, but they do not require the use of current financial resources. Therefore, depreciation expense is not reported as expenditures in Governmental Funds.</p>	(2,126,047)
<p>Bonds and notes proceeds provides current financial resources to Governmental Funds, but issuing debt increase long-term liabilities in the Government-Wide statement of Net Position. Repayment of bonds and notes principal is an expenditure in Governmental Funds, but the repayment reduces long -term liabilities in the Government-Wide Statement of Net Position. This is the amount by which the debt proceeds exceed debt service principal payments.</p>	1,095,000
<p>Under the modified accrual basis of accounting used in the governmental funds, expenditures are not recognized for transactions that are not normally paid with expendable financial resources. In the Statements of Activities , however, which is presented in the accrual basis, expenses and liabilities are presented regardless of when financial resources are available:</p>	
Net change in compensated absences liability	287,441
Net change in bonds payable	180,000
Net change in notes payable to CRIM	<u>(257,931)</u>
Change in Net Position of Governmental Activities	<u>\$ 97,861</u>

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

**MUNICIPALITY OF PEÑUELAS
COMMONWEALTH OF PUERTO RICO**

**NOTES TO BASIC FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 2014**

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Municipality of Peñuelas, Commonwealth of Puerto Rico (the Municipality), is a local municipal government constituted in 1793 in the Commonwealth of Puerto Rico. The Municipality has full legislative, fiscal and all other governmental powers and responsibilities expressly assigned by Law No. 81 of August 30, 1991, as amended, known as *Autonomous Municipalities Act of the Commonwealth of Puerto Rico* (Act No. 81).

The Municipality's governmental system consists of executive and legislative branches. The Constitution of the Commonwealth of Puerto Rico (the "Commonwealth") provides for the separation of powers of the executive, legislative and judicial branches. A Mayor, elected every four years by the citizens, exercises the executive power of the Municipality. The legislative power is exercised by the Municipal Legislature, which is also elected every four years. The General Justice Court System of the Commonwealth, which has jurisdiction over the Municipality, exercises the judiciary power.

The Municipality assumes responsibility for providing services to its citizens related to public housing, welfare, public safety, health, sanitation, education, culture, recreation, urban and economic development, and many other general and administrative duties.

a) *Financial Reporting Model*

The accompanying basic financial statements present the financial position of the governmental activities, each major governmental fund, and the aggregate remaining fund information of the Municipality at June 30, 2014, in conformity with Accounting Principles Generally Accepted in the United States of America (GAAP), as prescribed by the Governmental Accounting Standards Board (GASB). In addition, the accompanying basic financial statements present the changes in the financial position (results of operations) of the governmental activities, each major governmental fund, and the aggregate remaining fund information for the fiscal year ended June 30, 2014 in conformity with GAAP.

According to the financial reporting model established by GASB Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments* (GASB No. 34), the minimum required financial statement presentation applicable to the Municipality is composed of the following elements: (1) government-wide financial statements (GWFS), (2) governmental fund financial statements (GFFS), (3) notes to basic financial statements, and (4) required supplementary information (RSI).

RSI consists of: (1) a Management's Discussion and Analysis (MD&A) and (2) a budgetary comparison schedule – general fund. RSI is unaudited supplementary information required by GAAP presented along with, but separate from, the Municipality's basic financial statements.

MD&A is a narrative report that introduces the accompanying basic financial statements and provides an analytical overview of the Municipality's financial activities for the fiscal year ended June 30, 2014, based on the Municipality's knowledge of the transactions, events and conditions reflected in the basic financial statements. The MD&A also highlights certain key fiscal policies that control the Municipality's operations.

**MUNICIPALITY OF PEÑUELAS
COMMONWEALTH OF PUERTO RICO**

**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
YEAR ENDED JUNE 30, 2014**

The *Budgetary Comparison Schedule - General Fund* is a comparison of the actual results (using the budgetary basis of accounting, which differs from GAAP) with the original budget and the final amended budget for the General Fund. A budget to GAAP reconciliation is presented providing information of differences between the budgetary basis of accounting and GAAP.

b) *Financial Reporting Entity*

A financial reporting entity consists of a primary government and its component units. Accordingly, for financial reporting purposes, the primary government is the Municipality. In accordance with GASB No. 14 and GASB No. 61, the criteria used to determine whether organizations are to be included as component units within the Municipality's financial reporting entity are as follow: (1) The organization is legally separate entity; (2) The Municipality appoints a voting majority of the organization's board; (3) There is a financial benefit/burden relationship between the Municipality and the organization or the Municipality is able to impose its will on the organization.

Organizations meeting the above criteria are included in the Municipality's financial reporting entity as discretely presented component units. Entities which meet any of the following in addition to the above criteria are considered to be blended component units of the Municipality: (1) The organization's governing body is substantively the same as the Municipality's governing body and (a) there is a financial benefit or burden relationship between the Municipality and the organization, or (b) management of the Municipality has operational responsibility for the organization; (2) The organization provides services entirely, or almost entirely, to the Municipality, or otherwise exclusively, or almost exclusively, benefits the Municipality even though it does not provide services directly to it; (3) The organization's total debt outstanding, including leases, is expected to be repaid entirely or almost entirely with Municipality resources.

Legally separate organizations that do not otherwise meet the criteria for inclusion as a component unit may be included in the financial reporting entity if it is determined that their exclusion would render the financial statements misleading. This determination is based on the nature and significance of the organization's relationship with the Municipality. Based on the application of the criteria outlined above, the Municipality's management has concluded that there are no legally separate entities or organizations that should be reported as component units of the Municipality as of and for the fiscal year ended June 30, 2014.

c) *Government-wide Financial Statements*

The accompanying GWFS are composed of: (1) the statement of net position and (2) the statement of activities. These financial statements do not report fund information but rather report information of all of the Municipality's governmental activities. These statements are aimed at presenting a broad overview of the Municipality's finances through reporting its financial position and results of operations as a whole, using methods that are similar to those used by most private businesses.

The focus of the GWFS is not on compliance with budgets, regulatory requirements or on the use of available or currently expendable financial resources (referred to as fiscal accountability), but on operational accountability information about the Municipality as a single economic unit.

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Operational accountability is the Municipality's responsibility to report to the extent to which it has met its operating objectives efficiently and effectively, using all resources available for that purpose. It focuses on the Municipality's principal operating objective, which is to provide services to its citizens.

The accompanying statement of net position provides short-term and long-term information about the Municipality's financial position and condition by presenting all of the Municipality's assets and liabilities, with the difference between these two items reported as "net position" (equity). This statement assists management in assessing the level of services that can be provided by the Municipality in the future, and its ability to meet its obligations as they become due. In addition, this statement reports the extent to which the Municipality has invested in capital assets, including infrastructure, and discloses legal and contractual restrictions on resources.

Net position are classified in the accompanying statement of net position within the following three categories:

- **Invested in capital assets, net of related debt** – These consist of capital assets, net of accumulated depreciation and amortization, reduced by the outstanding balances of bonds, notes and other debt that are attributed to the acquisition, construction or improvement of those assets. For the purposes of determining the outstanding debt attributed to capital assets, the total long-term debt related to the acquisition, construction or improvement of capital assets have been reduced by any related unspent debt proceeds and any related unamortized debt issuance costs.
- **Restricted net position** – These consist of net position restricted by external parties (such as creditors, grantors, contributors, laws or regulations of other governments, etc.), or net position for which constraints are imposed by constitutional provisions or enabling legislation. Enabling legislation is defined as legislation that authorizes the Municipality to assess, levy, charge or otherwise mandate payment of resources (from external resource providers). Enabling legislation establishes restrictions if it includes a legally enforceable requirement that those resources be used only for the specific purposes stipulated in the legislation.

The classification of restricted net position identifies resources that have been received or earned by the Municipality with an explicit understanding between the Municipality and the resource providers that the resources would be used for specific purposes. Grants, contributions and donations are often given under those kinds of conditions. Bond indentures also often limit the use of bond proceeds to specific purposes.

Internally imposed designations of resources, including earmarking, are not reported as restricted net position. These designations consist of management's plans for the use of resources, which are subject to change at the discretion of the Municipal Legislature.

- **Unrestricted net position** – These consist of net position that are neither externally or legally restricted, nor invested in capital assets. However, unrestricted net position often are designated to indicate that management does not consider them to be available for general

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operations. Unrestricted net position often have constraints that are imposed by management, but can be removed or modified.

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

The accompanying statement of activities presents the results of the Municipality's operations by showing how the Municipality's net position changed during the year ended June 30, 2014, using a net (expense) revenue format. This statement presents the cost of each function/program as well as the extent to which each of the Municipality's functions, programs or other services either contributes to or draws from the Municipality's general revenues (such as property taxes, municipal license taxes, construction excise taxes, etc.).

A function/program describes a group of activities that are aimed at accomplishing a major service or regulatory responsibility. The functions/programs reported in the accompanying basic financial statements are: (1) general government, (2) urban and economic development, (3) public safety, (4) health and sanitation, (5) culture, recreation and education and (6) welfare and housing assistance. The governmental operations of the Municipality's departments and operational units are classified within the following functions/programs in the accompanying basic financial statements:

General Government:

- Municipal Legislature
- Mayor's Office
- Department of Finance and Budget
- Department of Human Resources
- Department of Municipal Secretary
- Department of Internal Audit
- Department of Public Relations

Public Works:

- Department of Public Works
- Department of Planning and Development
- Department of Recycling Services

Public Safety:

- Department of Municipal Police
- Office of Emergency Management

Health and Welfare:

- Department of Health
- Department of Elderly Affairs

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Department of Service to Citizen

Culture and Recreation:

Department of Recreation and Sports

Department of Art, Culture and Tourism

The statement of activities demonstrates the degree to which program revenues offset direct expenses of a given function/program or segments. Direct expenses are those that are clearly identifiable with a specific function, segment or operational unit. This statement reports revenues in two broad categories: (1) program revenues and (2) general revenues.

Program revenues are generated directly from a program itself or may come from parties outside the Municipality's taxpayers or citizens. In the statement of activities, program revenues reduce the costs (expenses) of the function/program to arrive at the net cost of the function/program that must be financed from the Municipality's general revenues. The accompanying statement of activities separately reports the following categories of program revenues:

- **Charges for services** – These generally consist of exchange or exchange-like transactions involving charges to customers or applicants who purchase, use or directly benefit from the goods, services or privileges provided, or are otherwise directly affected by the services. These include fees charged for specific services, charges for licenses and permits, and fines and forfeitures, among others.

- **Program-specific capital and operating grants and contributions** – These consist of transactions that are either mandatory or voluntary non-exchange transactions with other governments, organizations, or individuals that restrict the resources for use in a particular program. Capital grants and contributions consist of capital assets or resources that are restricted for capital purposes – to purchase, construct or renovate capital assets associated with a specific program. Operating grants and contributions consist of resources that are required to be used to finance the costs of operating a specific program or can be used either for operating or capital purposes of a specific program. Restricted capital and operating grants and contributions are program revenues because they are specifically attributable to a program and reduce the net expense of that program to the Municipality. They are reported net of estimated uncollectible amounts.

General revenues are the default category for revenues. It includes all revenues and gains that do not meet the definition of program revenues. Property taxes, municipal license taxes, sales taxes and construction excise taxes are reported as general revenues. All other nontax revenues (including unrestricted investment earnings, grants and contributions not restricted for specific programs and miscellaneous revenues) that do not meet the definition of program revenues are classified as general revenues. Resources that are dedicated internally by the Municipality are reported as general revenues rather than as program revenues. All general revenues are reported net of estimated uncollectible amounts, which are recorded as reduction of revenues rather than as expenses.

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The *general government* function/program reported in the accompanying statement of activities, includes expenses that are, in essence, indirect or overhead expenses of the Municipality's other functions/programs. Even though some of these costs have been charged to other funds in the governmental fund financial statements as indirect cost allocations permitted under some federal programs, the Municipality has reported these indirect expenses as direct expenses of the general government function. Accordingly, the Municipality does not allocate general government (indirect) expenses to other functions.

The effects of all interfund governmental activities (revenues, expenditures and other financing sources/uses among governmental funds) have been removed from the accompanying statements of net position and activities.

The Municipality classifies all of its activities as governmental activities in the accompanying GWFS. These are activities generally financed through taxes, intergovernmental revenues and other non-exchange revenues that can be used to support the Municipality's programs or services. These governmental activities are also generally reported in the governmental fund financial statements.

The Municipality has no fiduciary activities, which are those in which the Municipality would be holding or managing net position for specific individuals or other external parties in accordance with trust agreements or other custodial arrangements. In addition, the Municipality has no operations or activities that are primarily financed and operated in a manner similar to private business enterprises, where the costs of providing goods or services to the general public is financed primarily through user charges.

d) *Governmental Fund Financial Statements*

The accompanying GFFS are composed of: (1) the balance sheet – governmental funds and (2) the statement of revenues, expenditures and changes in fund balances – governmental funds. These financial statements report the financial position and results of operations of the Municipality's governmental funds by presenting sources, uses and balances of current financial resources. Some of these financial statements have a budgetary orientation and focus primarily on: (1) the Municipality's major funds, as defined below, (2) the fiscal accountability and (3) the individual parts of the Municipality's government. Fiscal accountability represents the Municipality's responsibility to justify that its actions in the current year have complied with public decisions concerning the raising and spending of public moneys in the short term (one fiscal year).

Each governmental fund is considered an independent fiscal entity accounted for within a set of self-balancing accounts that comprise its assets, deferred outflows of resources, liabilities, deferred inflows of resources, fund equity or deficit, revenue and expenditures. The accompanying GFFS segregate governmental funds according to their intended purpose and are used in demonstrating compliance with legal, financial and contractual provisions. The minimum number of governmental funds is maintained consistent with legal and self-imposed managerial requirements established by the Municipality. For financial reporting purposes, the Municipality classifies its governmental funds within the following categories:

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- **General fund** – The general fund is the Municipality’s main operating fund and a major governmental fund, as defined below, used to account for all financial resources and governmental activities not accounted for and reported in another fund. It is presumed that the Municipality’s governmental activities have been reported in the general fund except for transactions for which one of the following compelling reasons has required the use of another fund: (1) legal requirements, (2) GAAP requirements or (3) the demands of sound financial administration requiring the use of a governmental fund other than the general fund.
- **Special revenue funds** – The special revenue funds are major and non-major governmental funds, as defined below, used by the Municipality to account for the proceeds of specific revenue sources that are restricted or committed to expenditure for specified purposes other than debt service and capital projects. The uses and limitations of each special revenue fund are specified by municipal ordinances or 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.
- **Debt service fund** – The debt service fund is a major governmental fund, as defined below, used by the Municipality to account for all financial resources that are restricted, committed, or assigned to expenditure for principal and interest; for (1) bonds payable for which debt service payments are legally mandated to be accounted for in a debt service fund and/or (2) bonds payable or any general long-term debt for which the Municipality is being accumulating financial resources in advance to pay principal and interest payments maturing in future years. During the fiscal year ended June 30, 2014, the financial activity accounted for in the debt service fund was specifically related to bonds payable.

The outstanding balance of general long-term obligations for which debt service payments do not involve the advance accumulation of resources (such as notes payable, obligations under capital leases, accrued compensated absences, and claims and judgments) are only accounted for in the accompanying statement of net position. The debt service payments of such debts, as applicable, are generally accounted for in the general fund.

- **Capital projects funds** – Capital projects funds are major and non-major governmental funds, as defined below, used to account for all financial resources that are restricted, committed, or assigned to expenditure for capital outlays. Significant capital outlays financed from proceeds of general obligation, public improvement or special obligation bonds are accounted for also in the capital projects funds.

The capital projects funds has been used only for major capital acquisitions, construction or improvement activities that would distort financial resources trend data if not reported separately from the other Municipality’s operating activities. The routine purchases of minor capitalizable assets (such as furniture, office equipment, vehicles and other minor capital assets or improvements) have been reported in the governmental fund from which financial resources were used for the payment.

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The focus of the GFFS is on major governmental funds, which generally represent the Municipality's most important funds. Accordingly, the Municipality is required to segregate governmental funds between major and non-major categories within the GFFS. Major individual governmental funds are reported individually as separate columns in the GFFS, while data from all non-major governmental funds are aggregated into a single column, regardless of fund type.

By definition, the Municipality's general fund is always considered a major governmental fund for financial reporting purposes. In addition, any other fund is considered a major fund for financial reporting purposes if its total assets, deferred outflows of resources, liabilities, deferred inflows of resources, revenues or expenditures of that individual governmental fund are at least 10 percent of the corresponding element total (assets, deferred outflows of resources, liabilities, deferred inflows of resources, revenues or expenditures) for all governmental funds. For the purposes of applying the aforementioned major fund criteria, no eliminations of interfund balances have been made. Total revenues for these purposes means all revenues, including operating and nonoperating revenues (net of allowances), except for other financing sources. Total expenditures for these purposes mean all expenditures, including operating and nonoperating expenditures, except for other financing uses.

Based on the aforementioned criteria, the Municipality's major governmental funds reported in the accompanying governmental fund financial statements are: (1) the General Fund, (2) Head Start- Special Programs Fund, (3) Capital Improvement Fund and (4) Debt Service Fund.

General Fund – The general fund is the Municipality's main operating fund used to account for all financial resources and governmental activities not accounted for and reported in another fund.

Head Start – Special Programs Fund - is the fund in which revenues derived from the federal agencies that are used to provide comprehensive health, educational, nutritional, social, and other developmental services primarily to economically disadvantaged preschool children (ages 3 to 5) and infants and toddler (birth through age 3) so that the children will attain school readiness.

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

Debt service fund – The debt service fund is used by the Municipality to account for all financial resources that are restricted, committed, or assigned to expenditure for principal and interest; for (1) bonds payable for which debt service payments are legally mandated to be accounted for in a debt service fund and/or (2) bonds payable or any general long-term debt for which the Municipality is being accumulating financial resources in advance to pay principal and interest payments maturing in future years.

e) Measurement Focus and Basis of Accounting

Government-wide financial statements – The accompanying GWFS are prepared using the economic resources measurement focus and the accrual basis of accounting. Subject to the additional rules and limitations detailed below, revenues (including interest income) are

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generally recorded when earned and expenses are generally recorded when a liability is incurred, regardless of the timing of related cash flows.

All revenues, expenses, gains, losses, assets and liabilities resulting from exchange and exchange-like transactions are generally recorded when the exchange takes place. In exchange transactions, each party to the transaction receives and gives up essentially equal values.

An exchange-like transaction is one in which there is an identifiable exchange and the values exchanged, though related, may not be quite equal. Nevertheless, the exchange characteristics of the exchange-like transaction are strong enough to justify treating it as an exchange for accounting purposes (examples include fees for licenses and permits, charges for services, and miscellaneous revenues, which are recorded as revenues when collected because they are generally not measurable until actually received).

All revenues, expenses, gains, losses and assets resulting from nonexchange transactions are recorded using the criteria set forth by GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions* (GASB No. 33), which the Municipality adopted on July 1, 2003. GASB No. 33 established accounting and reporting standards for nonexchange transactions involving cash and financial or capital resources (for example, most taxes, grants and private donations). In a nonexchange transaction, the Municipality gives (or receives) value without directly receiving (or giving) equal value in return. This is different from an exchange transaction, in which each party receives and gives up essentially equal values. According to GASB No. 33, the Municipality groups its nonexchange transactions into the following four classes in the accompanying basic financial statements: (a) derived tax revenues, (b) imposed nonexchange revenues, (c) government mandated nonexchange transactions, and (d) voluntary nonexchange transactions.

In the case of derived tax revenue transactions (such as municipal license taxes), which result from assessments the Municipality places on exchange transactions, receivables and revenues are recorded when the underlying exchange has occurred (that generally is, when the taxpayers' net sales or revenues subject to tax take place).

In the case of imposed non-exchange revenue transactions (such as property taxes), which result from assessments made by the Municipality on nongovernmental entities, including individuals, other than assessments on exchange transactions, receivables are generally recorded in the period when an enforceable legal claim has arisen. Property taxes are generally recorded as revenues (net of amounts considered not collectible) in the period when resources are required to be used or the first period that the use of the resources is permitted.

Government-mandated non-exchange transactions (such as grants and contributions) result when a government at one level (such as the federal or state government) provides resources to another government (such as the Municipality), and the provider government requires the recipient government to use those resources for a specific purpose or purposes established in the provider's enabling legislation. In these types of transactions, receivables and revenues are generally recorded as follows:

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- For reimbursement-type (commonly known as “expenditure-driven awards”), receivables and revenues are recorded when all eligibility requirements imposed by the provider have been met. The Municipality must expend resources on the specific purpose or project before the provider reimburses any amounts. Revenue is, therefore, generally recognized as qualifying reimbursable expenditures are incurred.
- For other types of grants (mainly grants and contributions with purpose restrictions but with no time requirements), receivables and revenues are recorded when all applicable eligibility requirements are met. When the provider is a government (including the government of the United States of America) the applicable recognition period for both, the provider and the recipient, is the provider’s fiscal year and begins on the first day of that year.

Voluntary non-exchange transactions (such as donations and certain grants and entitlements) result from legislative or contractual agreements, other than exchanges, entered into willingly by two or more parties. In these types of transactions, receivables and revenues are generally accounted for in the same manner as government-mandated non-exchange transactions discussed above.

Receipts of any type of revenue sources collected in advance for use in the following period are recorded as unearned revenues.

Events that are neither exchange nor non-exchange transactions are recorded when it is probable that a loss has been incurred and the amount of loss is reasonably estimable.

According to GASB No. 34, all general capital assets and the unmatured long-term liabilities are recorded only in the accompanying statement of net position. The measurement focus and the basis of accounting used in the accompanying GWFS differ significantly from the measurement focus and basis of accounting used in the preparation of the accompanying governmental fund financial statements. Therefore, the accompanying governmental fund financial statements include reconciliations, as detailed in the accompanying table of contents, to better identify the relationship between the GWFS and the governmental fund financial statements.

Governmental fund financial statements – The accompanying GFFS are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are generally recognized as soon as they are both measurable and available. Revenues are generally considered to be available when they are collectible within the current year or soon enough thereafter to pay liabilities of the current year. For this purpose, the Municipality considers most revenues to be available if collected within 90 days after June 30, 2014, except for property taxes for which the availability period is 60 days. Revenue sources not meeting this availability criterion or collected in advance are recorded as unearned revenues at June 30, 2014. The principal revenue sources considered susceptible to accrual include property taxes, municipal license taxes, intergovernmental grants and contributions and interest income. The principal revenue sources meet both measurability and availability criteria in the accompanying GFFS, except for amounts recorded as unearned (earned and unavailable) revenues.

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In a manner similar to the GWFS, but subject to and limited by the availability criteria discussed above, all revenues, expenses, gains, losses, assets and liabilities resulting from exchange and exchange-like transactions are also generally recorded when the exchange takes place. Accordingly, fees for licenses and permits, charges for services and miscellaneous revenues are recorded as revenues when collected because they are generally not measurable until actually received.

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 or the first fiscal year that the use of the resources is permitted. Receivables and revenues from reimbursement-type grants, contributions, donations and entitlements are also generally recorded as qualifying reimbursable expenditures are incurred, while receivables and revenues from other types of grants are recorded when all eligibility requirements imposed by the provider have been met.

Interest income is recorded when earned only if collected within 90 days after year-end since these would be considered both measurable and available.

Pursuant to the provisions of GASB Interpretation No. 6, *Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements* (GASB No. 6), in the absence of an explicit requirement (i.e., the absence of an applicable modification, discussed below) the Municipality generally accrues a governmental fund liability and an expenditure (including salaries, professional services, supplies, utilities, etc.) in the period in which the government incurs the liability, to the extent that these liabilities are normally expected to be liquidated with current available financial resources. GASB No. 6 modified the recognition criteria for certain expenditures and liabilities reported under the modified accrual basis of accounting prior to GASB No. 34, and clarified a number of situations in which the Municipality should distinguish between governmental fund liabilities and general long-term liabilities. Therefore, the accompanying balance sheet – governmental funds generally reflects assets that will be converted into cash to satisfy current liabilities. Long-term assets (except for accounts receivables and inter-fund advances) and those assets that will not be converted into cash to satisfy current liabilities are generally not accounted for in the accompanying balance sheet – governmental funds. At the same time, long-term liabilities (generally, those unmatured that will not require the use of current financial resources to pay them) are not accounted for in the accompanying balance sheet – governmental funds.

Modifications to the accrual basis of accounting in accordance with GASB No. 6 include:

- Principal and interest on bonds payable are recorded when they mature (when payment is due), except for principal and interest due on July 1, 2014, which have been recorded as governmental fund liabilities at June 30, 2014, which is the date when resources are available in the debt service fund (generally, June 30).

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- Notes payable, obligations under capital leases, compensated absences, and amounts subject to accrued claims and judgments under litigation are recorded only when they mature (when payment is due).
- Certain accrued liabilities not due and payable or not normally expected to be liquidated with current available and expendable financial resources are recorded in the accompanying statement of net position. Such liabilities are recorded in the governmental funds when they mature.
- Executory purchase orders and contracts are recorded as assignments of fund balance in the governmental funds FFS.

Liabilities outside the bounds of these exceptions or modifications are reported as governmental fund liabilities when incurred (including salaries, professional services, supplies, utilities, etc.) since these liabilities normally are paid in a timely manner and in full from current financial resources.

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

Under the financial reporting model established by GASB No. 34, all general capital assets and the unmatured long-term liabilities (determined using the modified accrual basis of accounting) are no longer reported in account groups within the governmental fund balance sheet but are incorporated into the accompanying statement of net position since July 1, 2003.

f) Stewardship, Compliance and Accountability

Budgetary Control

According to the Autonomous Municipalities Act of the Commonwealth of Puerto Rico, the Mayor and its Administrative Cabinet prepare annual budgets each fiscal year for the Municipality's general fund and debt service fund. Such legally adopted budgets are based on expected expenditures by program and estimated resources by source for both funds. The annual budgets are developed using elements of performance-based program budgeting and zero-based budgeting, and include estimates of revenues and other resources for the ensuing fiscal year under laws and regulations existing at the time the budget is prepared.

The Mayor must submit an annual budgetary resolution project (the Project) to the Commissioner of Municipal Affairs of Puerto Rico (the Commissioner) and the Municipal Legislature no later than each May 10 and May 31, respectively. The Commissioner preliminarily verifies that the Project complies with all the applicable laws and regulations and may provide comments and suggestions to the Mayor on or before each June 15.

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The Municipal Legislature has 10 business days, up to June 15, to discuss and approve the Project with modifications. The Municipal Legislature may amend the budgets submitted by the Mayor but may not increase any items so far to cause a deficit without imposing taxes or identifying other sources of revenue to cover such deficit. After the Municipal Legislature modifies and preliminarily approves the Project, the modified Project is sent back to the Mayor for his approval or rejection within 6 days. The Mayor may decrease or eliminate any line item but may not increase or insert any new line item in the budgets. The Mayor may also veto the budgets in their entirety and return it to the Municipal Legislature with his objections. If the Mayor rejects the Project, the Municipal Legislature will have up to 8 days to adopt or reject the recommendations or objections of the Mayor. The approved Project is sent again to the Mayor, which then would have 3 days to sign and approve it.

If the budgets are not adopted prior to the end of the deadlines referred to above, the annual budgets for the preceding fiscal year, as approved by the Legislature and the Mayor, are automatically renewed for the ensuing fiscal year until the Municipal Legislature and the Mayor approve new budgets. This permits the Municipality to continue making payments for its operations and other purposes until the new budgets are approved.

The annual budgets may be updated for any estimate revisions as well as year-end encumbrances and may include any additional information requested by the Municipal Legislature. The Mayor may request subsequent amendments to the approved budgets, which are subject to the approval of the Municipal Legislature.

The Municipality's Department of Finance and Budget has the responsibility to ensure that budgetary spending control is maintained. For day-to-day management control, expenditures plus encumbrances may not exceed budgeted amounts at the expenditure-type level of each cost center (activity within a program within a fund). The Mayor may transfer unencumbered appropriations within programs within funds. The Municipal Legislature may transfer amounts among programs within and among funds.

The legal level of budgetary control (i.e., the level at which expenditures may not legally exceed appropriation) is at the functions/program level (general government, urban and economic development, public safety, health and sanitation, culture, recreation and education, and public housing and welfare) within a fund.

Under the laws and regulations of the Commonwealth, the appropriations made for any fiscal year shall not exceed the total revenue, including available surplus, estimated for said fiscal year unless the imposition of taxes sufficient to cover said appropriations is provided.

Budgetary Accounting

The Municipality's annual budgets are prepared under the budgetary (statutory) basis of accounting, which is not in accordance with GAAP.

Under the budgetary basis of accounting, revenue is generally recognized when cash is received. Short-term and long-term borrowings may be used to finance budgetary excess of expenditures over revenues.

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The Municipality uses encumbrance accounting to record the full amount of purchase orders, contracts and other commitments of appropriated resources as deductions from the appropriation prior to actual expenditure. In the governmental funds, encumbrance accounting is a significant aspect of budgetary control. Accordingly, expenditures are generally recorded when the related expenditure is incurred or encumbered. Available appropriations and encumbrances are established to lapse one year after the end of the fiscal year. Amounts required to settle claims and judgments against the Municipality, and certain other liabilities, are not recognized until they are encumbered or otherwise processed for payment. Unencumbered appropriations and encumbrances lapse at year-end. Other appropriations, mainly capital projects appropriations, are continuing accounts for which the Municipal Legislature has authorized that an unspent balance from the prior year be carried forward and made available for current spending.

The accompanying budgetary comparison schedule provides information about the general fund's original budget, the amendments made to such budget, and the actual general fund's results of operations under the budgetary basis of accounting for the fiscal year ended June 30, 2014. Further details of the Municipality's budgetary control at the legal level may be obtained from the Budgetary Liquidation Report for the fiscal year ended June 30, 2014. Copies of that report may be obtained by writing to the Municipality's Director of Finance and Budget.

Accounting principles applied for purposes of developing data on a budgetary basis differ significantly from those used to present the governmental fund financial statements in conformity with GAAP. Accordingly, the accompanying budgetary comparison schedule is accompanied by a reconciliation of the differences between the budgetary basis and GAAP actual amounts.

The Municipality does not legally adopt budgets for the state legislative joint resolutions capital fund. The financial resources received by these funds are not subject to budgeting by the Municipality since the resources received each year from the respective grantors varies from year to year, and the respective amounts are granted at their discretion.

g) Deposits

The Municipality's deposits are composed of cash on hand, demand deposits and cash equivalents in: (1) commercial banks, (2) the Government Development Bank for Puerto Rico (GDB), a governmental bank and a major component unit of the Commonwealth, who is statutorily designated as fiscal agent of the Municipality, and (3) the Municipal Revenue Collection Center (CRIM, by its Spanish acronyms), a governmental entity responsible for the imposition and collection of property taxes on behalf of all municipalities of Puerto Rico.

The Municipality follows the practice of pooling cash. The balance in the pooled cash account is available to meet current operating requirements. Under the laws and regulations of the Commonwealth, public funds deposited by the Municipality in commercial banks must be fully collateralized for the amounts deposited in excess of the federal depository insurance generally provided by the Federal Deposits Insurance Corporation (FDIC). All securities pledged as collateral are held by agents designated by the Secretary of the Treasury of the Commonwealth, but not in the Municipality's name.

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Cash in commercial banks of special revenue funds are restricted since its use is limited for the specified purposes, which are established by applicable agreements or required by law.

Cash in fiscal agent in the debt service fund represent property and sales tax collections which are retained and restricted for the payment of the Municipality's debt service, as established by law. Cash in fiscal agent in special revenue funds consists of unspent proceeds of bonds and notes, and the balance of interest and nonbearing accounts which are restricted for: (1) the acquisition, construction or improvement of major capital assets and the operations of federal and state funded programs

h) Accounts Receivable

In the accompanying GWFS, receivables consist of all revenues earned but not collected at June 30, 2014. Major receivable balances for the governmental activities include property taxes, municipal license, and intergovernmental receivables.

Tax receivables in the general fund represent uncollected sales taxes. Tax receivables in the debt service fund consist of uncollected property and sales taxes, which are restricted for the payment of the Municipality's debt service, as established by law.

Intergovernmental receivables are composed of: (1) amounts owed to the Municipality for reimbursement of expenditures incurred pursuant to federal and state funded programs which are recorded in the general fund, special revenue funds and capital project funds.

These accounts receivables are stated net of estimated allowances for uncollectible accounts, which are determined, based upon past collection experience, historical trends, current economic conditions and the periodic aging of accounts receivable.

Activities among funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as either "due to/from other funds" (i.e. the current portion of interfund loans) or "advances to/from other funds" (i.e., the non-current portion of interfund loans). All other outstanding balances between funds are reported as "due to/from other funds". Advances between funds, as reported in the GFFS, are offset by a fund balance reserve account in applicable governmental funds to indicate that they are not available for appropriation and are not expendable available financial resources.

i) Capital Assets

Capital assets used in governmental activities include land and land improvements, buildings, structures and building improvements, machinery and equipment, furniture and fixtures, licensed vehicles, construction in progress, and infrastructure. These assets are capitalized and reported in the accompanying statement of net position. Infrastructure assets are generally stationary in nature and include roads, bridges, streets and sidewalks, drainage systems and other similar assets.

The Municipality defines capital assets as assets with an individual cost of \$25 or more at the date of acquisition or construction, and with useful lives extending beyond one year. All assets

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with individual costs under \$25 or with useful lives not exceeding one year, are charged directly to expense in the accompanying statement of activities. In the governmental funds, all capital assets are recorded as expenditures.

In the statement of net position, all capital assets are recorded at cost or estimated historical cost if actual cost was unavailable, except for donated capital assets, which are recorded at their estimated fair value at the date of donation.

Major outlays for capital assets and improvements are capitalized in the statement of net position as projects are constructed. The costs of normal maintenance and repairs that do not add value to the asset or materially extend capital asset lives are not capitalized.

Depreciation and amortization expense is recorded only in the government-wide statement of activities. However, there is no depreciation or amortization recorded for land and construction-in-progress. Depreciable capital assets are generally depreciated or amortized over their estimated useful lives under the straight – line method, except for machinery and equipment held under capital leases which is depreciated over the shorter of its estimated useful life or the lease term. The estimated useful lives of major capital asset categories are:

	<u>Years</u>
Land improvements	40
Buildings, structures and building improvements	40
Infrastructure	40
Licensed vehicles	5
Furniture and fixtures	5
Machinery and equipment, excluding those held under capital leases	3 to 5

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

j) *Unearned Revenues*

In the governmental fund financial statements, unearned revenues arises when one of the following situations occurs:

- Potential revenue does not meet both the “measurable” and “available” criteria for revenue recognition in the current period. As previously discussed, available is defined as due (or past due) at June 30, and collected within 90 days (60 days for property taxes) thereafter to pay obligations due at June 30. In subsequent periods, when both criteria (measurable and available) are met, the liability for unearned revenue is removed and revenue is recognized.
- The Municipality receives resources before it has a legal claim to them. In subsequent periods, when the revenue recognition criterion is met, the liability for unearned revenue is removed and revenue is recognized.

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Unearned revenues at the government-wide level arise only when the Municipality receives resources before it has a legal claim to them.

k) Deferred Outflows/ Inflows of Resources

In addition to assets, the statement of net position and governmental funds balance sheet will sometimes report a separate section for deferred outflow of resources. This separate financial statement element, deferred outflows of resources, represents a consumption of net position or fund balance that applies to a future period (s) and so will not be recognized as an outflow of resources (expense/expenditure) until then. At June 30, 2014, the Municipality has no deferred outflows of resources.

In addition to liabilities, the statement of net position and governmental funds balance sheet will sometimes report a separate section for deferred inflow of resources. This separate financial statement element, deferred inflows of resources, represents an acquisition of net position or fund balances that applies to a future periods and so will not be recognized as an inflow of resources (revenue) until that time. At June 30, 2014, the Municipality has no deferred inflows of resources.

l) Compensated Absences

Compensated absences are accounted for under the provisions of Statement No. 16, *Accounting for Compensated Absences*, issued by GASB (GASB No. 16). Compensated absences include paid time off made available to employees in connection with vacation, sick leave and compensatory time. The liability for compensated absences recorded in the accompanying statement of net position is limited to leave that: (1) is attributable to services already rendered on or before June 30, 2014 and (2) is not contingent on a specific event (such as illness) that is outside the control of the Municipality and the employee. The liability for compensated absences includes salary-related costs, which are directly and incrementally related to the amount of salary paid to the employee (such as employer's share of social security taxes and medicare taxes).

The vacation policy of the Municipality is established by law and provides for the accumulation of regular vacations at a rate of 2.5 days per month (30 days per year) per employee. Employees accumulate regular sick leave at a rate of 1.5 days per month (18 days per year). Employees accumulate compensatory time at a rate of 1.5 times the overtime worked. All vacation and sick leave days accumulated by employees in excess of 30 days and 90 days, respectively, are paid to employees each year, if not consumed, as required by law. In the case of compensatory time, the excess of 240 hours is paid to employees each year, if not consumed.

Upon termination of employment, an employee receives compensation for all accumulated unpaid regular vacation leave at the current rate. In the case of regular sick leave, if the employee terminates his or her employment with the Municipality before reaching 10 years of services, such regular sick leave is not paid to the employee, if not consumed. Upon termination of employment, an employee does not receive compensation for compensatory time, if not consumed. After 10 years of services any regular sick leave balance is paid to the employee. Accumulated vacation time is fully vested to the employee at any time.

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The liability for compensated absences is reported in the statement of net position. A liability for compensated absences is reported in the GFFS only if they have matured, for example, as a result of employee resignations and retirements.

m) Long-term Debt

The long-term liabilities reported in the accompanying statements of net position include the Municipality's bonds, notes, obligation under capital leases, compensated absences and legal claims and judgments.

All long-term debt to be repaid from governmental resources is reported as liabilities in the accompanying statement of net position. Principal and interest payments on bonds due in July 1 of the following fiscal year are recorded as fund liabilities in the GFFS when resources are available in the debt service fund (generally at June 30). In the GFFS, the face amount of debt issued is reported as other financing sources when issued.

n) Accounting for Pension Costs

For the purpose of applying the requirements of GASB Statement No. 27, Accounting for Pensions by State and Local Government Employers (GASB No. 27), the Commonwealth of Puerto Rico is considered to be the sponsor of the Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS) and System 2000, the two retirement systems in which the employees of the Municipality participate. Accordingly, the Municipality is considered a participant and not a sponsor of these retirement systems since the majority of the participants in the aforementioned pension trust funds are part of the financial reporting entity of the Commonwealth. Accordingly, no portion of the net pension obligation (NPO) related to ERS has been allocated to the Municipality in the accompanying basic financial statements. The basic financial statements of the Commonwealth account for the total amount of the net pension obligation of ERS, including any amount that may be allocated to the Municipality.

According to GASB No. 27, the Municipality accounts for pension costs from the standpoint of a participant in a multiple-employer cost-sharing plan. Accordingly, pension costs recognized in the accompanying basic financial statements are equal to the statutorily required contributions, with a liability recorded for any unpaid required contributions.

o) Risk Management

The Municipality carries commercial insurance covering casualty, theft, tort claims and other losses. Insurance policies are negotiated by the Puerto Rico Treasury Department (the Treasury Department) on behalf of all municipalities of Puerto Rico. The Treasury Department pays the insurance premiums on behalf of the Municipality and then is reimbursed each year through monthly equal payments deducted from the Municipality's gross property tax collections made by CRIM.

The Municipality carries insurance coverage for death and bodily injuries caused by automobile accidents. This insurance is obtained through the Automobile Accidents Compensation Administration ("ACAA", by its Spanish acronym), a discretely component unit of the

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Commonwealth. This insurance is compulsory for all licensed vehicles used on public roads and highways in Puerto Rico. The annual premium is \$35 per licensed motor vehicle, which is paid directly to ACAA.

The Municipality obtains workers' compensation insurance coverage through the State Insurance Fund Corporation ("FSE" by its Spanish acronym), a component unit of the Commonwealth. This insurance covers workers against injuries, disability or death because of work or employment-related accidents, or because of illness suffered as a consequence of their employment. Workers' compensation insurance premiums are also paid through monthly deductions made by CRIM from the Municipality's gross property tax collections.

The Municipality obtains unemployment compensation, non-occupational disability, and drivers' insurance coverage for its employees through various insurance programs administered by the Commonwealth's Department of Labor and Human Resources (DOL). These insurance programs cover workers against unemployment and provide supplementary insurance coverage for temporary disability, or death because of work or employment-related accidents or because of illness suffered as a consequence of their employment. Unemployment compensation, non-occupational disability and drivers' insurance premiums are paid directly to DOL on a quarterly basis.

The Municipality also obtains medical insurance coverage for its employees. The current insurance policies have not been cancelled or terminated at June 30, 2014. In the past three years, the Municipality has not settled claims that exceeded insurance coverage.

p) Fund Balances

On July 1, 2010, the Municipality adopted the provisions of GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions No. 54* (GASB No. 54). GASB No. 54, which enhanced the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied. Also, this statement establishes fund balance classifications that comprise a hierarchy upon use of the resources reported in governmental funds.

According to the provisions of GASB No. 54, the fund balances are reported in five categories:

- ***Nonspendable*** – Amounts that cannot be spent because they are: a) not in spendable form or b) legally or contractually required to be maintained intact. Due to the nature or form of the resources, they generally cannot be expected to be converted into cash or a spendable form.
- ***Restricted*** – Represent resources that can be spent only for the specific purposes stipulated by constitutional provisions, external resource providers (externally imposed by creditor or grantors), or through enabling legislation (that is, legislation that creates a new revenue source and restricts its use).
- ***Committed*** – Amounts that can only be used for a specific purpose pursuant to constraints imposed by formal action (ordinances or resolutions) of the Municipality's highest level of decision making authority (Municipal Legislature). The formal action must occur prior to the

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end of the reporting period, however, the amount may be determined in the subsequent period. These are self-imposed limitations on available resources. These committed amounts cannot be used for any other purpose unless the government removes or changes the specified use by taking the same level of action it employed to previously commit those amounts. These committed amounts would be approved and adopted by formal action of the Municipal Legislature.

- **Assigned** – Represent resources intended to be used by the Municipality for specific purposes but do not meet the criteria to be classified as restricted or committed (generally executive orders approved by the Mayor). Intent can be expressed by the Municipal Legislature, the Mayor or by an official or body to which the Municipal Legislature delegates authority in conformity with the Law No. 81 of August 30, 1991, as amended, known as *Autonomous Municipalities Act of the Commonwealth of Puerto Rico* (Act No. 81). In governmental funds other than the general fund, assigned fund balance represents the remaining amount that is not restricted or committed.
- **Unassigned** – Represent the residual classification for the Municipality's general fund and includes all spendable amounts not contained in the other classifications. In other funds, the unassigned classification is used only to report a deficit balance resulting from overspending for specific purposes for which amounts had been restricted, committed, or assigned.

Negative fund balance amounts are assigned amounts reduced to the amount that will raise the fund balance to zero. Consequently, negative residual amounts is restricted, committed and assigned fund balance classifications have been reclassified to unassigned fund balances.

The Municipality reports resources constrained to stabilization as a specified purpose (restricted or committed fund balance in the general fund) only if: (1) such resources meet the other criteria for those classifications, as described above and (2) the circumstances or conditions that signal the need for stabilization are identified in sufficient detail and are not expected to occur routinely. However, the Municipality has not entered into any stabilization-like arrangements, nor has set aside material financial resources for emergencies and has not established formal minimum fund balance amounts as of and for the fiscal year ended June 30, 2014.

When an expenditure is incurred for purposes for which amounts are available in multiple fund balance classifications, the Municipality uses restricted resources first, and then unrestricted resources. Within unrestricted resources, the Municipality generally spends committed resources first, followed by assigned resources, and then unassigned resources.

At June 30, 2014, the accompanying fund financial statements reported fund balances as restricted, assigned and unassigned.

q) Interfund Activities

The Municipality has the following types of reciprocal and non-reciprocal inter-fund activities recorded among governmental funds in the accompanying GFFS:

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- **Inter-fund loans** – Represent resources (assets) provided by one governmental fund to other governmental fund with a requirement and commitment for repayment (reimbursement), which are recorded as “*due from*” in the lender governmental fund and “*due to*” in the borrower governmental fund. For amounts not expected to be collected, inter-fund receivables/payables are reduced to their estimated realizable (settlement) value, and the portion of the inter-fund loan that is not expected to be repaid is reported as a “*transfer-in*” from the governmental fund that provided the loan.
- **Inter-fund transfers (transfers-in/(out))** – Represent flows of assets (permanent reallocation of financial resources among governmental funds) without equivalent flows of assets in return and without a requirement for repayment. Transfers are reported as “*other financing uses*” in the governmental fund making transfers and as “*other financing sources*” in the governmental fund receiving transfers.
- **Inter-fund reimbursements** – Represent repayments (reimbursements) from the governmental fund responsible for particular expenditures or expenses to the governmental fund that initially paid for them.

In the GFFS, inter-fund activity has not been eliminated, as permitted by GAAP.

r) Use of Estimates

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

s) Future Adoption of Accounting Pronouncements

The GASB has issued the following standards that have effective dates after June 30, 2014:

- GASB Statement No. 68 *Accounting and Financial Reporting for Pensions—an amendment of GASB Statement No. 27 (Issued 06/12)*. The primary objective of this Statement is to improve accounting and financial reporting by state and local governments for pensions. It also improves information provided by state and local governmental employers about financial support for pensions that is provided by other entities. This Statement results from a comprehensive review of the effectiveness of existing standards of accounting and financial reporting for pensions with regard to providing decision-useful information, supporting assessments of accountability and interperiod equity, and creating additional transparency. This Statement is effective for fiscal years beginning after June 15, 2014.
- GASB Statement No. 69 *Government Combinations and Disposals of Government Operations (Issued 01/13)* This Statement establishes accounting and financial reporting standards related to government combinations and disposals of government operations. As used in this Statement, the term government combinations includes a variety of transactions referred to as mergers, acquisitions, and transfers of operations. The requirements of this Statement are

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effective for government combinations and disposals of government operations occurring in financial reporting periods beginning after December 15, 2013, and should be applied on a prospective basis.

- GASB Statement No. 70, *Accounting and Financial Reporting for Noexchange Financial Guarantees*. The objective of this Statement is to improve accounting and financial reporting by state and local governments that extend and receive nonexchange financial guarantees.
- GASB Statement No. 71 *Pension Transition for Contributions made Subsequent to the Measurement Date- an amendment of GASB 68*. This statement is effective for periods beginning after June 15, 2014. The objective of this Statement is to address an issue regarding application of the transition provisions of Statement No. 68, *Accounting and Financial Reporting for Pensions*. The provisions of this Statement are required to be applied simultaneously with the provisions of Statement 68.
- GASB Statement No. 72 *Fair Value Measurement and Application (Issued 2/15)*. The objective of this Statement is to provide guidance for determining a fair value measurement for financial reporting purposes. The requirements of this Statement are effective for financial statements for periods beginning after June 15, 2015. Earlier application is encouraged.

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

2. DEPOSITS

The Municipality maintains its deposits of cash in various commercial banks located in Puerto Rico, GDB and CRIM. Proceeds from all bonds and the funds related to certain federal grant awards are required by law to be held with GDB.

On July 1, 2004, the Municipality adopted the provisions of GASB Statement No. 40 (GASB No. 40), *Deposit and Investment Risk Disclosure, an Amendment to GASB Statement No. 3*. This statement requires that state and local governments disclose essential risk information about deposits and investments. The disclosure requirements cover four main areas: (1) credit risk, (2) interest rate risk, (3) custodial credit risk, (4) foreign exchange exposure.

- **Credit risk** -- This is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. In compliance with the laws and regulations of the Commonwealth, the Municipality has adopted, as its custodial credit risk policy, the *Statement of Investment Guidelines for the Government of the Commonwealth of Puerto Rico*. Accordingly, the Municipality is only allowed to invest its obligations of the Commonwealth, 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 for which credit risk exposure may be significant. Therefore, the Municipality's management has concluded that the credit

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risk related to any possible loss related to defaults by commercial banks on the Municipality's deposits is considered low at June 30, 2014.

- **Interest rate risk** – This is the risk that changes in interest rates of debt investments will adversely affect the fair value of an investment. The Municipality manages its exposure to declines in fair values by: (1) not including debt investments in its investments portfolio at June 30, 2014, (2) limiting the weighted average maturity of its investments to periods of three months or less and (3) keeping most of its banks deposits in interest bearing accounts generating interest at prevailing market rates. At June 30, 2014, the interest rate risk associated with the Municipality's cash and cash equivalent is considered low.

- **Custodial credit risk** – In the case of deposits, this is the risk that in the event of a bank failure, the Municipality's deposits may not be recovered. Pursuant to the *Statement of Investment Guidelines for the Government of the Commonwealth of Puerto Rico*, the balances deposited in commercial banks by the Municipality are insured by the Federal Deposit Insurance Corporation (FDIC), generally up to a maximum of \$250,000 per depositor. 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, amounting to \$5,664,142 at June 30, 2014, are uninsured and uncollateralized. However, no losses related to defaults by GDB on deposit transactions have been incurred by the Municipality through June 30, 2014. 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, 2014, 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, 2014.

The Municipality's bank balances in commercial banks of \$9,794,031 in the General Fund, \$781,226 in Head Start- Special Programs Fund and \$1,575,257 in Capital Improvements Funds were fully collateralized at June 30, 2014. In the Other Governmental Funds, there were deposits with commercial banks of \$873,017 that were fully collateralized.

The deposits at GDB of \$3,267 in the General Fund, \$2,141,932 in the Capital Improvements Fund, \$3,462,970 in the Debt Service Fund and the \$55,973 in Other Governmental Funds are unsecured and uncollateralized, as no collateral is required to be carried by governmental banks.

3. MUNICIPAL LICENSE TAXES

The Municipality is authorized by Law No. 81 to impose and collect municipal license taxes on all trade or business activities operated by any natural or legal person within the territorial area of

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Peñuelas. This is a self-assessed tax generally based on the business volume measured by gross sales. The Municipality establishes the applicable tax rates. At June 30, 2014, the municipal tax rates imposed by the Municipality were 1.50% for financing institutions and 0.40% for other types of taxpayers. Any taxpayers that have been granted with partial tax exemptions under any of the incentive tax laws of the Commonwealth ultimately pay municipal license taxes at reduced tax rates, generally between 60% and 90% under standard rates.

Each taxpayer must assess his/her corresponding municipal license tax by declaring his/her volume of business through a tax return to be filed every April 15 based on the actual volume of business generated in the preceding calendar year.

Taxpayers with a sales volume of \$3 million or more must include audited financial statements with their tax returns. The tax can be paid by the taxpayer in two equal installments due on July 15 and January 15, subsequent to the filing of the declaration.

The first installment of the tax covers the six-month period ended December 31, subsequent to the filing date of the declaration, while the second installment of the tax covers the six-month period ended June 30 of the subsequent calendar year. If a taxpayer elects to pay the tax in full on the filing date of the declaration (generally April 15), a 5% discount is granted automatically on the total tax amount due.

Any municipal license taxes collected in advance (that is, pertaining to a future period) are recorded as unearned revenues. Unearned municipal license tax revenues recorded in the accompanying GWFS and GFFS amounted to \$4,682,485 at June 30, 2014, which represents municipal licenses collected in advance for the taxable year 2014-2015.

4. PROPERTY TAXES

The Municipality is authorized by Law No. 81 to impose and collect personal and real property taxes. Under the laws and regulations of the Commonwealth, personal property taxes can be imposed to any natural or legal person that at January 1 of each year is engaged in trade or business and is the owner of personal property used in trade or business.

Personal property taxes are self-assessed by taxpayers every year generally using the book value of personal property assets owned by the taxpayer at January 1 (assessment date) and reporting such taxable value through a personal property tax return filed on May 15 subsequent to the assessment date. The total personal property tax rate in force at June 30, 2014 was 6.33% (of which taxpayers pay 6.13% and 0.20% is reimbursed by the Department of Treasury). Real property taxes are assessed by CRIM. The assessment on real property is made every January 1 and is based on estimated current values of the property deflated to 1957 market prices. The total real property tax rate in force at June 30, 2014 was 8.33% (of which 8.13% is paid by taxpayers and 0.20% is also reimbursed by the Department of Treasury).

Residential real property occupied by its owner is exempt by law from property taxes on the first \$15,000 of the assessed value (at 1957 market prices). For such exempt amounts, the Department of Treasury assumes payment of the basic tax (4% and 6% for personal and real property, respectively)

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to the Municipality, except for property assessed of less than \$3,500 (at 1957 market prices), for which no payment is made.

CRIM is responsible for the billing and collections of real and personal property taxes on behalf of the Municipality. Prior to the beginning of each fiscal year, CRIM informs the Municipality of the estimated amount of property tax expected to be collected for the ensuing fiscal year. Throughout the year, CRIM advances funds to the Municipality based on the initial estimated collections. CRIM is required by law to prepare a settlement statement on a fiscal year basis, whereby a comparison is made between the amounts advanced to the Municipality and amounts actually collected from taxpayers. This settlement has to be completed on a preliminary basis not later than each December 31. If CRIM remits to the Municipality property tax advances, which are less than the property tax actually collected, an additional property tax receivable is recorded at June 30. However, if advances exceed the amount actually collected by CRIM, an intergovernmental payable is recorded at June 30.

Law No. 81 provides for the levy of an annual special tax of 1.03% of the assessed value of all real and personal property not exonerated from taxation. Such special tax is levied and collected by CRIM. Collections of this special tax are remitted to the Commonwealth's debt service fund for payment of debt service on general obligations of the Commonwealth.

In addition, 1.50% of the total personal and real property taxes collected by CRIM is restricted for the Municipality's debt service requirements and is retained by GDB for such purposes.

The Additional Lottery System of the Commonwealth (the "Additional Lottery") is an operational unit reported as an enterprise fund of the Commonwealth, which currently operates several betting alternatives to the citizens of Puerto Rico. The Additional Lottery is required every year to distribute a portion of its excess of revenues over expenses as follows:

- i. Thirty five percent (35%) of its net earnings (defined as the excess of revenues over expenses less an amount earmarked for the Fund for Rent and Home Improvement Subsidy Program for the Low-Income Qualifying Elderly) is earmarked to the municipalities of the Commonwealth, of which a maximum of \$26 million, on an annual basis, is distributed to the Municipal Equalization Fund held by CRIM to cover operating expenses and permanent improvements of the municipalities.
- ii. An additional amount not exceeding \$16 million, on an annual basis, is distributed to the Municipal Equalization Fund, provided it is within the 35% corresponding to the municipalities of the Commonwealth. When the accumulated municipal appropriations from the municipalities' Puerto Rico Health Reform are covered up to June 30, 1997, these resources will be assigned to the Health Insurance Administration, a component unit of the Commonwealth.

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5. SALES TAX

On July 4, 2006, the Commonwealth Legislature approved Act No. 117 ("Act 117") which amends the Puerto Rico Internal Revenue Code of 1994 to provide, among other things, for a sale and use tax of 5.5% to be imposed by the Commonwealth Government. Act 117 also authorizes each municipal government to impose a municipal sale and use tax of 1.5%. This municipal sales and use tax has in general the same tax base and limitations (except for unprocessed foods) as those provided by the Commonwealth's sales and use tax.

On July 29, 2007, the Commonwealth Legislature approved Act No. 80 (Act 80) which amends Act No. 117 of July 4, 2006 to impose to all the Municipalities of Puerto Rico a uniform municipal sales and use tax of 1.5%. Effective August 1, 2007 1% of the 1.5% is collected by the Municipalities and the remaining .5% of the 1.5% is collected by the Puerto Rico Department of Treasury (PRDT).

The amount collected by the PRDT, (.5% of the 1.5%) is deposited in accounts or special funds in the Governmental Development Bank of Puerto Rico (GDB), subject to restrictions imposed and distributed as follows:

- .2% of the .5% will be deposited in a Municipal Development Fund to be distributed among all the municipalities in accordance with a formula created by the Act,
- .2% of the .5% will be deposited in a Municipal Redemption Fund to finance loans to Municipalities and,
- .1% of the .5% will be deposited in a Municipal Improvement Fund to finance capital improvement projects; these funds will be distributed based on legislation from the Commonwealth's Legislature

The Municipal Legislature approved a municipal ordinance to conform to dispositions of Act 80. Effective January 1, 2011 the Commonwealth of Puerto Rico adopted a new Internal Revenue Code (2011 PR Code). Subtitle D (Sections 4010 to 4070) of the 2011 PR Code incorporates the dispositions applicable to the sales and use tax. As stated by Section 4050 the Municipalities may use the sales and use tax proceeds to finance solid waste, recycling, capital projects, health and public safety programs as well as any other activity that promotes sound public administration.

Individuals, organizations and entities subject to collect the municipal sales and use tax must file a tax return to the PRDT. The tax is due the 10th day of each month based on tax collected in the preceding month. The Municipality recorded as revenue \$438,138 in the general fund corresponding to the 1% imposition and \$560,205 in the debt service fund corresponding to the Municipal Redemption Fund.

Individuals, organizations and entities subject to collect the municipal sales and use tax must file a tax return to the Municipality. The tax is due the 10th day of each month based on tax collected in the preceding month. Municipal sales and use tax receivable in the general and debt service funds at June 30, 2014, of \$32,940 and \$90,272, respectively, represents the tax collected on June (or before) by individuals, organizations and entities but reported and paid to the Municipality on or before July 10, net of uncollectible accounts.

**MUNICIPALITY OF PEÑUELAS
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**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
YEAR ENDED JUNE 30, 2014**

On June 30, 2013, the Commonwealth approved Act No. 40 which among other things, reduces the municipal sales and use tax from 1.5% to 1% and increasing the Commonwealth sales and use tax from 5.5% to 6% effective December 1, 2013. This Act was subsequently amended to change this effective date from December 1, 2013 to February 1, 2014.

In order to address the fiscal and credit crisis of the Commonwealth of Puerto Rico, the GDB liquidity, and the difficult fiscal situation of the municipalities of Puerto Rico, on January 24, 2014 the Commonwealth approved Act No. 18 and 19. Those Acts provide for the restructuring and creation of financing structures from sales and use tax sources to guarantee and pay municipal long-term debt issuances. As a result of this legislation the municipalities of Puerto Rico may improve its credit capacity along with maintaining sufficient resources for operations.

The purpose of the Act No. 18 of January 24, 2014 is to create a special fund called Municipal Administration Fund (FAM) under custody of the Governmental Development Bank of Puerto Rico ("GDB") that permits the Municipalities to guarantee and pay long term debt and provide funds for its general operations. In addition, this Act improves the financing capacity of the Puerto Rico Sales Tax Financing Corporation (COFINA), a Commonwealth fund administered by GDB and the P.R. Secretary of Treasury. The Act includes provisions for municipalities that do not want to be covered by the Act. Special rules apply for those municipalities. The Act is effective on February 1, 2014.

The 6% corresponding to the Commonwealth's sales and use tax will be deposited in COFINA. From these funds during a transitory period from February 1, 2014 to June 30, 2014 the Commonwealth will deposit \$43,440,184 in the FAM to be distributed to the Municipalities as follows:

- .2% will be deposited in a Municipal Development Fund to be distributed to the municipalities,
- .2% will be deposited in a Municipal Redemption Fund to guarantee and repay the municipalities long term debt and,
- .1% will be deposited in a Municipal Improvement Fund to finance capital improvement projects; these funds will be distributed based on legislation from the Commonwealth's Legislature.

After July 1, 2014 the 6% corresponding to the Commonwealth's sales and use tax will be deposited in COFINA. From these funds the Commonwealth will deposit .5% in the FAM. Distribution to municipalities will depend on whether the municipalities signed an agreement to be covered or not covered by the Act's provisions. The signed the agreement to be covered.

For municipalities covered by the agreement the .5% will be distributed as follows:

- .2% will be deposited in the Municipal Development Fund to be distributed to the municipalities,
- .2% will be deposited in a Municipal Redemption Fund to then be deposited in the municipalities general fund (the municipalities has the option to maintain funds in the

**MUNICIPALITY OF PEÑUELAS
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**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
YEAR ENDED JUNE 30, 2014**

Municipal Redemption Fund or to transfer funds from the Municipal Development Fund to increase its debt margin and issue loans to be obtained from financial institutions)

- .1% will be deposited in a Municipal Improvement Fund to finance capital improvement projects; these funds will be distributed based on legislation from the Commonwealth's Legislature.

For municipalities not covered by the agreement the .5% will be distributed as follows:

- .2% will be deposited in the Municipal Development Fund. Section 4 of the Act requires amounts deposited in the Municipal Development Fund of municipalities not covered by the Act to be redistributed to the municipalities covered by the Act,
- .2% will be deposited in a Municipal Redemption Fund to guarantee and repay long term debt through any financial institution (each semester the municipalities may transfer to their general fund the funds in excess of debt service requirements),
- .1% will be deposited in a Municipal Improvement Fund to finance capital improvement projects; these funds will be distributed based on legislation from the Commonwealth's Legislature.

The purpose of the Act No. 19 of January 24, 2014 is to create the Municipal Finance Corporation (COFIM) a public corporation and a component unit of the Governmental Development Bank of Puerto Rico (GDB) which may issue, pay or refinance long-term debt of municipalities. Principal and interest of these bonds and loans will be guaranteed with the municipal sales and use tax (1%). The Act includes provisions for municipalities that do not want to be covered by the Act. Special rules apply for those municipalities. The Act is effective on February 1, 2014.

After July 1, 2014, the 1% corresponding to the municipalities' sales and use tax will be deposited in COFIM. From these funds COFIM will deposit to the COFIM's sinking fund the greater of: .3% of the 1% municipal sales and use tax or an Annual Rental Fee (RFA). The RFA for fiscal year 2014-2015 will be \$65,541,281 and thereafter will be 1.5% of the RFA of the preceding fiscal period. The excess of the required deposit to the COFIM's sinking fund (.7% of the 1% of the municipal sales and use tax) will be transferred to the general fund of municipalities covered by the agreement or to the Municipal Redemption Fund as decided by the municipality. Before the transfer of the .7% to the municipalities covered by the Act, COFIM will transfer the 1% municipal sales and use tax to the municipalities not covered by the Act. These municipalities cannot obtain loans guaranteed by COFIM's sinking fund.

If at any moment the required deposits to the COFIM's sinking fund were not sufficient to pay the principal and interest of any outstanding obligation, the deficiency will be covered by appropriations of the Commonwealth's general fund budget.

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**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
YEAR ENDED JUNE 30, 2014**

6. INTERGOVERNMENTAL RECEIVABLE AND PAYABLE

Intergovernmental receivables and payables recorded in the accompanying GWFS and GFFS are as follows:

	General	Head Start - Special Programs	Other Governmental	Total Governmental	Statement of net
	Fund	Fund	Funds	Funds	position
<i>Intergovernmental receivables:</i>					
Puerto Rico Office of the Commissioner of Municipal Affairs- Community Development Block Grants Program	\$ -	\$ -	\$213,071	\$213,071	\$213,071
Homeland Security	-	-	48,473	48,473	48,473
Puerto Rico Department of Labor Act. No. 52	-	-	43,907	43,907	43,907
Puerto Rico Administration for Integral Care and Development of Children	-	\$43,697	-	\$43,697	\$43,697
Hazard Mitigation Grants Program	-	-	226,533	226,533	226,533
Total intergovernmental receivables	<u>\$ -</u>	<u>\$43,697</u>	<u>\$531,984</u>	<u>\$575,681</u>	<u>\$575,681</u>
<i>Intergovernmental payables:</i>					
Puerto Rico Aqueduct and Sewer Authority	\$133,185	\$ -	\$ -	\$133,185	\$133,185
State Department of Labor	58,677	-	-	58,677	58,677
State General Service Administration	1,456	-	-	1,456	1,456
State Department of Treasury	4,128	-	-	4,128	4,128
Others	1,992	-	-	1,992	1,992
Total intergovernmental payables	<u>\$199,438</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$199,438</u>	<u>\$199,438</u>

Intergovernmental receivables and payables represent the pending settlements of the aforementioned intergovernmental transactions.

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**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
YEAR ENDED JUNE 30, 2014**

7. INTERFUND TRANSACTIONS

The composition of interfund balances at June 30, 2014 and for the fiscal year then ended is as follows:

<u>Transfers-out:</u>	<u>Transfer-in:</u>	
	<u>General Fund</u>	<u>Debt Service Fund</u>
Major funds:		
General Fund	\$ -	\$ 367,889
Debt Service Fund	844,510	-
Other Governmental Fund	105,929	-
Total	<u>\$ 950,439</u>	<u>\$ 367,889</u>

<u>Due From:</u>	<u>Due to:</u>			<u>Total</u>
	<u>Head Start-Special Programs Fund</u>	<u>Capital Improvement Fund</u>	<u>Other Governmental Fund</u>	
Major funds:				
General Fund	\$ 582,200	\$ 53,061	\$ 498,478	\$ 1,133,739
Total	<u>\$ 582,200</u>	<u>\$ 53,061</u>	<u>\$ 498,478</u>	<u>\$ 1,133,739</u>

At June 30, 2014 all amounts due to among funds are considered collectible by the Municipality's management.

The principal purposes of inter-fund receivables and payables are to recognize in the outstanding balance of the loans granted, the effect of the practice of pooling cash in the current account, and to temporarily cover the payroll and other operating costs of several federally, and local and state funded programs.

The principal purposes of inter-fund transfers are to make a routinely transfer of resources from the general fund to the debt service fund to cover the principal and interest payment on certain bond. These debt service payments were made on January and July 2014. In addition, there are inter-fund transfers for operational purposes.

Inter-fund receivables and payables represent the pending settlements of the aforementioned transfers at June 30, 2014.

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**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
YEAR ENDED JUNE 30, 2014**

8. CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2014, was as follows:

Depreciation and amortization of capital assets was charged to functions/activities in the accompanying government-wide statement of activities as follows:

	<u>Balance at June 30, 2013</u>	<u>Additions</u>	<u>Reclasifications</u>	<u>Balance at June 30, 2014</u>
<u>COST BASIS:</u>				
Cost basis of capital assets, not subject to depreciation and amortization:				
Land	\$ 659,123	\$ -	-	\$ 659,123
Construction in progress	-	1,591,066	(1,591,066)	-
Total cost basis of capital assets, not subject to depreciation and amortization	<u>659,123</u>	<u>1,591,066</u>	<u>(1,591,066)</u>	<u>659,123</u>
Cost basis of capital assets, subject to depreciation and amortization:				
Buildings, structures and building improvements	29,426,441	-	169,393	29,595,834
Infrastructure	23,044,846	-	1,421,673	24,466,519
Land Improvements	228,502	-	-	228,502
Licensed vehicles	5,974,643	371,528	-	6,346,171
Machinery and equipment	3,016,919	26,011	-	3,042,930
Total cost basis of capital assets subject to depreciation and amortization	<u>61,691,351</u>	<u>397,539</u>	<u>1,591,066</u>	<u>63,679,956</u>
Total cost basis of capital assets	<u>\$ 62,350,474</u>	<u>\$ 1,988,605</u>	<u>\$ -</u>	<u>\$ 64,339,079</u>
		Depreciation and Amortization Expenses		
	<u>Balance at June 30, 2013</u>		<u>Reclasifications</u>	<u>Balance at June 30, 2014</u>
<u>ACCUMULATED DEPRECIATION AND AMORTIZATION:</u>				
Buildings, structures and building improvements	(6,889,157)	(1,001,331)	-	(7,890,488)
Infrastructure	(5,898,454)	(834,056)	-	(6,732,510)
Land Improvements	(188,669)	(10,243)	-	(198,912)
Licensed vehicles	(5,440,746)	(158,564)	-	(5,599,310)
Machinery and equipment	(2,307,820)	(121,853)	-	(2,429,673)
Total accumulated depreciation and Amortization	<u>(20,724,846)</u>	<u>(2,126,047)</u>	<u>-</u>	<u>(22,850,893)</u>
CAPITAL ASSETS, NET	<u>\$ 41,625,628</u>			<u>\$ 41,488,186</u>

The depreciation expense is detailed as follow:

General government	\$ 406,105
Public safety	30,902
Public works	725,848
Health and welfare	60,423
Culture, recreation and education	719,286
Community development	183,483
Total depreciation and amortization expense	<u>\$ 2,126,047</u>

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**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
YEAR ENDED JUNE 30, 2014**

9. EMPLOYEES RETIREMENT SYSTEM

a) Act No. 447 and System 2000 (until June 30, 2013)

As of June 30, 2014 regular employees of the Municipality contribute to a cost-sharing multiple employer defined benefit retirement plan administered by the Employee's 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, the municipalities of Puerto Rico and certain public corporations not having their own retirement systems.

The system provides retirement pensions, death, and disability benefits. Retirement benefits depend upon age at retirement and number of years of credited service. Benefits vest after ten years of plan participation.

The system operates under Act 447, approved on May 15, 1951 effective on January 1, 1952 and Act 1 of February 16, 1990 for employees that entered as participants of the Plan starting April 1, 1990 and ending December 31, 1999. Under this Act, retirement benefits were determined by the application of stipulated benefit ratios to the member's average compensation. Average compensation was computed based on the highest 36 months of compensation recognized by ERS. The annuity, for which a plan member was eligible, was limited to a minimum of \$200 per month and a maximum of 75% of the average compensation. ERS issues a publicly financial report that includes financial statements and required supplementary information of the Plan, which may be obtained from the ERS.

Act No. 305 of September 24, 1999 amended Act No. 447 of 1951 and Act 1 of February 16, 1990 to establish a new pension program (System 2000). The new pension program became effective on January 1, 2000. Employees participating in the Act 447 system as of December 31, 1999 had the choice to either stay in the defined benefit plan or transfer to the new program. Persons joining the government on or after January 1, 2000 were only allowed to become members of the new program. System 2000 was a hybrid defined contribution plan, also known as a cash balance plan.

There would be a pool of pension assets, which would be invested by the System, together with those of the current defined benefit plan. Benefits at retirement age would not be guaranteed by the State government and would be subjected to the total accumulated balance of the savings account. The annuity would be based on a formula, which assumed that each year the employee's contribution (with a minimum of 8.275% of the employee's salary up to a maximum of 10%) would be invested in an account which would either: (1) earn a fixed rate based on the two-year Constant Maturity Treasury Note or, (2) earn a rate equal to 75% of the return of the System's investment portfolio (net of management fees), or (3) earn a combination of both alternatives. If the savings accounts balance was \$10,000 or less at time of retirement, the balance would be distributed by the System to the participant as a lump sum. Participants received periodic account statements similar to those of defined contribution plans showing their accrued balances. The employer contributions (11.275% of the employee's salary) would be used to fund the plan. Under System 2000 the retirement age was reduced from 65 years to 60 for those employees who joined the current plan on or after April 1, 1990.

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**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
YEAR ENDED JUNE 30, 2014**

The Act No. 447, as amended, was the authority under which obligations to contribute to the Plan by the Plan members, employers and other contributing entities were established or amended. Plan members were required to contribute 5.775% of gross salary up to \$6,600 plus 8.275% of gross salary in excess of \$6,600 except for the Mayor or employee under a supplementation plan, which contributed 8.275% of gross salary. In order to address the unfunded actuarial accrued liability of the System, on July 6, 2011 (effective July 1, 2011) the Commonwealth Legislature approved Act No. 116 increasing the employers' contributions rate from 9.275% to 10.275% of employee compensation for fiscal year 2012, an additional 1% annually for each of the next four years, and 1.25% annually for each of the five years thereafter, reaching an aggregate contribution rate of 20.525% effective July 1, 2020. The purpose of this Act was to provide cash flow and strength the System to adequately cover administrative expenses and payment of benefits. The Municipality was required to contribute 9.275% of gross salary until the fiscal year ended on June 30, 2013. As stated in the Act, percent increases applicable to municipalities for fiscal years 2011-2012, 2012-2013 y 2013-2014 would be financed through the Commonwealth's budget approved by the Commonwealth's Legislature.

b) Act No. 3 of 2013 (beginning July 1, 2013)

In order to address its unfunded liability and rescue the System from insolvency, on April 4, 2013 the Commonwealth of Puerto Rico enacted Act No. 3 of 2013, representing a comprehensive reform of the ERS. Act No. 3 became effective on July 1, 2013 and amends the provisions of the different benefits structures under the ERS, including, but not limited to, the following:

- All participants (employees) under the defined benefit pension plans (Act 447 and Act 1) and the defined contribution plan (System 2000) were moved to a new hybrid plan ("New Plan").
- For active participants of the contributory defined benefit programs under Act No. 447 of 1951 and Act No. 1 of 1990, all retirement benefits accrued through June 30, 2013 were frozen. Thereafter, all future benefits will accrue under the New Plan. Participants will receive a pension at retirement age equivalent to what they had accrued under Act No. 447 and Act 1 up to June 30, 2013, and a supplemental annuity corresponding to contributions made after July 1, 2013.
- Participants under System 2000 will no longer receive a lump-sum payment upon retirement, but rather a lifetime annuity calculated at retirement based on a factor that will incorporate the individual's life expectancy and a rate of return.
- New participants under the New Plan will receive a lifetime annuity based on the accumulated balance of their individual accounts (employees' contributions plus a return on investment).
- Eliminated the possibility of accruing a merit pension (payable once the participant had achieved 30 years of creditable service) after June 30, 2013.
- Increased employee contributions from 8.275% to a minimum of 10.00%.

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**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
YEAR ENDED JUNE 30, 2014**

- After July 1, 2013 all employers must contribute 12.275% of employee contribution with an additional 1% annually up to June 30, 2016; after July 1, 2016 an additional 1.25% annually for each of the five years thereafter, reaching an aggregate contribution rate of 20.525% effective July 1, 2020. These contributions will be used to increase the System's assets, reduce the actuarial deficit and enable the System to comply with future obligations.
- Retirement age was modified as follows:
 - Act No. 447 regular employees: age 58 to 61,
 - Act No. 447 high risk employees (state and municipal police, firefighters and custody officials): from age 50 to 55 years,
 - Act No. 305 (System 2000) regular employees: age 60 to 65; high risk employees remains the same (55 years).
- Act 1 employees remained the same (65 years for regular employees and 55 for high risk employees. For new employees under the New Plan will retire after 67 years (retirement age will be 67 for regular employees and 58 for high risk employees).
- Due to changes to Special Laws, the minimum monthly pension for current retirees was increased from \$400 to \$500.
- Disability benefits were eliminated and substituted for a mandatory disability insurance policy. Beginning July 1, 2013, each employee must contribute to this insurance plan .25% of his or her monthly salary, up to a monthly maximum of \$5,000. Therefore, the maximum monthly employee contribution will be \$12.50 (\$5,000 x .25%).
- Survivor benefits were modified.

The actual combined employer and employee contributions for the current and past two years, which are equal to the statutory required contributions, are as follows:

Fiscal year ended June 30,	Total
2014	\$ 319,060
2013	368,568
2012	453,064
Totals	\$ 1,140,692

c) Act No. 32 of 2013 (beginning July 1, 2013)

On June 25, 2013, Act No. 32 was approved in order to amend Act No. 447 of 1957 by creating a new Article 5-117 Additional Uniform Contribution (AUC), with the purpose of solving the cash flow deficit of the System. For each fiscal year, beginning on July 1, 2013, the ERS will: 1)

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**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
YEAR ENDED JUNE 30, 2014**

determine the portion of the AUC attributable to each participating employer based on the percentage each employer's contributions represent of the total employer contributions established for that fiscal year; and 2) send to the director of the P.R. Office of Management and Budget (OMB) and to each public corporation and municipality whose employees are covered by this Act, a certification of the AUC owed by each employer.

Act No. 32 defines the concept of the AUC as follows:

- For the fiscal year 2013-2014, the AUC will be one hundred and forty million dollars (\$140,000,000).
- For each subsequent fiscal year, beginning with the 2014-2015 fiscal year until 2032-2033, the AUC will be the contribution certified by the external actuary of the System, at least 120 days prior to the beginning of each fiscal year, deemed necessary to prevent that the value of the System's projected gross assets, during any subsequent fiscal year, be lower than one thousand million dollars (\$1,000,000,000). If, for any fiscal, the certified AUC is not available within the 120-day period prior to the beginning of the said fiscal year or within a shorter term with the consent of the OMB, the AUC will be equal to the contribution certified for the immediate preceding fiscal year.

Each public corporation and municipality covered by this Act is directly responsible for the payment of their corresponding certified AUC. However, for any fiscal year, the OMB will consign in the Commonwealth's General Budget enough resources to subsidy totally or partially the AUC certified to any public corporation, municipality or governmental entity, including the Judiciary Branch, whose operating expenditures are not fully or partially covered by the General Budget and for which the OMB, has subsequently determined it does not have the financial capacity to assume such obligation during the fiscal year.

For the fiscal year 2013-2014, \$41.142 million dollars were assigned to OMB through Commonwealth Legislative Resolution of Special Assignments No. 17 (RC 17-2013) for the total or partial subsidy of the AUC of any public corporation or municipality that the agency determined did not have the financial capacity to assume this obligation. The OMB's evaluation of a municipality's financial capacity was based on two parameters: financial indicators and population. The financial indicators to be evaluated were: profitability index (net income as a percentage of revenues); capital ratio (the proportion between the net position of the entity and the AUC) and debt margin ratio (the proportion between the AUC and the municipality's special ad valorem tax debt margin (CAE)).

In addition to the pension benefits described above, the Municipality is required to cover annually the 3% increase in the retirement plan of its retired employees, as required by Commonwealth's laws. Also, the Municipality is required to finance costs related to the application of certain "Special Laws" issued by the Commonwealth Government. Those Special Laws granted increases in pensions and other benefits to retired employees of the Municipality such as medicines bonus, Christmas and summer bonuses and death benefits. However, beginning July 1, 2013, Act 3 of 2013 modified these Special Laws benefits as follows:

- Reduction in the Christmas bonus from \$600 to \$200 (current retirees),

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**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
YEAR ENDED JUNE 30, 2014**

- Elimination of summer bonus of \$100 (current retirees),
- No change in medical plan contribution of up to \$1,200 and medicine bonus of \$100 (current retirees).
- Eliminated all Special Law benefits to future retirees.

Act No. 3 also established that employers will contribute \$2,000 per for each retiree that began working for the government on or before December 31, 1999. This contribution was established based on the assumption that the System will benefit from the savings generated between this employer contribution and the Special Law benefits paid out to retirees.

The historical trend information regarding the accumulation of assets and pension benefit obligation in the ERS is not available. For the ten-year trend information, refer to the separately issued financial statements of the ERS as of and for the fiscal year ended June 30, 2014. The P.R. Retirement Plan Administration provides additional information of the ERS. They issue a public available financial report that includes financial statements and required supplementary information for ERS, as a component unit of the Commonwealth of Puerto Rico. That report may be obtained by writing to the Administration at PO Box 42003, Minillas Station, San Juan, P.R. 00940.

10. Unearned Revenues

At June 30, 2014, unearned revenues recorded as liabilities in the GWFS and the governmental fund financial statements are as follows:

	General Fund	Head Start- Special Program Fund	Other Governmental Funds	Total
<i>Unearned revenues:</i>				
Municipal licenses	\$4,682,485	\$ -	\$ -	\$ 4,682,485
Disaster Grants- Public Assistance P.R. Administration for Intergral Care and Development of Children	-	-	5,092	5,092
	-	84,777	-	84,777
Total unearned revenues	<u>\$4,682,485</u>	<u>\$ 84,777</u>	<u>\$ 5,092</u>	<u>\$ 4,772,354</u>

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**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
YEAR ENDED JUNE 30, 2014**

11. LONG-TERM DEBT

The Municipality's Legislature is legally authorized to determine the contracting of debts of the Municipality. Nevertheless, the laws and regulations of the Commonwealth also provide that:

- Direct obligations of the Municipality (evidenced principally by bonds and notes) are backed by the full faith, credit and taxing power of the Municipality; and
- Direct obligations are not to be issued if the amount of the principal of, and interest on, such bonds and notes (and on all such bonds and notes issued thereafter) which are payable in any fiscal year, together with any amount paid by the Municipality in the preceding fiscal year on account of bonds or notes guaranteed by the Municipality, exceed 10 percent of the total assessed value of the property located within the Municipality plus the balance of the ad valorem taxes in the debt service fund, for bonds payable to be repaid with the proceeds of property taxes restricted for debt service.

In addition, before any new bonds or notes are issued, the revenues of the debt service fund should be sufficient to cover the projected debt service requirement. At June 30, 2014, the Municipality is in compliance with the debt limitation requirements.

The general long-term debt activity for the year ended June 30, 2014 was as follows:

	Balance at June 30, 2013	Borrowings or Additions	Payments or Deductions	Balance at June 30, 2014	Due Within One Year
Bonds and bond anticipation notes payables	\$ 24,891,000	\$ -	\$ (1,095,000)	\$ 23,796,000	\$ 1,220,000
Notes payable to:					
Municipal Revenue Collection Center (CRIM):					
Act No. 42- Advances over collections through fiscal year 2000	1,010,399	-	(29,082)	981,317	30,910
Act No. 146 -Financing of delinquent property tax accounts sold	440,115	-	(23,164)	416,951	23,163
Fiscal year 2012-2013 Final Settlement	229,387	-	-	229,387	229,387
Fiscal year 2013-2014 Final Settlement	-	310,177	-	310,177	-
Compensated absences	2,638,677	2,154,951	(2,442,392)	2,351,236	152,411
Total	<u>\$ 29,209,578</u>	<u>\$ 2,465,128</u>	<u>\$ (3,589,638)</u>	<u>\$ 28,085,068</u>	<u>\$ 1,655,871</u>

a) Bonds Payable

The Municipality issues general and special (public improvements) obligations bonds and notes to provide for the acquisition and construction of major capital facilities and equipment, as well as, to cover certain operating needs. Bonds and notes payable at June 30, 2014 is composed of the following debts:

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YEAR ENDED JUNE 30, 2014**

<u>General and Special Obligations:</u>	<u>Outstanding Amount</u>
\$2,630,000 rent bond series of 1999 payable in annual installments ranging from \$150,000 to \$245,000 through July 2019, interest ranging 5.00% to 7.81%	\$ 1,075,000
\$1,760,000 rent bond series of 2000 payable in annual installments ranging from \$45,000 to \$130,000 through July 2026, interest ranging 5.00% to 7.00%	1,055,000
\$1,300,000 rent bond series of 2001 payable in annual installments ranging from \$35,000 to \$105,000 through July 2027, interest at 5.00% to 8.00%	890,000
\$1,070,000 rent bond series of 2001 payable in annual installments ranging from \$70,000 to \$110,000 through July 2018, interest ranging 5.00% to 8.00%	390,000
\$135,000 rent bond series of 2002 payable in annual installments ranging from \$5,000 to \$10,000 through July 2027, interest rating at 5.00% to 7.00%	75,000
\$475,000 rent bond series of 2002 payable in annual installments ranging from \$20,000 to \$45,000 through July 2022, interest ranging 5.00% to 7.00%	270,000
\$1,965,000 rent bond series of 2002 payable in annual installments ranging from \$55,000 to \$160,000 through July 2027, interest at 5.00% to 7.00%	1,410,000
\$2,085,000 rent bond series of 2002 payable in annual installments ranging from \$65,000 to \$165,000 through July 2026, interest at 5.00% to 7.00%	1,415,000
\$1,115,000 rent bond series of 2004 payable in annual installments ranging from \$30,000 to \$85,000 through July 2028, interest ranging 5.00% to 6.50%	825,000
\$1,195,000 general obligations bonds series of 2004 payable in semi annual installments ranging of \$125,000 to \$150,000 through July 2015, interest ranging of 5.00%	150,000
\$1,730,000 general obligations bonds series of 2005 payable in semi annual installments ranging of \$45,000 to \$120,000 through July 2031, interest of 5.00%	1,385,000
\$3,021,000 general obligation bonds series of 2005 payable in semi annual installments ranging of \$10,000 to \$281,000 through July 2030, interest ranging of 5.00%	2,906,000
\$3,685,000 general obligation bonds series 2005 payable in semi annual installments ranging from \$100,000 to \$ 250,000 through July 2031, interest ranging of 5.00%	2,945,000

**MUNICIPALITY OF PEÑUELAS
COMMONWEALTH OF PUERTO RICO**

**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
YEAR ENDED JUNE 30, 2014**

<u>General and Special Obligations: (continued)</u>	<u>Outstanding Amount</u>
\$1,390,000 general obligation bonds series 2006 payable in semi annual installments ranging from \$30,000 to \$ 105,000 through July 2031, interest ranging 6.25% to 7.25%	1,155,000
\$1,585,000 general obligation note series of 2008 payable in semi annual installments ranging of \$30,000 to \$130,000 through July 2033, interest ranging from 3.93% to 7.5%	1,415,000
\$2,000,000. general obligation bond series of 2008 payable in annual installments ranging of \$35,000 to \$180,000 through July 2033, interest from 5.40% to 7.50%	1,830,000
\$1,800,000 general obligation bond series of 2009 payable in annual installments ranging of \$35,000 to \$150,000 through July 2034, interest ranging 5.40 to 7.50%	1,640,000
\$2,095,000 general obligation bond series of 2011 payable in annual installments ranging of \$25,000 to \$175,000 through July 2036, interest at 6% to 7.50%	2,005,000
\$1,000,000 general obligation bond series of 2011 payable in annual installments ranging of \$10,000 to \$85,000 through July , interest at 6% to 7.50%	960,000
Total bonds	\$ 23,796,000

These bonds are payable from the special ad valorem property tax of 1.50% and from the 0.4% of sales and use taxes collected by the Treasury Department on behalf of the Municipality, which are restricted for debt service and transferred to the Government Development Bank for Puerto Rico for such purposes.

The laws and regulations of the Commonwealth provide that public debt of the Municipality will constitute a first claim on the available revenue of the Municipality. Public debt includes bonds and notes payable. The good faith, credit and taxing power of the Municipality are irrevocably pledged for the prompt payment of the principal and interest of the bonds and notes payable.

The Municipality levies an annual additional special tax of 1.50% of the assessed value of personal and real property. The proceeds of this additional special tax are deposited in a sinking fund established at GDB whereby sufficient funds must be set aside to redeem the bonds in minimum annual or biannual principal and interest payments. The proceeds of this special tax are recorded in the debt service fund.

Interest rates on serial bonds subject to variable rates are reviewed periodically by GDB and are based on the fluctuation of GDB's weighted average rate for its commercial paper program, not to exceed 8%. Under this program, GDB issues commercial paper in the U.S. taxable and tax-exempt markets,

**MUNICIPALITY OF PEÑUELAS
COMMONWEALTH OF PUERTO RICO**

**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
YEAR ENDED JUNE 30, 2014**

in the Eurodollar market and to corporations that have tax exemption under the Commonwealth's Industrial Incentives Act and qualify for benefits provided by the U.S. Internal Revenue Code Section 936.

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

Year ended June 30	Principal	Interest	Total
2015	\$ 1,220,000	\$ 1,500,242	\$ 2,720,242
2016	1,155,000	1,429,113	2,584,113
2017	1,235,000	1,361,663	2,596,663
2018	1,305,000	1,243,688	2,548,688
2019	1,275,000	1,210,335	2,485,335
2020-2024	6,290,000	4,942,137	11,232,137
2025-2029	6,875,000	2,855,149	9,730,149
2030-2034	3,936,000	926,513	4,862,513
2035-2038	505,000	38,437	543,437
Total	\$ 23,796,000	\$ 15,507,277	\$ 39,303,277

b) Notes Payable to CRIM

Act No. 42 – Act No. 42 of January 26, 2000 was enacted to authorize CRIM to enter into a financing agreement of up to \$200 million, for a term not exceeding 30 years. The financing agreement allows for the financing of a debt that the municipalities of Puerto Rico have with CRIM, arising from the final settlements of property tax advances versus actual collections through fiscal year 2000. The amounts that the municipalities will collect from the additional property taxes resulting from the increases in the subsidy from the Commonwealth to the municipalities are assigned through this law to repay such loan. The increase in this subsidy was the result of the Public Law No. 238 of August 15, 1999.

In addition, on July 1, 2002, the Municipality entered into a repayment agreement with GDB and CRIM to pay off the remaining \$1,236,483 of excess of property tax advances through fiscal year 2000 and 2001. CRIM retains the principal and interest from the property tax advances of the Municipality. The amounts retained by CRIM are remitted to GDB on July 1 of each year through July 1, 2032. The repayment agreement bears interest at variable rates determined by GDB. The outstanding principal balances of the note payable to CRIM amounted \$981,317, at June 30, 2014. The principal and interest maturities are as follows:

**MUNICIPALITY OF PEÑUELAS
COMMONWEALTH OF PUERTO RICO**

**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
YEAR ENDED JUNE 30, 2014**

Year ended June 30	Principal	Interest	Total
2015	\$ 30,910	\$ 60,248	\$ 91,158
2016	32,852	58,306	91,158
2017	34,916	56,242	91,158
2018	37,110	54,048	91,158
2019	39,442	51,716	91,158
2020-2024	237,646	218,144	455,790
2025-2029	322,296	133,494	455,790
2030-2034	246,145	27,329	273,474
Total	\$ 981,317	\$ 659,527	\$ 1,640,844

Financing of delinquent property tax accounts sold – On July 1, 2007, the Municipality entered into a financing agreement with CRIM in the amount of \$579,165 for the payment of delinquent property tax account sold to private investors. The financing agreement in the form of a line of credit bearing interests at 6.50% during the first 5 years, and variable interests 125 points over LIBOR rate during the next 25 years. At June 30, 2014, the outstanding principal balances amounted to \$416,951. The principal and interest maturities are as follows:

Year ended June 30	Principal	Interest	Total
2015	\$ 23,164	\$ 10,440	\$ 33,604
2016	23,164	9,860	33,024
2017	23,164	9,280	32,444
2018	23,164	8,700	31,864
2019	23,164	8,120	31,284
2020-2024	115,820	32,901	148,721
2025-2029	115,820	17,401	133,221
2030-2034	69,491	3,480	72,971
Total	\$ 416,951	\$ 100,182	\$ 517,133

Fiscal Year 2012-2013 Settlement Statement – On December 13, 2013, CRIM, as required by law, prepared the final settlement for the fiscal year 2012-2013, whereby a comparison was made between the amounts advanced to the Municipality and amounts actually collected from taxpayers. According to the final settlement, advances to the Municipality exceeded the amount actually collected by the CRIM, and therefore, according to law, a payable to the CRIM amounted to \$229,387 should be recorded as long term liability in the GWFS at June 30, 2014. Such amount must be paid (through withholding from monthly advances from CRIM) in twelve equal installments.

**MUNICIPALITY OF PEÑUELAS
COMMONWEALTH OF PUERTO RICO**

**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
YEAR ENDED JUNE 30, 2014**

Fiscal Year 2013-2014 Settlement Statement – On December 2014, CRIM, as required by law, prepared the final settlement for the fiscal year 2013-2014, whereby a comparison was made between the amounts advanced to the Municipality and amounts actually collected from taxpayers. According to the final settlement, advances to the Municipality exceeded the amount actually collected by the CRIM, and therefore, according to law, a payable to the CRIM amounted to \$310,177 should be recorded as long term liability in the GWFS at June 30, 2014. Such amount must be paid (through withholding from monthly advances from CRIM) in twelve equal installments.

Compensated Absences

At June 30, 2014, the liability for compensated absences is composed as follows:

	<u>Due within One year</u>	<u>Due after one year</u>	<u>Total</u>
Vacations and sick leave	<u>\$ 152,411</u>	<u>\$ 2,198,825</u>	<u>\$2,351,236</u>
Total	<u>\$ 152,411</u>	<u>\$ 2,198,825</u>	<u>\$2,351,236</u>

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**MUNICIPALITY OF PEÑUELAS
COMMONWEALTH OF PUERTO RICO**

**NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
YEAR ENDED JUNE 30, 2014**

12. FUND BALANCE (DEFICIT)

As of June 30, 2014, fund balance (deficit) is comprised of the following:

<u>Fund balances (deficit)</u>	<u>General fund</u>	<u>Capital Improvement Fund</u>	<u>Debt Service Fund</u>	<u>Other Governmental Fund</u>	<u>Total</u>
<i>Restricted for:</i>					
General government	\$ 3,267	\$ -	\$ -	\$ -	\$ 3,267
Public works	-	3,557,176	-	692,939	4,250,115
Health and welfare	-	-	-	133,604	133,604
Debt service	-	-	2,268,060	-	2,268,060
<i>Assigned to:</i>					
General government	7,844	-	-	-	7,844
Public works	7,527	-	-	-	7,527
Health and welfare	3,782	-	-	-	3,782
Culture and recreation	7,743	-	-	-	7,743
<i>Unassigned</i>	5,494,327	-	-	-	5,494,327
Total fund balances (deficit)	<u>\$ 5,524,490</u>	<u>\$3,557,176</u>	<u>\$2,268,060</u>	<u>\$ 826,543</u>	<u>\$12,176,269</u>

13. COMMITMENTS AND CONTINGENCIES

Litigations

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

With respect to pending and threatened litigation, the Municipality has not reported liabilities in the general fund for awarded unfavorable judgment because there is not liabilities with a fixed or expected due date, which will require future available financial resources for its payment.

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

Federal Programs

The municipality participates in a number of federal financial assistance programs. These programs are subject to audit on behalf the grantors to assure compliance with grant provisions. If expenditures are disallowed due to noncompliance with grant programs requirements, the Municipality may be required to reimburse, these costs, to the grantor agency. It is the Municipality's Management opinion, that any amount disallowed by federal agencies, will be immaterial to the financial statements.

MUNICIPALITY OF PEÑUELAS
COMMONWEALTH OF PUERTO RICO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
YEAR ENDED JUNE 30, 2014

Commitments

The Municipality has reported, outstanding encumbrances amounting to \$26,896 as assigned fund balance in the general fund at June 30, 2014. The municipality intends to honor these encumbrances, which will continue to be liquidated under the current year's budget during a lapse of period that extends into the subsequent fiscal year.

Construction Commitments

The Municipality has commitments at June 30, 2014 of approximately \$1,244,000 for construction, improvements or renovation of certain capital assets.

14. SUBSEQUENT EVENTS

Management has evaluated subsequent events through March 29, 2015, the date the financial statements were available to be issued.

End of Notes to Basic Financial statements

**Required Supplementary Information
Budgetary Comparison Schedule – General Fund
Fiscal Year Ended June 30, 2014**

**MUNICIPALITY OF PEÑUELAS
COMMONWEALTH OF PUERTO RICO**

**BUDGETARY COMPARISON SCHEDULE- GENERAL FUND
JUNE 30, 2014**

	<u>Budgeted amounts</u>		Actual amounts	Variance with
	Original	Final	(budgetary basis)	final budget – over (under)
Revenues:				
Property taxes	\$ 3,617,264	\$ 3,617,264	\$ 3,617,264	\$ -
Municipal license taxes	10,452,716	10,452,716	8,737,976	(1,714,740)
Sales and use taxes	533,000	533,000	438,138	(94,862)
Construction excise taxes	331,000	331,000	407,860	76,860
Intergovernmental grants and contributions	4,662,494	4,662,494	5,703,863	1,041,369
Interest on deposits	52,000	52,000	37,908	(14,092)
Charges for services	92,500	92,500	17,090	(75,410)
Miscellaneous	71,000	71,000	398,403	327,403
Total revenues	19,811,974	19,811,974	19,358,502	(453,472)
Expenditures and encumbrances:				
General government	7,382,543	7,569,238	8,036,926	(467,688)
Public works	6,232,970	5,979,582	5,809,824	169,758
Public safety	1,139,491	1,149,466	1,101,442	48,024
Health and welfare	1,725,911	1,715,473	1,629,998	85,475
Culture and recreation	2,567,760	2,659,723	2,514,305	145,418
Education	279,824	255,017	246,268	8,749
Total expenditures	19,328,499	19,328,499	19,338,763	(10,264)
Revenues over (under) expenditures and encumbrances	483,475	483,475	19,739	(463,736)
Other financing sources (uses):				
Transfer to other governmental funds	(483,475)	(483,475)	(367,889)	115,586
Total other financing sources uses)	(483,475)	(483,475)	(367,889)	115,586
Net increase (decrease) in fund balance (deficit)	\$ -	\$ -	\$ (348,150)	\$ (348,150)

**MUNICIPALITY OF PEÑUELAS
COMMONWEALTH OF PUERTO RICO**

**BUDGETARY COMPARISON SCHEDULE- GENERAL FUND
JUNE 30, 2014**

Reconciliation of differences:

Sources/inflows of financial resources:

Actual amounts (budgetary basis) "available for appropriations" from the budgetary comparison schedule	\$ 19,358,502
Differences - budgetary basis to GAAP:	
Differences in bases of accounting:	
GAAP adjustments to revenues	223,346
Total revenues reported on the statement of revenues, expenditures and changes in fund balances	\$ 19,581,848

Uses/outflows of financial resources:

Actual amounts (budgetary basis) "total charges to appropriations" from the budgetary comparison schedule (including other financing uses)	\$ 19,338,763
Entity differences:	
Prior year expenditures	489,396
Encumbrances	(26,896)
GAAP adjustment to expenditures	(53,506)
Total expenditures and other financing sources reported on the statement of revenues, expenditures and changes in fund balances	\$ 19,747,757

See accompanying notes to financial statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

FOR THE FISCAL YEAR ENDED JUNE 30, 2014

Federal Grantor / Pass-Through Grantor / Program or Cluster Title	Federal CFDA Number	Entity Identifying Number	Federal Expenditures
U.S. DEPARTMENT OF AGRICULTURE:			
Pass-through the Department of Education of the Commonwealth of Puerto Rico:			
Child and Adult Care Food Program	10.558	CCC-253	\$ 452,170
Total U.S. Department of Agriculture			452,170
U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT:			
Direct Programs:			
Section 8 Housing Choice Vouchers Program	14.871		1,363,201
Pass-through the Office of the Commissioner of Municipal Affairs of the Commonwealth of Puerto Rico:			
Community Development Block Grants/ State's Program	14.228	AB/FC 51	448,044
Total U.S. Department of Housing and Urban Development			1,811,245
U.S. DEPARTMENT OF TRANSPORTATION:			
Pass-through the Department of Transportation and Public Works and Transportation Authority of the Commonwealth of Puerto Rico:			
Metropolitan Transportation Planning and State and None- Metropolitan Planning and Research	20.505	N/AV	22,400
Total U.S. Department of Transportation			22,400

See accompanying Notes to Schedule of Expenditures of Federal Awards

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (CONTINUED)

FOR THE FISCAL YEAR ENDED JUNE 30, 2014

Federal Grantor / Pass-Through Grantor / Program or Cluster Title	Federal CFDA Number	Entity Identifying Number	Federal Expenditures
U.S. DEPARTMENT OF HOMELAND SECURITY:			
Pass-Through Governor's Office – Governor's Authorized Representative (GAR)			
Disaster Grants – Public Assistance	97.036	N/AV	96,775
Hazard Mitigation Grant	97.067	4017-DR-PR 1919-DR-PR	<u>210,530</u>
Total Department of Homeland Security			<u>307,305</u>
U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICE:			
Pass-Through the Administration for Integral Care and Development of Children of the Commonwealth of Puerto Rico:			
Head Start	93.600	241-2013-000208/ 241-2014-000139	3,600,657
Early Head Start			<u>247,970</u>
Total Head Start			<u>3,848,627</u>
Total U.S. Department of Health and Human Service			<u>3,848,627</u>
TOTAL EXPENDITURE OF FEDERAL AWARDS			<u>\$ 6,441,747</u>

See accompanying Notes to Schedule of Expenditures of Federal Awards

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

FOR THE FISCAL YEAR ENDED JUNE 30, 2014

NOTE 1 – GENERAL

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of the Municipality of Peñuelas, Puerto Rico (Municipality) and is presented on the modified accrual basis. 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. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the general-purpose financial statements. The reporting entity is defined in Note (I) (A) to the general-purpose combined financial statements.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying Schedule of Expenditures of Federal Awards is prepared from Municipality's accounting records and is not intended to present financial position or the results of operations.

The Municipality in accordance with the terms records the financial transactions and conditions of the grants, which are consistent with accounting principles generally accepted in the United States of America.

Expenditures are recognized in the accounting period in which the liability is incurred, if measurable or when actually paid, whichever occurs first.

NOTE 3 – FEDERAL CFDA NUMBER

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

NOTE 4 – PASS-THROUGH GRANTOR'S NUMBER

State or local government redistribution of federal awards to the Municipality, treated as if they were received directly from the federal government. OMB Circular A-133 requires the schedule to include the name of the pass-through entity and identifying number assigned by the pass-through entity for federal awards received as a sub recipient. Numbers identified as N/AV are not available.

NOTE 5 – MAJOR PROGRAMS

Major programs are identified in the Summary of Auditor's Results Section of the Schedule of Findings and Questioned Costs.

PEDRO C. ORTIZ LEDEE
CERTIFIED PUBLIC ACCOUNTANT

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

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

I have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of each major fund, and the aggregate remaining fund information of Municipality of Peñuelas, Puerto Rico (Municipality), as of and for the fiscal year ended June 30, 2014, and the related notes to the financial statements. I was engaged to audit the financial statements of the governmental activities. These financial statements collectively comprise the Municipality's basic financial statements and have issued my report thereon dated March 29, 2015. I did not express an opinion on the governmental activities because I was unable to obtain sufficient and competent evidential matter related to the capital assets.

Internal Control over Financial Reporting

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

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

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. I consider the deficiency described in the accompanying Schedule of Findings and Questioned Costs to be material weaknesses. Finding 2014-001.

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

Compliance and Other Matters

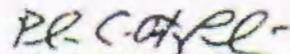
As part of obtaining reasonable assurance about whether the Municipality's financial statements are free of material misstatement, I performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of my audit, and accordingly, I do not express such an opinion. The results of my tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying Schedule of Findings and Questioned Costs as items 2014-001.

Municipality's Response to Findings

Municipality's response to the findings identified in my audit are described in the accompanying Schedule of Findings and Questioned Costs. Municipality's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly I express no opinion on it.

Purpose of this Report

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


Pedro C. Ortiz Ledee, CPA
License Number 5200

Guayama, Puerto Rico
March 29, 2015



PEDRO C. ORTIZ LEDEE
CERTIFIED PUBLIC ACCOUNTANT

**INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE FOR EACH MAJOR PROGRAM
AND ON INTERNAL CONTROL OVER COMPLIANCE REQUIRED BY OMB CIRCULAR A-
133**

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

Report on Compliance for Each Major Federal Program

I have audited Municipality of Peñuelas, Puerto Rico (Municipality) compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each Municipality's major federal programs for the fiscal year ended June 30, 2014. The Municipality's major federal programs are identified in the summary of auditor's results section of the accompanying Schedule of Findings and Questioned Costs.

Management's Responsibility

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

Auditor's Responsibility

My responsibility is to express an opinion on compliance for each of the Municipality's major federal programs based on my audit of the types of compliance requirements referred to above. I 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 I 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's compliance with those requirements and performing such other procedures as I considered necessary in the circumstances.

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

Basis for Qualified Opinion on Major Federal Programs

As identified in the findings numbers listed in the table below and described in the accompanying Schedule of Findings and Questioned Costs, the Municipality, did not comply with requirements regarding the following:

**INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE FOR EACH MAJOR PROGRAM
AND ON INTERNAL CONTROL OVER COMPLIANCE REQUIRED BY OMB CIRCULAR A-
133 (CONTINUED)**

Basis for Qualified Opinion on Major Federal Programs (continued)

Awarding Agency	Federal Program	Compliance Requirement	Finding Number
Housing and Urban Development	14.871- Section 8 Housing Choice Vouchers	Special Test- Utility Allowance Schedule	2014-002
Housing and Urban Development	14.871- Section 8 Housing Choice Vouchers	Special Test- Rolling Forward Equity Balances	2014-003
Health and Human Services	93.600- Head Start	Cash Management	2014-004
Department of Agriculture	10.558- Child and Adult Care Food Program	Period of Availability	2014-006

Compliance with such requirements is necessary, my opinion, for the Municipality to comply with the requirements applicable to the programs.

Qualified Opinion on Major Federal Programs

In my opinion, except for the noncompliance described in the "Basis for Qualified Opinion on Major Federal Programs" paragraph, the Municipality, complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of the major federal programs listed in the "Basis for Qualified Opinion on Major Federal Programs" paragraph for the year ended June 30, 2014.

Unmodified Opinion on Each of the Other Major Federal Programs

In my opinion, the Municipality complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on the other major federal program identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs for the year ended June 30, 2014.

Other Matters

The results of my auditing procedures disclosed other instances of noncompliance, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying Schedule of Findings and Questioned Costs as item 2014-005. My opinion on each major federal program is not modified with respect to these matters.

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

**INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE FOR EACH MAJOR PROGRAM
AND ON INTERNAL CONTROL OVER COMPLIANCE REQUIRED BY OMB CIRCULAR A-
133 (CONTINUED)**

Report on Internal Control over Compliance

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

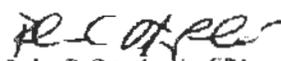
My consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as discussed below, I identified certain deficiencies in internal control over compliance that I consider to be material weaknesses and significant deficiencies.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct noncompliance with a type of compliance requirement of a federal program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected on a timely basis. I considered the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs as items 2014-002, 2014-003, 2014-004 and 2014-006 to be material weaknesses.

A significant deficiency in internal control over compliance is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance. I consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs as item 2014-005 to be significant deficiencies.

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

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


Pedro C. Ortiz Ledee, CPA
License Number 5200

Guayama, Puerto Rico
March 29, 2015



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2014

SECTION I – SUMMARY OF AUDITOR’S RESULTS

Financial Statements

<u>Opinion Units</u>	<u>Type of Opinions</u>	
Governmental activities	Disclaimer	
General Fund	Unmodified	
Head Start- Special Programs Fund	Unmodified	
Capital Improvement Fund	Unmodified	
Debt Service Fund	Unmodified	
Aggregated remaining fund	Unmodified	
Internal control over financial reporting:		
Material weakness identified?	Yes <input checked="" type="checkbox"/>	No
Significant deficiencies identified?	Yes	None reported <input checked="" type="checkbox"/>
Noncompliance material to financial statements noted?	Yes <input checked="" type="checkbox"/>	No

Federal awards

Internal Control over major programs:		
Material weakness identified?	Yes <input checked="" type="checkbox"/>	No
Significant deficiencies identified?	Yes <input checked="" type="checkbox"/>	None reported
Type of auditor’s report issued on compliance for major programs:	Qualified opinion, except for unmodified opinion for Community Development Block Grants - State’s	
Any audit findings disclosed that are required to be reported in accordance with Circular A-133, Section .510(a)?	Yes <input checked="" type="checkbox"/>	No

Identification of major programs

<u>CFDA Number</u>	<u>Name of Federal Program or Cluster</u>
10.558	Child and Adult Care Food Program
14.228	Community Development Block Grants – State’s
14.871	Section 8 Housing Choice Voucher
93.600	Head Start/ Early Head Start

Dollar threshold used to distinguish between Type A and Type B programs	\$300,000
Auditee qualified as low-risk auditee?	Yes No <input checked="" type="checkbox"/>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

FOR THE FISCAL YEAR ENDED JUNE 30, 2014

SECTION II – FINANCIAL STATEMENTS FINDINGS

FINDING	2014-001
REQUIREMENT	ACCOUNTING RECORDS- CAPITAL ASSETS
CONDITION	The Municipality does not have an effective system to account for capital assets, including the infrastructure assets.
CONTEXT	During the examination of the accounting records, I noted that the Municipality does not have adequate internal controls and procedures to ensure that all capital expenditures and dispositions are recorded in the capital assets subsidiary ledger. Also, the Municipality did not have adequate supporting documentation of the cost of the capital assets, including the infrastructure, reported in the statement of net position at June 30, 2014.
CRITERIA	Article 8.010 (c) (3) of the State Law Number 81- <i>Ley de Municipios Autonomos del Estado Libre Asociados de Puerto Rico de 1991</i> of August 30, 1991, stated that Municipality should maintain updated property accounting records.
CAUSE	The lack of an adequate capital assets register did not permit the proper accounting over the capital assets additions, the accumulated depreciation and the depreciation expense presented in the financial statements of the Municipality.
EFFECT	The Municipality's government wide financial statements do not present fairly, the financial position of the governmental activities, and the change in net position.
RECOMMENDATION	I recommend management and the Property Division of the Municipality to make an inventory of the capital assets, support it with adequate documentation and reconcile it with the capital assets subsidiary ledger. Also, the accounting staff should determine if the accumulated depreciation and depreciation expense are properly calculated.
Management Response and Corrective Action	The Municipality's Finance Department staff plan to continue the effort in order to update the capital assets subsidiary ledger ,principally the infrastructure assets. Implementation Date: December 2015 Responsible Person: Mr. Arnaldo Rivera Rivera Finance Department Director

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

FOR THE FISCAL YEAR ENDED JUNE 30, 2014

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING NUMBER	2014-002
FEDERAL PROGRAM	SECTION 8 HOUSING CHOICE VOUCHERS (CFDA 14.871) U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
REQUIREMENT	COMPLIANCE AND INTERNAL CONTROL
NONCOMPLIANCE	SPECIAL TEST- UTILITY ALLOWANCE SCHEDULE
CONDITION	The Program did not updated the utility allowance schedule.
CONTEXT	During the utility allowance schedule test, I noted that the Program has not reviewed the utility rates data within the last twelve (12) months to ascertain if there has been a change of ten percent or more in utility rates.
CRITERIA	Code of Federal Regulations, 24 CFR, Section 982.517 (4) (c) states that the PHA must review its schedule of utility allowance each year, and must revise its allowance for a utility category if there has been a change of 10 percent (10%) or more in the utility rate since the last time the utility allowance schedule was revised. The PHA must maintain information supporting its annual review of utility allowance and any revisions made in its utility allowance schedule.
CAUSE	The Program does not document that there has not been a change of 10% or more in the utilities, during the fiscal year 2013-2014, in order to revise the schedule.
EFFECT	The Program is not in compliance with Code of Federal Regulation 24, Section 24 CFR, Section 982.517 (4) (c).
RECOMMENDATION	I recommended management to revise and update annually, if necessary, its utility allowance schedule as required by this compliance requirement.
QUESTIONED COSTS	None
Management Response and Corrective Action	The Municipality is in the processs to procure services in order to review the utility allowance schedule. Implementation Date: June 2015 Responsible Person: Mrs. Nancy Rivera Program Coordinator

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

FOR THE FISCAL YEAR ENDED JUNE 30, 2014

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING NUMBER	2014-003
FEDERAL PROGRAM	SECTION 8 HOUSING CHOICE VOUCHERS (CFDA 14.871) U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
REQUIREMENT	COMPLIANCE AND INTERNAL CONTROL
NONCOMPLIANCE	SPECIAL TEST- ROLLING FORWARD EQUITY BALANCES
CONDITION	The Program considered HAP revenues in the calculation of the administrative fees equity.
CONTEXT	During the examination of the accounting records, I noted that during the months of November 2013 and December 2013, the Program recorded approximately, \$60,961 of HAP (VO) revenues as administrative fees. This situation caused that the Program reported a zero HAP reserve in the VMS and a negative HAP reserve of \$33,370 in the un-audited financial information, for the fiscal year ended June 30, 2014, submitted through the FASS-PH system.
CRITERIA	Code of Federal Regulations, 24 CFR, Section 982.158 (a) (b) states that the PHA must maintain complete and accurate accounts and other records for the program in accordance with HUD requirements, in a manner that permits a speedy and effective audit. The records must be in the form required by HUD, including requirements governing computerized or electronic forms of record-keeping. Also, the PHA must furnish to HUD accounts and other records, reports, documents and information, as required by HUD.
CAUSE	The Program's internal control over the accounting records failed to assure that the Program's equity were properly calculated.
EFFECT	The Program is not in compliance with Code of Federal Regulation 24, Section 982.158 (a) (b).
RECOMMENDATION	I recommended management to prepare an analysis, supported by adequate accounting records, of the HAP and the administrative fee equities accounts and adjust or correct any errors on these accounts.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

FOR THE FISCAL YEAR ENDED JUNE 30, 2014

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING NUMBER	2014-003 (CONTINUED)
FEDERAL PROGRAM	SECTION 8 HOUSING CHOICE VOUCHERS PROGRAM (CFDA 14.871) U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
REQUIREMENT	COMPLIANCE AND INTERNAL CONTROL
NONCOMPLIANCE	SPECIAL TEST- ROLLING FORWARD EQUITY BALANCES
QUESTIONED COSTS	None

**Management Response
and Corrective Action**

The Program accounting staff was instructed to classify properly the Federal cash collected between administrative fees or HAP revenues. Also, the Program accounting staff made the accounting adjustments to correct the misleading revenue classification mentioned in the Condition. The audited financial information to be submitted through the FASS-PH system for the fiscal year ended June 30, 2014 include the effect of the adjustment made to correct the revenue classification error. Also, the Program accounting staff will ammend the HAP and Administrative reserves in the VMS.

Implementation Date: April 2015
Responsible Person: Mrs. Nancy Rivera
Program Coordinator

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

FOR THE FISCAL YEAR ENDED JUNE 30, 2014

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING NUMBER	2014-004
FEDERAL PROGRAM	HEAD START (CFDA NO. 93.600) U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES; PASS THROUGH COMMONWEALTH OF PUERTO RICO- ADMINISTRATION FOR CARE AND INTEGRAL DEVELOPMENT OF CHILDHOOD (ACUDEN)
REQUIREMENT	COMPLIANCE AND INTERNAL CONTROL
NONCOMPLIANCE	CASH MANAGEMENT
CONDITION	The Program maintained high levels of adjusted bank balances during fiscal year 2013-2014.
CONTEXT	During the cash management test, I noted that the Head Start program maintained an average cash balance of approximately \$217,608 in bank reconciliations during fiscal year 2013-2014.
CRITERIA	Code of Federal Regulation 45, Section 92.20 (b) (7) states that the Program must maintain procedures for minimizing the time elapsed between the transfer of funds from the U.S. Treasury and disbursement made by grantees and sub grantees when advance payment procedures are used.
CAUSE	The Program did not maintain appropriate cash management procedures in order to disburse the funds requested to the pass-through entity in a timely manner.
EFFECT	The Program is not in compliance with Code of Federal Regulation 45, 92.20 (b) (7).
RECOMMENDATION	I recommended management to continue strengthening its disbursement procedures to minimize the time between the transfer of funds by the pass through entity and the disbursements made by the Program. Also, the Program should reimburse, in a timely manner, the payroll loans granted by the Municipality to the Program.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

FOR THE FISCAL YEAR ENDED JUNE 30, 2014

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING NUMBER	2014-004 (CONTINUED)
FEDERAL PROGRAM	HEAD START (CFDA NO. 93.600) U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES; PASS THROUGH COMMONWEALTH OF PUERTO RICO- ADMINISTRATION FOR CARE AND INTEGRAL DEVELOPMENT OF CHILDHOOD (ACUDEN)
REQUIREMENT	COMPLIANCE AND INTERNAL CONTROL
NONCOMPLIANCE	CASH MANAGEMENT
QUESTIONED COSTS	None

**Management Response
and Corrective Action**

The requisition of funds system established by the Commonwealth of Puerto Rico Child Care and Development Administration (ACUDEN) has been designed to request funds on a monthly basis. Therefore, each month, we complete and submit the request of funds form provided by ACUDEN, requesting funds based on cash received to date, cash outlay obligations and a forecast of expenditures for the next month (payroll, fringe benefits, contractual services, etc.). The funds requested and received from ACUDEN each month are disbursed during each month period principally to pay the payroll and fringe benefits or to reimburse it to the General Fund, to pay the monthly portion of contractual services, and to pay for other expenditures related to the Program administrative and programmatic activities. Therefore, is our opinion that the requisition of funds system established by the Pass-through Grantor, that is the non-federal entity that should exercise sound cash management in funds transfers to subgrantees, has been followed by us in compliance with the grant agreement clauses.

Implementation Date: Not Applicable
Responsible Person: Mrs. Wanda Jaime
Program Director

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

FOR THE FISCAL YEAR ENDED JUNE 30, 2014

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING NUMBER	2014-005
FEDERAL PROGRAM	HEAD START (CFDA NO. 93.600) U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES; PASS THROUGH COMMONWEALTH OF PUERTO RICO- ADMINISTRATION FOR CARE AND INTEGRAL DEVELOPMENT OF CHILDHOOD (ACUDEN)
REQUIREMENT	COMPLIANCE AND INTERNAL CONTROL
NONCOMPLIANCE	REPORTING
CONDITION	The Program did not submit in a timely manner, the financial reports to the pass-through entity.
CONTEXT	During the reporting test, I noted that the 2014 Final Liquidation Report, of the Head Start and Early Head Start Program were not submitted, to the pass-through entity, fifteen (15) days after the end of the program year. The due date for these reports was March 15, 2014 and the Program submitted the reports in April 1, 2014.
CRITERIA	Code of Federal Regulation 45, 92.20 (b) (1) states that the grantees and subgrantees financial management system must assure accurate, current, and complete disclosure of the financial results of the financially assisted activities in accordance with the financial reporting requirements of the grant or subgrant. In addition, Clause Nine, states that after the end of the program year, the Municipality will submit to the pass-through entity, in fifteen (15) days after the end of the closing year, a trial balance, a statement of revenues and expenditures, the financial report SF-425 and a budget liquidation for the closing period.
CAUSE	Internal controls and procedures failed to assure that closing year procedures were made, in a timely manner.
EFFECT	The Program failed to submit to the pass through entity, in a timely manner, the closing year reports in accordance with the Clause Nine of the grant agreement.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

FOR THE FISCAL YEAR ENDED JUNE 30, 2014

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING NUMBER	2014-005 (CONTINUED)
FEDERAL PROGRAM	HEAD START (CFDA NO. 93.600) U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES; PASS THROUGH COMMONWEALTH OF PUERTO RICO- ADMINISTRATION FOR CARE AND INTEGRAL DEVELOPMENT OF CHILDHOOD (ACUDEN)
REQUIREMENT	COMPLIANCE AND INTERNAL CONTROL
NONCOMPLIANCE	REPORTING
RECOMMENDATION	The Program should continue strengthening its procedures and controls to ensure that the accounting system information is updated and the closing year procedures are made in a timely manner.
QUESTIONED COSTS	None
Management Response and Corrective Action	The Program accounting staff was instructed to prepare and submit on a timely basis required financial reports. Implementation Date: April 2015 Responsible Person: Mrs. Wanda Jaime Program Director

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

FOR THE FISCAL YEAR ENDED JUNE 30, 2014

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING NUMBER	2014-006
FEDERAL PROGRAM	CHILD AND ADULT CARE FOOD PROGRAM (CFDA NO. 10.558) U.S. DEPARTMENT OF AGRICULTURE; PASS THROUGH COMMONWEALTH OF PUERTO RICO- DEPARTMENT OF EDUCATION
REQUIREMENT	COMPLIANCE AND INTERNAL CONTROL
NONCOMPLIANCE	PERIOD OF AVAILABILITY
CONDITION	The Program disbursed funds for goods after the period of availability.
CONTEXT	During the grant disbursement test, I examined nine (9) disbursement vouchers, for the purchase of food and I noted that seven (7) invoices amounting to \$181,715 were paid, after of the period of availability. The purchase orders related to this invoices were from the budget obligations of program year 2012-2013.
CRITERIA	Code of Federal Regulation 7, Section 3016.23 (b) states that a grantee must liquidate all obligations incurred under the award not later than 90 days after the end of the funding period (or as specified in a program regulation) to coincide with the submission of the annual Financial Status Report (SF-269). The Federal agency may extend this deadline at the request of the grantee.
CAUSE	The Program does not maintained adequate internal controls to monitor the outstanding obligations which are scheduled to be paid during the period of availability.
EFFECT	The Program is not in compliance with Code of Federal Regulation 7, Subpart C, Section 3016.23 (b).
RECOMMENDATION	I recommend management to establish adequate internal controls, to assure that the purchases orders are prepared in a timely basis and that are liquidated during the period of availability.
QUESTIONED COSTS	None

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

FOR THE FISCAL YEAR ENDED JUNE 30, 2014

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING NUMBER	2014-006 (CONTINUED)
FEDERAL PROGRAM	CHILD AND ADULT CARE FOOD PROGRAM (CFDA NO. 10.558) U.S. DEPARTMENT OF AGRICULTURE; PASS THROUGH COMMONWEALTH OF PUERTO RICO- DEPARTMENT OF EDUCATION
REQUIREMENT	COMPLIANCE AND INTERNAL CONTROL
NONCOMPLIANCE	PERIOD OF AVAILABILITY
Management Response and Corrective Action	<p>The transactions mentioned in the Finding were for necessary and reasonable obligations related to purchase orders placed during the fiscal year 2012-2013 in order to provide nonprofit food service (acquisition of food) to enrolled Head Start participants. Also, such funds were obligated and disbursed to meet the Child and Adult Care Program (C&ACFP) meal service requirements. But, although the compilation and pre-audit of documents related to transactions related to the acquisition of food to our Head Start Centers is very complex, we will instruct our Program fiscal staff to strength the internal control and procedures in order to accelerate the payment process.</p> <p>Implementation Date: April 2015 Responsible Person: Mrs. Wanda Jaime Program Director</p>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF PEÑUELAS**

**SUMMARY SCHEDULE OF PRIOR YEARS FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2014**

The following schedule contains the original number and title of each of the findings of federal awards included in the *Report on Compliance with Requirements Applicable to Each Major Program and Internal Control over Compliance in Accordance with OMB Circular A-133* and the Schedule of Prior Years' Audit Findings for the Fiscal Year ended June 30, 2014. The following legend indicates the current status of the prior years' audit findings:

ORIGINAL FINDING NUMBER	CFDA NUMBER	TITLE
12-04	14.871	Eligibility Full corrective action was taken.
11-06	14.871	Eligibility Full corrective action was taken.
11-07	93.600	Reporting No corrective action has been taken. The auditor reissued the finding for the current year. Finding reference 2014-005
10-10	93.600	Reporting No corrective action has been taken. The auditor reissued the finding for the current year. Finding reference 2014-005