

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

**MUNICIPIO DE QUEBRADILLAS  
AUDITORÍA 2010-2011  
30 DE JUNIO DE 2011**

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF QUEBRADILLAS**

**BASIC FINANCIAL STATEMENTS  
FOR THE FISCAL YEAR ENDED  
JUNE 30, 2011**

**ORTIZ, RIVERA, RIVERA & CO.**

CERTIFIED PUBLIC ACCOUNTANTS • VALUE ADDED SERVICES

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**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF QUEBRADILLAS  
BASIC FINANCIAL STATEMENTS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

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Ortiz, Rivera, Rivera & Co.

Certified Public Accountants and Business Advisors

CPA Orlando Luis Ortiz Cabrera  
CPA Marco Antonio Rivera Zúñiga  
CPA Luis Rivera Zúñiga  
CPA Zoraida Cruz Claudio

**Members:**  
American Institute of Certified  
Public Accountants (AICPA)  
Puerto Rico Board of Certified  
Public Accountants

## INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying financial statements of the governmental activities, each major fund and the aggregate remaining fund information of the Municipality of Quebradillas, as of and for the year ended June 30, 2011, which collectively comprise the Municipality's basic financial statements, as listed in the table of contents. These financial statements are the responsibility of the Municipality's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund and the aggregate remaining fund information of the Municipality of Quebradillas as of June 30, 2011, and the respective changes in financial position, thereof and the respective budgetary comparison for the general and debt service funds for the fiscal year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated October 11, 2011 on our consideration of the Municipality's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations,

contracts and grants agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis on pages 3 through 9, is not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Municipality of Quebradillas' financial statements as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements, and in our opinion, the information is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

San Juan, Puerto Rico  
December 12, 2011

*Ortiz, Rivera, Rivera & Co.*

The stamp E16502 was affixed  
to the original of this report.



**Commonwealth of Puerto Rico  
Municipality of Quebradillas**

**Management's Discussion and Analysis**

**Year Ended June 30, 2011**

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**MANAGEMENT'S DISCUSSION AND ANALYSIS**

The Municipality of Quebradillas (the "Municipality") discussion and analysis has been designed with the followings goals:

- a) Assist the reader in focusing on significant financial issues,
- b) Provide an overview of the Municipality's financial activity,
- c) Identify changes in the Municipality's financial position (its ability to address the next and subsequent year challenges),
- d) Identify any material deviations from the financial plan (the approved budget), and;
- e) Identify individual fund issues or concerns.

Since the Management's Discussion and Analysis (MD & A) is designed to focus on the current year activities, resulting changes and currently known facts, please read it in conjunction with the Municipality's financial statements.

**FINANCIAL HIGHLIGHTS**

- The Municipality net assets increased by \$3,982,288.
- In the fund financial statements, general fund revenues increased \$9,869 (or 0.09%).
- The General Fund (the primary operating fund) reflected, on a current financial resource basis, an increase of \$753,414.
- On a budgetary basis, actual revenues exceed actual expenditures by \$1,101,773.
- Capital expenditures amounted to \$3,425,803.

**USING THIS ANNUAL REPORT**

This annual report consists of a series of new financial statements with a change in the focus from previous financial statements. The new focus is on both the Municipality as a whole (government-wide) and the major individual funds. Both perspectives (government-wide and major fund) allow the user to address relevant questions, broaden a basis for comparison (year to year or government to government) and enhance the Municipality's accountability.

**Government-Wide Financial Statements**

The Government-Wide Financial Statements are designed to provide users of the financial statements with a broad overview of the Municipality's finances in a manner similar to private-sector companies.

**Commonwealth of Puerto Rico  
Municipality of Quebradillas**

**Management's Discussion and Analysis**

**Year Ended June 30, 2011**

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The Statement of Net Assets presents information on all of the Municipality's assets and liabilities, with the difference between both reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the Municipality is improving or deteriorating.

The Statement of Activities presents information showing how the Municipality's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the related cash flows. Thus, revenues and expenses are reported in the Statement of Activities that will only result in cash flows in future fiscal periods. The Statement of Activities is focused on both the gross and net cost of various activities, which are provided by the government's general tax and other revenues. This is intended to summarize and simplify the user's analysis of cost of various governmental services.

**Fund Financial Statements**

The Fund Financial Statements provide detailed information about the Municipality's most significant funds, not the Municipality as a whole. The Municipality has only one kind of fund, which is the governmental fund.

Governmental funds are used to account for essentially the same functions reported as governmental activities in the Government Wide Financial Statements. However, unlike the Government Wide Financial Statements, Government Fund Financial Statements focus on near term inflows and outflows of spendable resources, as well as on balances of spendable resources available at the end of the fiscal year. Such information is useful in evaluating the Municipality's near term financial requirements.

Because the focus of governmental funds is narrower than that of the government wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government wide financial statements. By doing so, users of the basic financial statements may better understand the long-term impact of the Municipality's near term financial decisions. Both of the Governmental Fund Balance Sheet and the Governmental Fund Statement of Revenues, Expenditures and Changes in Fund Balances provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

**Commonwealth of Puerto Rico  
Municipality of Quebradillas**

**Management's Discussion and Analysis**

**Year Ended June 30, 2011**

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**Infrastructure Assets**

Historically, a government's largest group of assets (infrastructure – roads, bridges, traffic signals, underground pipes [unless associated with a utility], etc.) have not been reported nor depreciated in government financial statements. GASB 34 requires that these assets be valued and reported within the governmental column of the Government-Wide Statements. Additionally, the government must elect to either (a)

Depreciate these assets over their estimated useful life or (b) Develop a system of asset management designed to maintain the service delivery potential to near perpetuity. If the government develops the asset management system (the modified approach), which periodically (at least every third year), by category, measures and demonstrates its maintenance of locally established levels of service standards, the government may record its cost of maintenance in lieu of depreciation. The information about the condition and maintenance of condition of the government infrastructure assets should assist financial statement users in evaluating a local government and its performance over time. The Municipality has elected to depreciate infrastructure assets instead of using the modified approach.

**FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE**

**Net Assets**

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. The Municipality's net assets totaled \$28.7 million at the end of 2011, compared to \$24.7 million at the end of the previous year.

The largest portion of the Municipality's net assets consists of the investment made throughout the years in capital assets such as land, buildings, equipment and infrastructure. 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 its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from the Debt Service Fund, since the capital assets themselves cannot be used to liquidate these liabilities. The amounts restricted for debt service represents another portion of the net assets, and these are resources subject to external restrictions for the purposes explained above.

The unrestricted deficit is the consequence of previous budgets which did not provide funding for incurred long-term obligations such as compensated absences and claims and judgments among others. Historically, such obligations have been budgeted on a pay as you go basis without providing funding for their future liquidation. Consequently, the Municipality cannot draw from its

**Commonwealth of Puerto Rico  
Municipality of Quebradillas**

**Management's Discussion and Analysis**

**Year Ended June 30, 2011**

existing assets to provide services to its citizens and depends on its taxing ability to continue its operations. The restricted portion consists of monies reserved for debt service and future capital expenditures.

**Municipality of Quebradillas  
Condensed Statement of Net Assets  
June 30, 2011 and 2010**

	<u>2011</u>	<u>2010</u>
Current assets	\$ 12,059,427	\$ 8,462,536
Capital assets	<u>30,649,190</u>	<u>30,649,190</u>
Total assets	<u>42,708,617</u>	<u>39,111,726</u>
Current liabilities	3,353,923	3,353,923
Noncurrent liabilities	<u>10,976,503</u>	<u>10,976,503</u>
Total liabilities	<u>13,945,029</u>	<u>14,330,426</u>
Invested in capital assets, net of related debt	40,040,272	30,649,190
Restricted	3,258,019	1,288,825
Unrestricted	<u>(14,534,703)</u>	<u>(7,156,715)</u>
Total net assets	<u>\$ 28,763,588</u>	<u>\$ 24,781,300</u>

**Changes in Net Assets**

The Municipality's net assets increased by \$3.9 million approximately, forty-one (41%) percent of the Municipality's total revenue came from Taxes generated by the general fund. Federal Grants was seven (7%) percent, while the State Contributions made fifty (50%) percent of the total revenues. The Municipality's expenses cover a range of services. The largest expenses were for general government, public works and public safety.

**Commonwealth of Puerto Rico  
Municipality of Quebradillas**

**Management's Discussion and Analysis**

**Year Ended June 30, 2011**

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**FINANCIAL ANALYSIS OF THE MUNICIPALITY'S INDIVIDUAL FUNDS**

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

**Governmental Funds**

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

As of the end of the current fiscal year, the Municipality's governmental funds reported combined ending fund balances of \$6,369,125 an increase of \$1,000,512 in comparison with the prior year. There are reservations of fund balance amounting to \$5,285,125.

The general fund is included within the governmental funds; it is the chief operating fund of the Municipality. As of June 30, 2011, the general fund has a balance of \$1,321,647. The prior year superavit of \$568,233 was increased by \$753,414 during fiscal year 2011.

**GENERAL FUND BUDGETARY HIGHLIGHTS**

Over the course of the year, the Municipality Council revised the Municipality's budget to reclassify certain expenditures among the different governmental functions. Such reclassifications were necessary to provide for the developments that affected the Municipality's finances.

Revenues of the current year had increased by \$9,869 compared with the prior year. The increase in fund balance is directly related to this increase in revenues. The actual revenues exceeded the revised budget revenues by \$828,640 (net). The most significant variances were in municipal licenses and licenses and permits by \$351,433 and \$269,657, respectively.

**Commonwealth of Puerto Rico  
Municipality of Quebradillas**

**Management's Discussion and Analysis**

**Year Ended June 30, 2011**

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**CAPITAL ASSETS AND DEBT ADMINISTRATION**

**Capital Assets**

The Municipality's investment in capital assets as of June 30, 2011, amounts to \$42.7 million, net of accumulated depreciation of \$9.7 million, leaving a net book value of \$33 million. This investment in capital assets includes land, buildings, improvements, equipment, intangibles, infrastructure and construction in progress. Infrastructure assets are items that are normally immovable and of value only to the state, such as roads, bridges, streets and sidewalks, drainage systems, lighting systems, and similar items.

The Municipality finances a significant portion of its construction activities through bond issuances. 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.

The Municipality acquired a total of \$5,656,772 of capital assets during the fiscal year 2010-2011. Capital assets acquired during the year were as follows:

- Construction in Progress - \$2,871,014
- Building and building improvements - \$1,965,564
- Acquisition of Equipment and Vehicles - \$354,790

Other projects related to repair and maintenance of roads (not capitalized) was development during the year 2011.

**Debt Administration**

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

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

**Commonwealth of Puerto Rico  
Municipality of Quebradillas**

**Management's Discussion and Analysis**

**Year Ended June 30, 2011**

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be sufficient to service to maturity the municipality's outstanding general obligation debt and the additional proposed general obligation debt ("Payment Capacity").

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

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

The Municipality relies primarily on property and municipal taxes as well as federal grants to carry out the governmental activities. Historically, property and municipal taxes have been very predictable with increases of approximately five percent. Federal grant revenues may vary if new grants are available but the revenue also is very predictable.

**FINANCIAL CONTACT**

The Municipality's financial statements are designed to present users (citizens, taxpayers, customers, investors and creditors) with a general overview of the Municipality's finances and to demonstrate the Municipality's accountability. If you have questions about the report or need additional financial information, contact Mrs. Edna M. Perez, Chief Financial Officer on the Finance Offices in the Central Town, Quebradillas, Puerto Rico.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF QUEBRADILLAS  
STATEMENT OF NET ASSETS  
JUNE 30, 2011**

<u>Assets</u>	<u>Governmental Activities</u>
Cash in bank (Notes 2 and 5)	\$ 3,686,589
Cash with fiscal agent (Notes 2 and 5)	3,672,638
Accounts receivable:	
Sales and use taxes	44,967
Due from other agencies (Note 9)	2,219,226
Capital assets, net (Note 11)	<u>33,085,197</u>
 Total assets	 <u><u>\$ 42,708,617</u></u>
 <b><u>Liabilities and Net Assets</u></b>	
<b>Liabilities</b>	
Accounts payable and accrued liabilities	\$ 628,812
Due to other agencies (Note 12)	2,104,936
Matured bonds and interest payable	328,723
Deferred revenues (Note 13):	
Municipal license tax	451,824
Noncurrent liabilities (Note 15):	
Due within one year	588,216
Due in more than one year	9,415,929
Accrued interest	426,589
Total liabilities	<u>13,945,029</u>
<b>Net Assets</b>	
Investment in capital assets, net of related debt	40,040,272
Restricted for:	
Debt service	1,769,577
Capital projects	1,488,442
Unrestricted	<u>(14,534,703)</u>
Total net assets	<u>28,763,588</u>
 Total liabilities and net assets	 <u><u>\$ 42,708,617</u></u>

The accompanying notes are an integral part of these basic financial statements.

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**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF QUEBRADILLAS  
STATEMENT OF ACTIVITIES  
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

<u>Functions/Programs</u>	Program Revenues			Net (Expense) Revenue and Changes in Net Assets Primary
	Expenses	Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions
<b>Primary Government:</b>				
General government	\$ 5,382,997	\$ 655,872	\$ -	\$ (4,727,125)
Public safety	1,787,164			(1,787,164)
Culture and recreation	607,907			(607,907)
Health and welfare	935,508		817,907	(117,601)
Public work	2,783,155			41,778
Economic development	458,893			(458,893)
Interest on long-term debt	361,155			(361,155)
<b>Total primary government</b>	<b>\$ 12,316,779</b>	<b>\$ 655,872</b>	<b>\$ 817,907</b>	<b>(8,018,067)</b>
				<b>2,752,204</b>
				<b>778,085</b>
				<b>1,251,512</b>
				<b>6,268,652</b>
				<b>117,114</b>
				<b>832,788</b>
				<b>12,000,355</b>
				<b>3,982,288</b>
				<b>24,781,300</b>
				<b>\$ 28,763,588</b>

General revenues:

Property taxes (Note 6)	2,752,204
Municipal license tax (Note 7)	778,085
Sales and use tax (Note 8)	1,251,512
Grants and contributions not restricted to specific programs	6,268,652
Interest, fines and penalties	117,114
Miscellaneous	832,788
<b>Total general revenues</b>	<b>12,000,355</b>
Change in net assets	<b>3,982,288</b>
Net assets at beginning of year	<b>24,781,300</b>
Net assets at end of year	<b>\$ 28,763,588</b>

The accompanying notes are an integral part of these basic financial statements.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF QUEBRADILLAS  
BALANCE SHEET-GOVERNMENTAL FUNDS  
JUNE 30, 2011

<u>Assets</u>	General	Debt Service	SBGP Program	Loan \$1,710,000	Other Governmental Funds	Total Governmental Funds
Cash and cash equivalents (Notes 2 and 5)	\$ 2,222,942	\$ -	\$ 3,302	\$ -	\$ 1,460,345	\$ 3,686,589
Cash with fiscal agent (Notes 2 and 5)		2,056,482		1,488,442	127,714	3,672,638
Accounts receivable:						
Sales and use taxes	44,967					44,967
Due from other agencies (Note 9)	2,113,336	41,818	14,996		49,076	2,219,226
Due from other funds (Note 10)	162,526				431,633	594,159
<b>Total assets</b>	<b>\$4,543,771</b>	<b>\$2,098,300</b>	<b>\$18,298</b>	<b>\$1,488,442</b>	<b>\$ 2,068,768</b>	<b>\$ 10,217,579</b>

The accompanying notes are an integral part of these basic financial statements.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF QUEBRADILLAS  
BALANCE SHEET-GOVERNMENTAL FUNDS  
JUNE 30, 2011**

<u>Liabilities and Fund Balance</u>	<u>General</u>	<u>Debt Service</u>	<u>SBG Program</u>	<u>Loan</u> \$1,710,000	<u>Other Governmental Funds</u>	<u>Total Governmental Funds</u>
<b>Liabilities</b>						
Accounts payable and accrued liabilities	\$ 242,306	-	\$ 93,354	-	\$ 33,152	\$ 368,812
Due to other funds (Note 10)	431,633		28,368		134,158	594,159
Due to other agencies (Note 12)	2,096,361				8,575	2,104,936
General obligations:						
Bonds						
Interest						
General obligations: (Note 15)						
Bonds		230,000				230,000
Interest		98,723				98,723
Deferred revenues: (Note 13)						
Municipal license tax	451,824					451,824
Total liabilities	<u>3,222,124</u>	<u>328,723</u>	<u>121,722</u>	<u>-</u>	<u>175,885</u>	<u>3,848,454</u>
<b>Fund Balances (Deficit)</b>						
Restricted						
Committed				1,488,442	1,943,994	1,943,994
Assigned	79,983	1,769,577			1,633	3,259,652
Unassigned	1,241,664		(103,424)		1,496	81,479
Total fund balances (deficit)	<u>1,321,647</u>	<u>1,769,577</u>	<u>(103,424)</u>	<u>1,488,442</u>	<u>(54,240)</u>	<u>1,084,000</u>
Total liabilities and fund balances	<u>\$ 4,543,771</u>	<u>\$ 2,098,300</u>	<u>\$ 18,298</u>	<u>\$ 1,488,442</u>	<u>\$ 2,068,768</u>	<u>\$ 10,217,579</u>

The accompanying notes are an integral part of these basic financial statements.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF QUEBRADILLAS  
RECONCILIATION OF THE GOVERNMENTAL FUNDS  
BALANCE SHEET TO STATEMENT OF NET ASSETS  
JUNE 30, 2011**

Total fund balances - governmental funds \$ 6,369,125

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

- Capital assets, net used in governmental activities are not current financial resources and therefore are not reported in the governmental funds balance sheet 33,085,197
  
- Some liabilities, including bonds payable, are not due and payable in the current period and therefore are not reported in the funds. **(Note 4)** (10,690,734)

Net assets of governmental activities \$ 28,763,588

The accompanying notes are an integral part of these basic financial statements.

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**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF QUEBRADILLAS  
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES - GOVERNMENTAL FUNDS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

	General	Debt Service	SBGP Program	Loan \$1,710,000	Other Governmental Funds	Total Governmental Funds
<b>REVENUES</b>						
Property taxes (Note 6)	\$ 2,240,996	\$ 511,208	\$ -	\$ -	\$ -	\$ 2,752,204
Municipal license taxes (Note 7)	778,085					778,085
Sales and use taxes (Note 8)	852,827	398,685				1,251,512
Licenses, permits, and other local taxes	614,957					614,957
Charges for services	40,915					40,915
<b>Intergovernmental revenues (Note 14):</b>						
Federal grants and contributions	5,393,674		2,824,933		817,907	3,642,840
State contributions	116,240				874,978	6,268,652
Interest, fines, and penalties	801,784	874				117,114
Other revenues	10,839,478	910,767	2,824,933	-	31,004	832,788
<b>Total revenues</b>	10,839,478	910,767	2,824,933	-	1,723,889	16,299,067
<b>EXPENDITURES</b>						
Current:						
General government	5,235,854				146,032	5,381,886
Public safety	1,702,237				7,097	1,709,334
Health and welfare	464,696				470,812	935,508
Culture and recreation	251,308				273,839	525,147
Public works	2,053,413					2,053,413
Economic development			2,820,375	213,831	245,062	458,893
Capital outlays					605,428	3,425,803
Debt service:						
Principal		422,846				422,846
Interest and other		385,725				385,725
Total expenditures	9,707,508	808,571	2,820,375	213,831	1,748,270	15,298,555
Excess (deficiency) of revenues over (under) expenditures	1,131,970	102,196	4,558	(213,831)	(24,381)	1,000,512
<b>OTHER FINANCING SOURCES (USES)</b>						
Transfers in	874					874
Transfers out	(379,430)					(380,304)
Total other financing sources	(378,556)	378,556	-	-	-	-
Excess (deficiency) of revenues over expenditures and other financing sources	753,414	480,752	4,558	(213,831)	(24,381)	1,000,512
<b>FUND BALANCE (DEFICIT) AT BEGINNING OF YEAR</b>	568,233	1,288,825	(107,982)	1,702,273	1,917,264	5,368,613
<b>FUND BALANCE (DEFICIT) AT END OF YEAR</b>	\$ 1,321,647	\$ 1,769,577	\$ (103,424)	\$ 1,488,442	\$ 1,892,883	\$ 6,369,125

*[Handwritten signature]*  
30/06/2011

The accompanying notes are an integral part of these basic financial statements.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF QUEBRADILLAS  
RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES, AND  
CHANGES IN FUND BALANCES OF GOVERNMENTAL FUNDS  
TO THE STATEMENT OF ACTIVITIES  
FOR THE FISCAL YEAR ENDED JUNE 30, 2011

Net change in fund balances - total governmental funds	\$1,000,512
Amounts reported for governmental activities in the statement of activities are different because:	
• Governmental funds report capital outlays as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense.	3,425,803
• Depreciation expense on capital assets is reported in the statement of activities, but they do not require the use of current financial resources. Therefore, depreciation expense is not reported as expenditure in governmental funds.	(989,796)
• Governmental funds report principal payments on long-term obligations as expenditures, whereas the principal payments reduces the long-term obligations in the statement of activities.	422,846
• Change in accrued interest expense which does not require the use of current financial resources.	24,570
• Some expenses reported in the statement of activities do not require the use of current financial resources; therefore, are not reported as expenditures in governmental funds.	98,353
Changes in net assets of governmental activities	<u>\$3,982,288</u>

The accompanying notes are an integral part of these basic financial statements.



**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF QUEBRADILLAS  
NOTES TO THE FINANCIAL STATEMENTS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

**1. ORGANIZATION**

The Municipality of Quebradillas, Puerto Rico (Municipality) was founded in 1823. The Municipality is a political legal entity with full legislative and administrative faculties in every affair of the municipal character, with perpetual succession existence and legal personality, separate and independent from the central government of the Commonwealth of Puerto Rico. The Municipality provides a full range of services including health, public works, environmental control, education, public safety, public housing and community development, culture and recreation as well as many other general and administrative services.

The Municipal Government comprises the executive and legislative branches. The executive power is exercised by the Mayor and the legislative by the Municipal Assembly, which has 14 members. The members of these branches are elected every four years in the Puerto Rico general elections.

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The accompanying financial statements of the Municipality have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) as applicable to governmental entities. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

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

- Management's Discussion and Analysis - Introduces the basic financial statements and provides an analytical overview of the Municipality's financial activities.
- Government - Wide Financial Statements - The reporting model includes financial statements prepared using full accrual of accounting for all of the government's activities. This approach includes not just current assets and liabilities, but also capital assets and long-term liabilities (such as buildings and infrastructure, including bridges and roads, and general obligation debt).

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF QUEBRADILLAS**  
**NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)**  
**FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

- Statement of Net Assets - The statement of net assets is designed to display the financial position of the Municipality, including capital assets and infrastructure. The net assets of the Municipality will be broken down into three categories; invested in capital assets, net of related debt; restricted; and unrestricted.
- Statement of Program Activities - The government - wide statement of activities report expenses and revenues in a format that focuses on the cost of each of the government's functions. The expense of individual functions is compared to the revenues generated directly by the function.
- Budgetary comparison schedules - Demonstrating compliance with the adopted budget is an important component of a government's accountability to the public. Under the reporting model, the Municipality will continue to provide budgetary comparison information in their financial statements. An important change, however, is a requirement to add the government's original budget to the current comparison of final budget and actual results.

The following is a summary of the more significant policies.

**a. Reporting Entity**

A reporting entity is comprised of the primary government, component units and other organizations that are included to ensure that financial statements are not misleading. The primary government consists of all funds, departments, boards and agencies that are not legally separate from the Municipality and for which the Municipality is financial accountable.

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

- 1) The Mayor appoints a voting majority of an organization's governing body and, either (1) the Municipality has the ability to impose its will on that organization

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF QUEBRADILLAS  
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

or (2) the organization has the potential to provide specific financial benefits to, or impose specific financial burdens on, the Municipality.

- 2) The economic resources, for which the Municipality is entitled, either received or held by the separate organization, are entirely or almost entirely for the direct benefit of the Municipality or its constituents.

GAAP details two methods of presentation: blending the financial data of the component units' balances and transactions in a manner similar to the presentation of the Municipality's balances and transactions or discrete presentation of the component units' financial data in columns separate from the Municipality's balances and transactions.

The Municipality's management has concluded that, based on the aforementioned criteria, there are no legally separate entities or organizations that should be reported as component units of the Municipality for the fiscal year ended June 30, 2011.

**b. Government-Wide and Fund Financial Statements**

The government-wide financial statements (i.e., the statement of net assets and the statement of changes in net assets) report information on all the activities of the Municipality. For the most part, the effect of interfund activity has been removed from these statements. Governmental activities are supported mainly by taxes and intergovernmental revenues.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function or segment. Program revenues include 1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items not properly included among program revenues are reported instead as general revenues.

The fund financial statements segregate transactions related to certain functions or activities in separate funds in order to aid financial management and to demonstrate legal compliance. These statements present each major fund as a

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF QUEBRADILLAS  
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

separate column on the fund financial statements; all non-major funds are aggregated and presented in a single column.

For the fiscal year ended June 30, 2011, the Municipality implemented Government Accounting Standards Board Statement No. 54 (GASB 54), "*Fund Balance Reporting and Governmental Fund Type Definitions*". The requirements of this statement are effective for financial statement periods beginning after June 15, 2011.

GASB 54 enhances the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied, and it clarifies the existing governmental fund type definitions. It establishes fund balance classifications that comprise a hierarchy based primarily on the extent to which a government is bound to observe constraints imposed upon the use of the resources reported in governmental funds.

GASB 54 also provides guidance for classifying stabilization amounts on the face of the balance sheet and requires disclosure of certain information about stabilization arrangements in the notes to the financial statements. The definitions of the General fund, special revenue fund type, capital projects fund type, debt service fund type, and permanent fund type are also clarified by the provisions in this statement.

**c. Measurement Focus, Basis of Accounting, and Financial Statement Presentation**

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

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

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF QUEBRADILLAS  
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

collected within the current period or soon enough thereafter. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures, as well as expenditures related to compensated absences and claims and judgments, are recorded only when payment is due.

Property taxes, franchise taxes, licenses, and interest associated with the current fiscal period are all considered to be susceptible to accrual and so have been recognized as revenues of the current fiscal period. Only the portion of special assessments receivable due within the current fiscal period is considered to be susceptible to accrual as revenue of the current period. All other revenue items are considered to be measurable and available only when cash is received by the government.

Private-section standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed in the government-wide financial statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board.

As a general rule the effect of interfund activity has been eliminated from the government-wide financial statements.

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

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

The Municipality reports the following major governmental funds:

1) General Fund

This is the operating fund of the Municipality and accounts for all financial resources, except those required to be accounted for in another fund.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF QUEBRADILLAS  
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

2) Debt Service Fund

This fund is used to account for the resources accumulated and payments made for principal and interest on long-term general obligation debt of governmental funds.

3) SBGP Program

SBGP is used to account for revenues sources for the related activities for the development of viable urban communities by providing decent housing, a suitable living environment, and expanding economic opportunities.

4) Loan \$1,710,000

The Loan \$1,710,000 fund is used to account for the financial resources for the acquisition of personal property and/or construction of major improvements which are not financed by other funds.

**d. Cash and Cash with Fiscal Agent**

The Municipality's Finance Director is responsible for investing available resources. The Municipality is restricted by law to invest only in savings accounts with banks qualified as a depository of public funds by the Puerto Rico Treasury Department (PRTD) or in instruments of the Government Development Bank for Puerto Rico (GDB).

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

**e. Interfund Receivables and Payables**

Activities between funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as either due to/from other funds (i.e., the current portion of interfund loans) or advances

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF QUEBRADILLAS  
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

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.

**f. Capital Assets**

Capital assets, which include property, plant, equipment, and infrastructure (which is normally immovable and of value only to the Municipality, such as roads, bridges, streets' sidewalks, and drainage system), are reported in the applicable governmental or component units columns in the government-wide financial statements.

Capital assets purchased or acquired are carried at historical cost or estimated historical cost. Contributed assets are recorded at fair market value as of the date donated. Additions, improvements and other capital outlays that significantly extend the useful life of an asset are capitalized. Other costs incurred for repairs and maintenance are expensed as incurred.

Depreciation in capital assets is calculated on the straight-line basis over the following estimated useful lives:

	<u>Useful Life</u>
Infrastructure	20-50 years
Buildings and building improvements	20-50 years
Furniture and fixtures	5-20 years
Vehicles and equipment	5-20 years

**g. Fund Balances**

In the current year, the Municipality adopted the provisions of GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions* (GASB No. 54), which enhanced the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied. This statement establishes fund balance classifications that comprise a hierarchy based primarily on the extent to which the Municipality is bound to observe constraints imposed upon the use of the resources reported in governmental funds.

Pursuant to the provisions of GASB No. 54, the accompanying fund financial statements report fund balance amounts that are considered nonspendable, such as fund balance associated with inventories. Other fund balances have been

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF QUEBRADILLAS  
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

reported as restricted, committed, assigned, and unassigned, based on the relative strength of the constraints that control how specific amounts can be spent, as described as follows:

- 1) *Nonspendable* - Represent resources that cannot be spent readily with cash or are legally or contractually required not be spent, including but not limited to inventories, prepaid items, and long term balances of interfund loans and accounts receivable.
- 2) *Restricted* - Represent resources that can be spent only for the specific purposes stipulated by constitutional provisions, external resource providers (externally imposed by creditors or grantors), or through enabling legislation (that is, legislation that creates a new revenue source and restricts its use). Effectively, restrictions may be changed or lifted only with the consent of resource providers.
- 3) *Committed* - Represent resources used for specific purposes, imposed by formal action of the Municipal's highest level of decision making authority (Municipal Legislature through resolutions and ordinances) and can only be changed by a similar law, ordinance or resolution, no later than the end of fiscal year.
- 4) *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 Autonomous Municipalities Act of Puerto Rico, as amended. In governmental funds other than the general fund, assigned fund balance represents the remaining amount that is not restricted or committed.
- 5) *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 in

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF QUEBRADILLAS  
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

restricted, committed, and assigned fund balance classification 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, 2011.

In situations when an expenditure is made for a purpose 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 when expenditures.

The classification of the Municipality's individual governmental funds among general, debt service, special revenue, and capital projects fund types used in prior fiscal years for financial reporting purposes was not affected by the implementation of GASB No. 54. In addition, the financial positions and the results of operations reported in the accompanying fund financial statements as of and for the fiscal year ended June 30, 2011 have not been affected for this change in accounting principle. Accordingly, the accompanying fund financial statements have not reported any retroactive restatements or reclassifications of fund equities as of July 1, 2011.

**h. Risk Financing**

The Municipality carries insurance to cover casualty, theft, tort claims and other losses. Insurance policies are negotiated by the Puerto Rico Treasury Department and costs are allocated among all the municipalities of Puerto Rico. Cost of insurance allocated to the Municipality and deducted from the gross property tax collections by the Municipal Revenue Collection Center (the "CRIM") for the year ended June 30, 2011 amounted to approximately \$220,638. The current insurance policies have not been cancelled or terminated. The CRIM also deducted approximately \$167,411 for workers' compensation insurance covering all municipal employees.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF QUEBRADILLAS  
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

**i. Compensated Absences**

Employees are entitled to 30 days vacations leave and 18 days sick leave per year. Sick leave is recorded as an expenditure in the year paid. Employees are entitled to payment of unused sick leave upon retirement if have been employed for at least 10 years in the municipal government. On July 1997, state Law 152 supra amended the Article 12.016, Section b (2) of the Municipal Law, authorizing the Municipality to pay any excess of vacations and sick leave accumulated over the maximum previously permitted by law. Calculations must be made until December 31 of every year. Excess of sick leave must be paid until March 31 next every natural year. Excess of vacations can be paid after July 1 of every fiscal year.

**j. Use of Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenditures/expenses during the reporting period. The most significant estimates consist of the contribution received from the Puerto Rico Electric Power Authority and the Municipal Revenue Collection Center caused by the delay of the notification of the actual revenues and expenditures to the presented in the financial statements of the agencies mentioned above.

**k. Future Adoption of Accounting Pronouncements**

The Governmental Accounting Standards Board (GASB) has issued the following statements that the Municipality has not yet adopted:

Statement Number	Statement Name	Adoption Required in Fiscal Year
57	OPEB Measurement by Agent Employees and Agent Multi-Employers Plans	2011-12
60	Accounting and Financial Reporting for Service Concession Arrangements	2012-13

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF QUEBRADILLAS  
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

<u>Statement Number</u>	<u>Statement Name</u>	<u>Adoption Required in Fiscal Year</u>
61	The Financial Reporting Entity: Omnibus - an amendment of GASB Statements No. 14 and 34	2012-13
62	Codification of Accounting and Financial Reporting Guidance Contained in Pre - November 30, 1989 FASB and AICPA Pronouncements	2012-13
63	Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position	2012-13
64	Derivative Instruments: Application of Hedge Accounting Termination Provisions - an Amendment of GASB Statement No. 53	2011-12

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

**3. STEWARDSHIP, COMPLIANCE, AND ACCOUNTABILITY**

**a. Budgetary Control**

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

The Municipality prepares its annual budget including the operations of the general and the debt service funds.

Revenues and Expenditures - Budget and Actual (Budgetary Basis), accordingly, includes only the operations of the general and the debt service funds. The

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF QUEBRADILLAS  
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

amounts budgeted under the Special Revenue Fund were excluded since they are received and expended over a period of time which generally exceeds the current year.

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

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

The annual budget is presented in the Combined Statement of Revenues and Expenditures - Budget and Actual (Budgetary Basis) is the budget ordinance to June 30, 2011 representing the original budget.

**b. Budget/GAAP Reconciliation**

The following schedule presents comparisons of the legally adopted budget with actual data on a budget basis. Because accounting principles applied for purposes of developing data on a budget basis differ significantly from those used to present financial statements in conformity with GAAP, a reconciliation of entity and timing differences in the excess of revenues and other financing sources over expenditures and other financing use for the year ended June 30, 2011 is presented below for the general and debt service funds:

	<u><b>Debt Service</b></u>
Excess of revenues over expenditures - budgetary basis	\$ 102,196
Entity differences:	
Non-budgeted revenues	<u>378,556</u>
Excess of revenues over expenditures - GAAP basis	<u><u>\$ 480,752</u></u>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF QUEBRADILLAS  
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

**Explanation of differences:**

<b>Sources/inflows of resources</b>	<u><b>General Fund</b></u>
Actual amounts (budgetary basis) "available appropriation" from the budgetary comparison schedule	\$ 10,324,845
Differences - budget to GAAP:	
Transfers from other funds are inflows of budgetary resources but are not revenues for financial reporting purposes	(379,430)
Non-budgeted revenues	712,469
Reprogrammed funds	<u>181,594</u>
Total revenues as reported on the statement of revenues, expenditures, and changes in fund balances	<u><u>\$ 10,839,478</u></u>
<b>Uses/outflows of resources</b>	
Actual amounts (budgetary basis) "total charges to appropriations" from the budgetary comparison schedule	\$ 9,404,666
Differences-budget to GAAP:	
Current year encumbrances recorded as expenditures for budgetary purposes	(79,983)
Prior year encumbrances	16,784
Transfers to other funds are outflow of budgetary uses but are not expenditures for financial reporting purposes	(379,430)
Non budgeted expenditures	<u>745,471</u>
Total expenditures as reported on the statement of revenues, expenditures, and changes in fund balances	<u><u>\$ 9,707,508</u></u>

**c. Legal Compliance**

The legal level of budgetary control is at the individual department level for general fund expenditures, and principal and interest due for the debt service fund.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF QUEBRADILLAS  
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

**4. RECONCILIATION OF GOVERNMENT-WIDE AND FUND FINANCIAL STATEMENTS**

The governmental fund balance sheet includes a reconciliation between fund balance-governmental funds and net assets of governmental activities as reported in the government-wide statement of net assets. One element of that reconciliation explains that some liabilities, including bonds payable, are not due and payable in the current period and therefore are not reported in the funds. The details of the approximately \$10.7 million differences are as follows:

Bonds payable	\$ 5,465,000
Compensated absences	1,495,846
Notes payable	2,676,600
Accrued interest	426,589
Other long-term liabilities	366,699
Christmas bonus	<u>260,000</u>
 Net adjustment to reduce fund balance governmental funds to arrive at net assets of governmental activities	          <u><u>\$10,690,734</u></u>

**5. DEPOSITS**

Custodial credit risk is the risk that in the event of a bank failure, the government's deposits may not be returned to it. Under Puerto Rico statutes, public funds deposited in commercial banks must be fully collateralized for the amount deposited in excess of federal depository insurance. All securities pledged as collateral are held by the Secretary of the Treasury of Puerto Rico. In addition, the Municipality maintains deposits with the Government Development Bank for Puerto Rico (GDB). The deposits at GDB of approximately \$1,616,156 are restricted principally for capital projects, and the \$2,056,482 in the debt service fund are unsecured and uncollateralized, as no collateral is required to be carried by governmental banks.

The Municipality maintains its investments in two (2) banks located at Puerto Rico. All kind of deposit is guaranteed by the Federal Deposit Insurance Corporation (FDIC) up to \$250,000.

The excess is covered by collateral provided by banks and held by the Treasury Department of the Commonwealth of Puerto Rico pursuant to applicable laws and regulations.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF QUEBRADILLAS  
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

**6. PROPERTY TAXES**

The Municipal Revenues Collection Center (CRIM) of the Commonwealth of Puerto Rico is responsible by law for the assessment, levy and collection of all real and personal property taxes. The tax on personal property is self assessed by the taxpayer. The assessment is made in a return which must be filed with the CRIM by May 15 of each year. The tax on real property is assessed by the CRIM. The assessment is made as of January 1 of each year and is based on estimated current values of the property as of year 1957. The tax on personal property must be paid in full together with the return on or before May 15. The tax on real property is due in two equal installments in July 1 and January 1, following the assessment date.

The rates are 8.83% for real property and 6.83% for personal property. The composition is as follows:

	<u>Real</u>	<u>Personal</u>
Basic property	6.00%	4.00%
Additional special property - state	1.03%	1.03%
Additional special property - municipal	2.00%	2.00%
Discounts made by state to tax payer	( .20%)	( .20%)
	<u>8.83%</u>	<u>6.83%</u>

The Municipality's basic property tax rate represents the portion which is appropriated for general purposes and accounted for in the general fund.

The "Additional special property tax - municipal" is restricted for debt service and retained by GDB for such purposes and it is recorded as revenue in the Debt Service Fund when collected by the CRIM and reported to the Municipality.

The "Additional special property tax - state" is collected by the CRIM for the payment of principal and interest of general obligation bonds and certain other obligations issued by the state government.

Residential real property occupied by its owner is exempt by law from the payment of property taxes on the first \$15,000 of the assessed value. For such exempted amounts, the Department of Treasury assumes payment of the basic tax to the Municipality, except for property assessed at less than \$3,500, for which no payment

**COMMONWEALTH OF PUERTO RICO  
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NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

is made. Revenue related to the basic tax on exempt property is recorded in the General Fund when payments are received from the CRIM.

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

Prior to the beginning of each fiscal year, the CRIM informs the Municipality of the estimated amount of property tax expected to be collected for the ensuing fiscal year. Throughout the year, the CRIM advances funds to the Municipality based on the initial estimated collections. The CRIM is required by law to prepare a settlement statement on a fiscal year basis, whereby a comparison is made between the amounts advanced to the Municipality and amounts actually collected from taxpayers. This settlement has to be completed on a preliminary basis not later than three months after fiscal year-end, and a final settlement made not later than six months after year ends. If the CRIM remits to the Municipality property tax advances, which are less than the tax actually collected, a receivable from the CRIM is recorded at June 30. However, if advances exceed the amount actually collected by the CRIM, a payable to the CRIM is recorded at June 30.

Currently, the Municipality has received the preliminary settlement from CRIM related to fiscal year 2010-11, but not the final settlement as the six months period after fiscal year ends, provided by law to CRIM to issue this, has not yet expired. Management believes, based in part on the experience from prior years, that when received, the final settlement from CRIM will not show a significant difference from the preliminary settlement and that such difference, if any, will not have a material effect on the financial condition of the Municipality.

Based on the preliminary settlement already received, during the year ended June 30, 2011, the amount collected by CRIM from taxpayers and charges exceeded the amount advanced by CRIM for the same period by approximately \$64,802. Such amount is presented as due from CRIM in the accompanying financial statements. (See note 9).

**7. MUNICIPAL LICENSE TAX**

Municipal License Tax receivables are recorded in the fiscal year in which payment is due and, accordingly, represent taxes which are due and uncollected at June 30, 2011. The annual Municipal License Tax is determined based on the gross income of all commerce and industrial organizations who have operations in the

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF QUEBRADILLAS  
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

Municipality of Quebradillas, and are not totally or partially exempt under the Industrial Incentive Law of Puerto Rico.

An annual return of business volume should be filed on or before April 15 of each year and payable in two equal installments due on July 1 and January 1. A discount of 5% is allowed when full payment is made on or before April 15.

The rates of municipal license in the Municipality of Quebradillas, are as follows:

Savings and loans associations	= 1.00%
Financial institutions	= 1.50%
Other organizations:	
Up to \$100,000	= .30%
\$100,000 up to \$200,000	= .40%
Over \$200,000	= .50%

The amounts collected in advance are recorded as deferred revenues in the General Fund. The Municipality invoiced and collected in advance during the current year approximately \$451,824, corresponding to the next fiscal year municipal license.

**8. SALES AND USE TAXES**

On July 29, 2007 the Commonwealth Legislature approved Act. No. 80 ("Act. 80") which imposed 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% will be collected by the Puerto Rico Department of Treasury.

Act 80 also provides for restrictions on the use of the resources (including the .5 of 1.5% collected by the Commonwealth Government) to be invested in solid waste an recycling programs, capital improvements and health and public safety cost. Amount collected by the Commonwealth Government will be deposited in accounts of special funds in the Government Development Bank of Puerto Rico ("GDB"), subject to restrictions imposed and distributed as follows:

- a. .2% of the .5% will be deposited in a "Municipal Development Fund" to finance costs as restricted by the Act.
- b. .2% of the .5% will be deposited in a "Municipal Redemption Fund" to finance loans to municipalities subject to restrictions imposed by the Act and,

**COMMONWEALTH OF PUERTO RICO  
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NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

c. .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.

**9. DUE FROM OTHER AGENCIES**

Represents grants and contributions due from local and federal agencies:

Puerto Rico Electric Power Authority	\$2,048,534
CRIM (Preliminary Liquidation 2010-11)	64,802
CRIM	41,818
Labor Department	25,710
OCAM	14,996
Puerto Rico Department of Justice	8,257
Department of Transportation and Public Work	6,826
U.S. Department of Agriculture	2,052
U.S. Department of Health and Human Services	6,231
	<u>\$2,219,226</u>

**10. INTERFUND TRANSACTIONS**

**a. Due From/To Other Funds:**

The due from and due to other fund balances as of June 30, 2011, are as follows:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
General	Other Governmental Funds	\$ 134,158
General	S.B.G.P. Fund	28,368
Other Governmental	General	431,633
		<u>\$ 594,159</u>

The balance of \$431,633 due to the general fund from the Other Governmental Fund represents amount due from prior years related to state contributions' grants. Remaining transfers are used to use unrestricted revenues collected in the general fund to finance various programs accounted for in other funds in accordance with budgetary authorizations.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF QUEBRADILLAS  
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

**b. Interfund Transfers:**

Interfund transfers for the year ended June 30, 2011 consisted of the following:

<u>Transfer In</u>	<u>Transfer Out</u>	<u>Amount</u>
Debt Service	General Fund	\$ 379,430
General Fund	Debt Service	874
		<u>\$ 380,304</u>

The transfers are used to (1) move revenues from the fund that statute or budget requires to collect them to the fund that statute or budget requires to expend them, (2) move receipts restricted to debt service from the fund collection the receipts to the debt service fund as debt service payments become due, and (3) use unrestricted revenues collected in the general fund to finance various programs accounted for in other funds in accordance with budgetary authorizations.

**11. CAPITAL ASSETS**

Capital asset activity for the Municipality for the year ended June 30, 2011 was as follows:

<u>Primary Government</u>	<u>Balance June 30, 2010</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance June 30, 2011</u>
<b>Governmental Activities:</b>				
Capital assets, not being depreciated:				
Land	\$ 520,000	\$ -	\$ -	\$ 520,000
Construction in progress	1,167,069	2,871,014	2,230,969	1,807,114
Total capital assets, not being depreciated	<u>1,687,069</u>	<u>2,871,014</u>	<u>2,230,969</u>	<u>2,327,114</u>
Capital assets, being depreciated:				
Land improvement	1,552,433	-	-	1,552,433
Buildings and building improvements	28,786,945	1,965,564	-	30,752,509
Equipment	697,235	283,590	-	980,825
Vehicles	2,480,006	71,200	-	2,551,206
Infrastructure	4,159,106	465,404	-	4,624,510
Total capital assets, being depreciated	<u>37,675,725</u>	<u>2,785,758</u>	<u>-</u>	<u>40,461,483</u>
Less accumulated depreciation for:				
Land improvement	815,119	53,962	-	869,081
Buildings and building improvements	3,114,881	612,580	-	3,727,461
Equipment	466,562	129,615	-	596,177
Vehicles	2,146,062	76,530	-	2,222,592
Infrastructure	2,170,980	117,109	-	2,288,089
Total accumulated depreciation	<u>8,713,604</u>	<u>989,796</u>	<u>-</u>	<u>9,703,400</u>
Total capital assets, being depreciated, net	<u>28,962,121</u>	<u>1,795,962</u>	<u>-</u>	<u>30,758,083</u>
Governmental activities capital assets, net	<u>\$ 30,649,190</u>	<u>\$ 4,666,976</u>	<u>\$ 2,230,969</u>	<u>\$ 33,085,197</u>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF QUEBRADILLAS  
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

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

General government	\$ 99,464
Public safety	77,830
Recreation	82,760
Public works	<u>729,742</u>
 Total depreciation expense-governmental activities	 <u><u>\$989,796</u></u>

**12. DUE TO OTHER AGENCIES**

Puerto Rico Electric Power Authority	\$2,048,534
U.S. Department of Housing and Urban Development	8,575
General Services Administration	47,617
Puerto Rico Water and Sewer Authority	<u>210</u>
 Total	 <u><u>\$2,104,936</u></u>

**13. DEFERRED REVENUES**

**a. Municipal License Tax**

The deferred revenues of approximately \$451,824 in the general fund related to municipal license tax collected in fiscal year 2010-11 that will be earned in fiscal year 2011-2012.

**b. Federal Government**

The deferred revenues presented as federal government represents the portion of federal grants received for which qualifying expenditures have not been incurred.

The amounts were determined taking into consideration the specific years of the grant.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF QUEBRADILLAS  
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

**14. INTERGOVERNMENTAL REVENUES**

Intergovernmental revenues in the general and capital projects funds consist mainly of collections from the Commonwealth of Puerto Rico and the CRIM, and payments in lieu of taxes from the Puerto Rico Electric Power Authority.

**15. LONG-TERM DEBTS**

Bonds and other long-term liabilities outstanding at June 30, 2011, are as follows:

\$570,000 series of 2002, payable in annual installments of \$10,000 to \$50,000 until July 1, 2026, interest from 2.7% to 5.6%.	\$ 445,000
\$2,000,000 series of 2001, payable in annual installments of \$20,000 to \$175,000 until July 1, 2026, interest from 5% to 7%.	1,615,000
\$638,800 series of 2002, payable in annual installments of \$10,700 to \$49,200 until July 1, 2027, interest from 5% to 7.5%.	511,600
\$670,000 series of 2003, payable in annual installments of \$10,000 to \$50,000 until July 1, 2028, interest from 5% to 7.5%.	550,000
\$2,135,000 series of 2005, payable in annual installments of \$65,000 to \$165,000 until July 1, 2024, interest from 4.37% to 6.5%.	1,610,000
\$455,000 series of 2004, payable in annual installments of \$15,000 to \$35,000 until July 1, 2024, interest from 3.27% to 6.5%.	340,000
\$1,110,000 series of 2008, payable in annual installments of \$25,000 to \$10,000 until July 1, 2027, interest from 6.48% to 7.5%.	995,000

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF QUEBRADILLAS  
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

\$420,000 series of 2010, payable in annual installments of \$50,000 to \$75,000 until July 1, 2016, interest from 5% to 7%.	\$ 325,000
\$1,710,000 series of 2010, payable in annual installments of \$25,000 to \$145,000 until July 1, 2034, interest from 6% to 7.5%.	1,660,000
\$100,000 series of 2010, payable in annual installments of \$5,000 to \$20,000 until July 1, 2026, interest from 6% to 7.5%.	90,000
	90,000
Total bonds and notes payable	\$ 8,141,600

**Other Long-Term Liabilities**

Note payable of \$203,419 represents a repayment agreement with GDB and CRIM to repay the excess of property taxes advances from fiscal years up to 2001. The CRIM will retain the principal and interest from the property taxes advances. The amounts retained by CRIM will be remitted to GDB on July 1 of each year through 2032. The repayment agreement is payable in annual aggregate principal installments of \$15,024 plus interest rate of 6.19%.	\$ 174,962
Note payable of \$936,377 represents a financing agreement with the Treasury Department to pay the debt related to social security tax from 1982 to 1986. The financing agreement is payable in monthly installments of \$5,200 plus interest rate of 6%.	174,257
Note payable of \$268,425 represents a financing agreement with CRIM to the repayment of catastral digitalization. The agreement is due in semester payment of \$18,001 until November 28, 2011, at interest rate of 5.95%.	17,480
	17,480
Total other long-term liabilities	\$ 366,699

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF QUEBRADILLAS  
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

The annual debt service requirements for the bonds payable and notes payable at June 30, 2011, are as follows:

	<i>Bonds</i>		<i>Notes Payable</i>	
	<u>Principal</u>	<u>Interest</u>	<u>Principal</u>	<u>Interest</u>
2012	\$ 255,000	\$ 293,425	\$ 99,100	\$ 133,164
2013	265,000	326,788	105,400	175,312
2014	285,000	311,866	111,700	168,136
2015	300,000	294,295	123,100	160,526
2016	325,000	275,785	129,600	152,150
2017-2021	1,465,000	1,188,234	809,100	614,810
2022-2026	1,555,000	667,856	1,154,400	294,300
2027-2031	610,000	278,125	144,200	12,623
2032-2036	405,000	62,250	-	-
	<u>\$ 5,465,000</u>	<u>\$3,698,624</u>	<u>\$ 2,676,600</u>	<u>\$ 1,711,021</u>

Long-term liability activity for the year ended June 30, 2011, was as follows:

<u>Primary Government</u>	<u>Beginning Balance</u>	<u>Additions</u>	<u>Payments</u>	<u>Adjustment</u>	<u>Ending Balance</u>	<u>Due within One Year</u>
<b>Governmental Activities:</b>						
Bonds payable	\$ 5,695,000	\$ -	\$ 230,000	\$ -	\$ 5,465,000	\$ 255,000
Notes payable	2,769,600	-	93,000	-	2,676,600	99,100
Total long-term debt	<u>8,464,600</u>	<u>-</u>	<u>323,000</u>	<u>-</u>	<u>8,141,600</u>	<u>354,100</u>
<b>Other long-term liabilities:</b>						
CRIM - Law 42	178,947	-	3,985	-	174,962	4,236
CRIM - LIMS	50,941	-	33,461	-	17,480	17,480
Treasury Department	236,657	-	62,400	-	174,257	62,400
Compensated absences	1,594,199	-	112,763	14,410	1,495,846	150,000
Total other long-term liabilities	<u>2,060,744</u>	<u>-</u>	<u>212,609</u>	<u>14,410</u>	<u>1,862,545</u>	<u>234,116</u>
Total noncurrent liabilities, governmental activities	<u>\$ 10,525,344</u>	<u>\$ -</u>	<u>\$ 535,609</u>	<u>\$ 14,410</u>	<u>\$ 10,004,145</u>	<u>\$ 588,216</u>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF QUEBRADILLAS  
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

**16. FUND BALANCES**

	<u>General</u>	<u>Debt Service</u>	<u>SBGP Program</u>	<u>Loan \$1,710,000</u>	<u>Other Governmental Funds</u>	<u>Total</u>
Restricted:						
General government	\$ -	\$ -	\$ -	\$ -	\$ 7,846	\$ 7,846
Public safety					20,746	20,746
Public works					1,772,520	1,772,520
Health and welfare					75,008	75,008
Education					67,874	67,874
Debt service		1,769,577				1,769,577
Committed:						
Public works				1,488,442	1,633	1,490,075
Assigned:						
General government	51,482					51,482
Public safety	2,324					2,324
Public works	22,693					22,693
Culture	45					45
Recreation	851					851
Health and welfare	2,588				1,496	4,084
Unassigned	1,241,664		(103,424)		(54,240)	1,084,000
	<u>\$1,321,647</u>	<u>\$1,769,577</u>	<u>\$(103,424)</u>	<u>\$ 1,488,442</u>	<u>\$ 1,892,883</u>	<u>\$ 6,369,125</u>

**17. FUND BALANCE DEFICIT**

The following funds had a deficit in fund balance at June 30, 2011:

<u>Fund</u>	<u>Deficit</u>
SBGP Program	\$ (103,424)
Other Governmental Funds	<u>(54,240)</u>
Total	<u>\$ (157,664)</u>

The deficit of these funds will be eliminated by grant proceeds in fiscal year 2012.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF QUEBRADILLAS  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

**1. SUMMARY OF AUDIT RESULTS**

Financial Statements

Type of auditor's report issued: Unqualified opinion

Internal control over financial reporting:

Material weakness (es) identified?  Yes  No

Significant deficiency (ies) identified?  Yes  No

Noncompliance material to financial statements noted?  Yes  No

Federal Awards

Internal control over major programs:

Material weakness (es) identified?  Yes  No

Significant deficiency (ies) identified?  Yes  No

Type of auditor's report issued on compliance for major programs: Unqualified opinion

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

Identification of major programs:

14.558	SBGP
14.255	SBGP - Recovery Act Funded

Dollar threshold used to distinguish between type A and Type B programs:  
\$300,000

Audited qualified as low-risk auditee?  Yes  No

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF QUEBRADILLAS  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

**2. FINDINGS - FINANCIAL STATEMENTS AUDIT**

None

**3. FINDINGS AND QUESTIONED COSTS – MAJOR FEDERAL AWARD PROGRAM  
AUDIT**

**a. SBGP- CFDA No. 14.228**

• **Condition 11-1**

The Contract 2011-000058 related to construction purpose, does not include the Davis Bacon Act clause.

Cause

The program's management failed to monitor that the required clause is included in the construction contract.

Effect

The program is not in compliance with the Davis Bacon Act.

Criteria

The Davis Bacon Act as amended, requires that each contract over \$2,000 for construction, alteration, or repair of public building or public works shall contain a clause setting forth the minimum wages to be paid to various classes of laborers and mechanics employed under contract.

Recommendation

The contracts made by the Municipality should be reviewed with state and federal regulations before be signed.

Questioned Cost

None

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF QUEBRADILLAS  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

- **Condition 11-2**

The Federal Program Office did not request the extension for the 2008 year program contract (OCAM) on time.

Cause

The federal program did not maintain a due date schedule for request the extension for the contracts.

Effect

The program is not in compliance with the OCAM contract clauses. The program operates without a valid contract.

Criteria

The federal funds of SBGP can be available through a signed contract into the Municipality and OCAM for each program year. Based on ninth clause of the SBGP Program 2008 contract, the funds are available for 24 months after the contract is signed. Then, based on fourth clause, the Municipality can request an extension that should be realized at least 45 days before the contract ends.

Recommendation

The Federal Program Office should establish a due date schedule for monitoring the due date of each program year contract.

Questioned Cost

None

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF QUEBRADILLAS  
SCHEDULE OF STATUS OF PRIOR YEAR  
AUDIT FINDINGS AND QUESTIONED COSTS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

The Municipality of Quebradillas has no prior year audit findings.

**EXHIBIT I**

**CORRECTIVE ACTION PLAN**

**ORTIZ, RIVERA, RIVERA & CO.**

CERTIFIED PUBLIC ACCOUNTANTS • VALUE ADDED SERVICES

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ESTADO LIBRE ASOCIADO DE PUERTO RICO

*Gobierno Municipal de Quebradillas*

Honorable Heriberto Vélez Vélez  
Alcalde

## CORRECTIVE ACTION PLAN

October 11, 2011

Cognizant or Oversight Agency for Audit:

Municipality of Quebradillas respectfully submits the following corrective action plan for the year ended June 30, 2011.

Name and address of independent public accounting firm: Ortiz, Rivera, Rivera & Co., Suite 152, PO Box 70250, San Juan, Puerto Rico 00936-7250.

Audit period: Fiscal year ended June 30, 2011.

The findings from the June 30, 2011 schedule of findings and questioned costs are discussed below. The findings are numbered consistently with the numbers assigned in the schedule.

### **FINDINGS - FEDERAL AWARD PROGRAM AUDITS, DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT**

#### **Finding 11-1: SBGP - CFDA 14.228**

Reportable Condition: See Condition 11-1

#### Recommendation

The contracts made by the Municipality should be reviewed with state and federal regulations before be signed.

#### Action Taken

The Federal Program Office Director will revise the construction contracts before signing in order to ensure the contract includes all required clauses.

**Finding 11-2: SBGP - CFDA 14.228**

Reportable Condition: See Condition 11-2

Recommendation

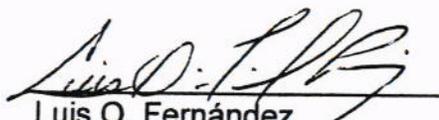
The Federal Program Office should establish a due date schedule for monitoring the due date of each program year contract.

Action Taken

The Federal Program Office Director is monitoring all due dates, in order to give the follow-up necessary to comply with the requirements.

If the Cognizant or Oversight Agency for Audit has questions regarding this plan, please call Luis O. Fernández at (787) 291-0162.

Cordially,

  
Luis O. Fernández  
Federal Program Director

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF QUEBRADILLAS  
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

**18. NET ASSETS**

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

Capital assets, net of accumulated depreciation.	\$ 33,085,197
Outstanding balance on capital related debt	5,465,000
Unspent capital debt proceeds	<u>1,490,075</u>
Total invested in capital assets, net of related debt	\$ <u>40,040,272</u>

**19. RETIREMENT PLAN**

**a. Plan Description**

The Employee's Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS) is the administrator of a cost-sharing multiple-employer retirement system established by the Commonwealth of Puerto Rico. The System was created under the ACT 447, approved on May 15, 1951, as amended, and became effective on January 1, 1952.

ERS covers all regular employees of the Commonwealth of Puerto Rico and its instrumentalities and of certain municipalities and components units not covered by their own retirement systems.

Participation is mandatory except for members of the Legislature, Government Secretaries, Heads for Agencies and Public Instrumentalities, Assistants to the Governor, the Comptroller of Puerto Rico, Gubernatorial Board and Committee appointees and Experimental Service Station employees.

ERS provides retirement, death and disability benefits. Disability retirement benefits are available to members for occupational and non-occupational disabilities. Retirement benefits depend upon age at retirement and number of years of credited service. Benefits vest after ten years of plan participation.

Members who have attained an age of at least fifty-five (55) years and have completed at least twenty-five (25) years of creditable service or members who have attained an age of at least fifty-eight (58) years and have completed at least ten (10) years of creditable service, are entitled to an annual benefit, payable monthly for life.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF QUEBRADILLAS  
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

The amounts of the annuity will be one and one-half percent of the average compensation multiplied by the number of years of creditable service up to twenty years, plus 2% of the average compensation multiplied by the number of years of creditable service in excess of twenty years. In no case the annuity will be less than \$200 per month.

Participants who have completed at least thirty (30) years of creditable service are entitled to receive the Merit Annuity. Participants who have not attained fifty-five (55) years of age will receive 65% of the average compensation or if they have attained fifty-five (55) years of age will receive 75% of the average compensation. Disability retirement benefits are available to members for occupational and non-occupational disability. However, for non-occupational disability a member must have at least ten (10) years of service.

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

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

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

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**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF QUEBRADILLAS  
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

**b. Contribution Requirements**

Commonwealth legislation requires employees to contribute 5.775% of gross salary up to \$6,600 plus 8.275% of gross salary in excess of \$6,600. The Municipality's contributions are 9.275% of gross salary. Contributions' requirements are established by law. The actuarially determined contribution requirement and contributions actually made for the year ended June 30, 2011 was approximately \$280,454. The Municipality's payroll for employees covered by ERS was approximately \$3.3 million. The Municipality total payroll for all employees was approximately \$4.5 million.

Additional information on the ERS is provided in its financial statements for the year ended June 30, 2011, a copy of which can be obtained from the ERS, Minillas Station, PO Box 42003, San Juan, PR 00940.

**20. RISK MANAGEMENT**

The Risk Management Division of the Municipality's Legal Department is responsible of assuring that the Municipality's property is properly insured. Annually, the Risk Management Division compiles the information of all property owned and its respective market value. After evaluating this information, the Risk Management Division submits the data regarding the Municipality's properties to the Area of Public Insurance at the Department of the Treasury of the Commonwealth of Puerto Rico who is responsible for purchasing all property and casualty insurance policies of all municipalities.

**21. LEASES**

**Operating Leases**

Leasing Arrangement with the Municipality as Lessor:

- a. The Municipality leases spaces in its Market Place under operating lease agreements with terms ranging from one to five years.
- b. Total income from leases during the year ended June 30, 2011 was approximately \$29,822.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF QUEBRADILLAS  
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

- c. The Municipality retains title to its leased property. The lessee pays taxes, licenses, insurance, and maintenance costs of the leased assets.

The Municipality is obligated under noncancellable operational leases, with periods not longer than one year.

**22. CONTINGENCIES**

The Municipality receives Federal Grants for specific purposes that are subject to review and audit by the grantor agencies. Although such audits could generate expenditure disallowances under the terms of the grants, management believes that any required reimbursements would not be material.

**23. COMMITMENTS**

The Municipality of Quebradillas had outstanding or planned construction projects as of June 30, 2011. These projects are evidenced by contractual commitments with contractors. The construction projects are commitments of the Other Governmental Funds, and SBGP Program that amounted to approximately \$129,574.

**24. SUBSEQUENT EVENTS**

In preparing these financial statements, the Municipality has evaluated events and transactions for potential recognition or disclosure through December 12, 2011, the date the financial statements were issued.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF QUEBRADILLAS  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

<u>Federal Grantor/Program Title</u>	<u>Federal CFDA Number</u>	<u>Federal Disbursements/ Expenditures</u>
<b>U.S. Department of Housing and Urban Development (HUD)</b>		
Direct Programs:		
Section 8 Housing Choice Vouchers	14.871	\$ 190,587
Pass-through Commissioner Office of Municipal Affairs -		
Community Development Block Grant-States:		
Program SBGP	14.228	2,688,244
Program SBGP-Recovery Act Funded	14.255	132,132
Neighborhood Stabilization Program - Recovery Act Funded	14.256	176,115
Emergency Shelter Grants Program	14.231	22,521
Pass-through Department of Family:		
Homelessness Prevention and Rapid Re-Housing Program (Recovery Act Funded)	14.257	118,726
Subtotal U.S. Department of HUD		<u>3,328,325</u>
<b>U.S. Department of Agriculture</b>		
Community Development:		
Child and Adult Care Food Program	10.558	39,500
Pass-through Rural Development:		
Rural Housing Preservation Grants	10.433	99,943
Subtotal U.S. Department of Agriculture		<u>139,443</u>
<b>U.S. Department of Justice</b>		
Direct Program:		
Crime Victim Assistance	16.575	27,603
Pass-through Puerto Rico Department of Justice		
Edward Byrne Memorial Justice Assistance Grant Program	16.738	129,520
Subtotal U.S. Department of Justice		<u>157,123</u>
<b>U.S. Department of Health and Human Services (HHS)</b>		
Governor's Office (Elderly Affairs Office):		
Special Programs for the Aging Title III, Part B,		
Grants for Supportive Services and Senior Centers	93.044	82,679
Aging Congregate Nutrition Services for States	93.707	883
Pass-through the Office of Administration for Children and Families		
Child and Care and Development Block Grant	93.575	231,869
ARRA/Child and Care and Development Block Grant	93.713	41,969
Subtotal U.S. Department of HHS		<u>357,400</u>
<b>TOTAL</b>		<u>\$ 3,982,291</u>

See the notes to the Schedule of Expenditures of Federal Awards.

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ORTIZ, RIVERA, RIVERA & CO.

CERTIFIED PUBLIC ACCOUNTANTS • VALUE ADDED SERVICES

Suite 152, PO Box 70250, San Juan, P.R. 00936-7250 • Phone (787) 756-8524, Fax (787) 274-0562

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF QUEBRADILLAS  
NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

**1. SIGNIFICANT ACCOUNTING POLICIES**

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of the Municipality of Quebradillas and is presented on the modified accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.

**2. BASIS OF PRESENTATION**

The expenditures of the schedule are included in the Municipality's basic financial statements in the accompanying Statement of Revenues, Expenditures and Changes in Fund Balances-Governmental Funds. The reconciliation of expenditures in the basic financial statements to the Schedule of Expenditures of Federal Awards is as follows:

	<u>Expenditures</u>
Expenditures as per basic financial statements:	
Federal expenditures included within other governmental funds	\$1,161,915
SBGP Program Fund	<u>2,820,376</u>
Total expenditures per schedule of expenditures of federal awards	<u>\$3,982,291</u>

See the notes to the Schedule of Expenditures of Federal Awards.

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Ortiz, Rivera, Rivera & Co.  
Certified Public Accountants and Business Advisors

CPA Orlando Luis Ortiz Cabrera  
CPA Marco Antonio Rivera Zúñiga  
CPA Luis Rivera Zúñiga  
CPA Zoraida Cruz Claudio

Members:  
American Institute of Certified  
Public Accountants (AICPA)  
Puerto Rico Board of Certified  
Public Accountants

**INDEPENDENT AUDITORS' 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  
Municipal Legislature  
Municipality of Quebradillas  
Quebradillas, Puerto Rico

We have audited the financial statements of the governmental activities, each major fund and the aggregate remaining fund information of the Municipality of Quebradillas, as of and for the year ended June 30, 2011, which collectively comprise the Municipality's basic financial statements and have issued our report thereon dated October 11, 2011. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

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

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

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

Compliance and Other Matters

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

We noted certain other matters that we reported to management of the Municipality of Quebradillas in a separate letter dated October 11, 2011.

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

San Juan, Puerto Rico  
December 12, 2011

*Ortiz, Rivera, Rivera & Co.*

The stamp E16503 was affixed to the original of this report.





Ortiz, Rivera, Rivera & Co.  
Certified Public Accountants and Business Advisors

CPA Orlando Luis Ortiz Cabrera  
CPA Marco Antonio Rivera Zúñiga  
CPA Luis Rivera Zúñiga  
CPA Zoraida Cruz Claudio

Members:  
American Institute of Certified  
Public Accountants (AICPA)  
Puerto Rico Board of Certified  
Public Accountants

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

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

Compliance

We have audited Municipality of Quebradillas' compliance with the types of compliance requirements described in the *U. S. Office of Management and Budget OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each Municipality of Quebradillas' major federal programs for the year ended June 30, 2011. Municipality of Quebradillas' major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of Municipality of Quebradillas' management. Our responsibility is to express an opinion on Municipality of Quebradillas' compliance based on our audit.

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

In our opinion, the Municipality of Quebradillas complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2011. However, the results of our auditing procedures disclosed instances of non compliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which is described in the accompanying Schedule of Findings and Questioned Costs as items 11-1 and 11-2.

#### Internal Control over Compliance

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

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

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

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

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

San Juan, Puerto Rico  
December 12, 2011

*Ortiz, Rivera, Rivera & Co.*

The stamp E16504 was affixed to the original of this report.

