

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

**MUNICIPIO DE SAN GERMAN
AUDITORÍA 2012-2013
30 DE JUNIO DE 2013**

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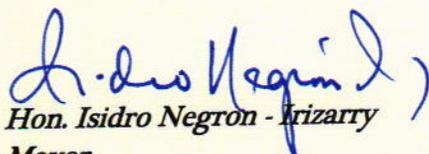


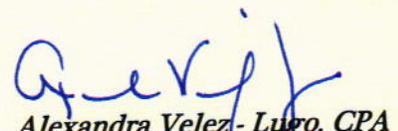
**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMÁN**

***BASIC FINANCIAL STATEMENTS, REQUIRED SUPPLEMENTARY
INFORMATION AND INDEPENDENT
AUDITORS' REPORT
(WITH ADDITIONAL REPORTS REQUIRED
UNDER THE OMB CIRCULAR A-133)***

***AS OF AND FOR THE FISCAL YEAR ENDED
JUNE 30, 2013***




***Hon. Isidro Negron - Irizarry
Mayor***


***Alexandra Velez-Lugo, CPA
Finance Director***

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMÁN**

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INDEPENDENT AUDITOR'S REPORT

Honorable Mayor and Member of the
Municipal Assembly
San Germán, Puerto Rico

Report on the Financial Statements

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of **Municipality of San Germán, Puerto Rico**, as of and for the year ended June 30, 2013, and the related notes to the financial statements, which collectively comprise the Municipality's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

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 San Germán, Puerto Rico**, as of June 30, 2013, and the respective changes in financial position thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and budgetary comparison information on pages 3 through 15 and 61 through 63 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information:

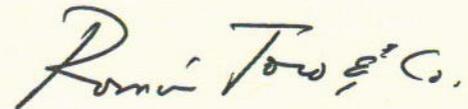
Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the **Municipality of San Germán, Puerto Rico's** basic financial statements. The financial data schedule is presented for purposes of additional analysis and is not a required part of the basic financial statements.

The financial data schedule is the responsibility of management and was derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and others records used to prepare the basic financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America.

In our opinion, the financial data schedule is fairly stated in all material aspects in relation to the basic financial statements as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated May 15, 2014, on our consideration of the **Autonomous Municipality of San Germán, Puerto Rico's** internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of 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* in considering **Autonomous Municipality of San Germán, Puerto Rico's** internal control over financial reporting and compliance.



ROMAN TORO & CO., CPA, C.S.P.
LICENSE # 35 - IN FORCE

Yauco, Puerto Rico
May 15, 2014

Stamp #E115197 was affixed to
the original report



MANAGEMENT'S DISCUSSION AND ANALYSIS

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMÁN
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2013**

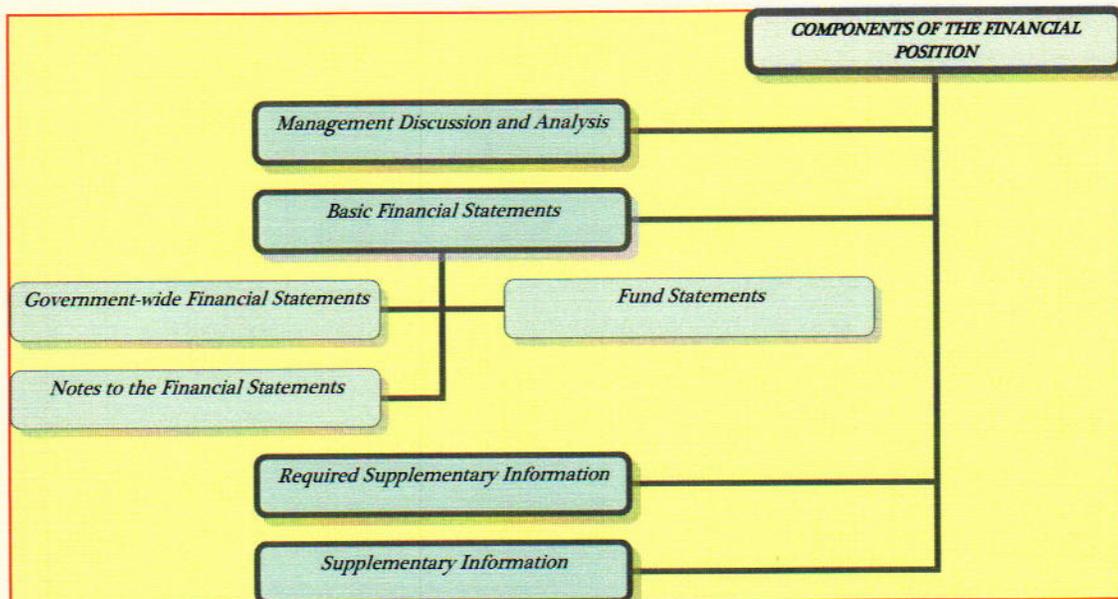
As management of the Municipality of San Germán ("the Municipality"), we offer readers of the Municipality's financial statements this narrative overview and analysis of the financial activities of the Municipality for the fiscal year ended June 30, 2013. We encourage readers to consider the information presented here in conjunction with additional information that we have furnished in our basic financial statements presented in this report.

FINANCIAL HIGHLIGHTS

- The assets of the Municipality, on a government-wide basis, exceeded its liabilities at the close of fiscal year 2013 by \$41,480,782 (net position), a decrease of 2% in comparison with 2012. Of this amount, the Municipality presented an unrestricted net position (deficit) of \$(4,115,500).
- Revenues decreased 7% and expenses decreased 12% when compared with fiscal year 2012. Net position decreased \$637,973 in 2013.
- A positive net change in the fund balances of the Municipality's governmental funds of \$1,876,401 in the fiscal year 2013 resulted in reported ending fund balances of \$11,882,347 increasing 19% with respect to 2012 year. Approximately -16% of the total fund balances is unrestricted (assigned or unassigned).
- For the fiscal year 2013, the General Fund reported an excess of expenditures and other financing uses over revenues and other financing sources (deficit) of \$1,887,171. The unassigned fund balance deficit amounts to \$2,404,303 or 61% increase over the 2012 year deficit.
- The investment in capital assets as of June 30, 2013 was \$56,735,879 (net of depreciation).
- Long-term debt (total primary government) increased to \$30,793,034 or approximately 52% with respect to the prior year.
- On a budgetary basis, actual expenditures and other financing uses exceeded actual revenue and other financing uses by \$319,630 (deficit).

OVERVIEW OF THE FINANCIAL STATEMENTS

The Municipality's basic financial statements comprise four components: (1) management's discussion and analysis (presented here), (2) basic financial statements, and (3) required supplementary information and (4) other supplementary information.



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMÁN
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2013**

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

Basic Financial Statements

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

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

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

- ***Fund Financial Statements***

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

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMÁN
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2013**

The governmental fund statements focus on major funds. The Municipality's major funds are the general fund (which accounts for the main operating activities of the Municipality) and funds that comply with a minimum criterion that is, a percentage of the assets and deferred outflows; liabilities and deferred inflows; revenues or expenditures or based on the Municipality's official's criteria if the fund is particularly important to financial statement users. Funds that do not comply with this criterion are grouped and presented in a single column as other governmental funds.

- **Notes to the financial statements**

The basic financial statements also include notes to explain information in the financial statements and provide more detailed data.

Required supplementary information

The statements and notes are followed by the required supplementary information that contains the budgetary comparison schedule for the General Fund.

Supplementary information

The supplementary information includes a financial data schedule containing financial information of the Section 8 Housing Choice Voucher Program administered by the Municipality.

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE

Net Position

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

TABLE 1

<i>Summary Statement of Net Position As of June 30,</i>		
	Governmental Activities	
	2013	2012
Assets		
Current and other assets	\$ 20,376,935	\$ 18,110,076
Capital assets	56,735,879	48,740,306
Total assets	\$ 77,112,814	\$ 66,850,382
Liabilities		
Current and other liabilities	\$ 4,838,998	\$ 4,432,412
Long term liabilities	30,793,034	20,299,215
Total liabilities	35,632,032	24,731,627
Net Position		
Net investment in capital assets	40,102,889	35,489,707
Restricted	5,493,393	8,932,658
Unrestricted (deficit)	(4,115,500)	(2,303,610)
Total net position	\$ 41,480,782	\$ 42,118,755

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMÁN
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2013**

Net position (difference of non-fiduciary assets, deferred outflows versus liabilities and deferred inflows) serve as a useful indicator of a government's financial position. Over time, increases or decreases in the Municipality's net position is one indicator of whether its financial health is improving or deteriorating. At June 30, 2013, assets exceeded its liabilities by \$41,480,782. Of this amount, \$(4,115,500) represents unrestricted net position (deficit). This deficit primarily arises from long-term obligations such as compensated absences and other operational debts, for which the Municipality did not provide funding in previous budgets. Historically, such obligations have been budgeted on a "pay as you go" basis without providing funding for their future liquidation. In addition, operational loans and certain general obligation bonds do not have a related capital asset to be reported as net investment in capital assets. Therefore, they are reported as part of the unrestricted net position section. Restricted net position represents resources that are subject to external restrictions on how they may be used.

The largest portion of the Municipality's net position reflects its investment in capital assets (land, buildings, equipment, and infrastructure) less accumulated depreciation and less any related outstanding debt used to acquire those assets. The Municipality uses these assets to provide services to its citizens and, consequently, these assets are not available for future spending. The resources needed to repay the debt related to these capital assets must be provided from other sources because capital assets are not generally liquidated for the purpose of retiring debt.

Net position reported a decrease of 2% with respect to fiscal period 2012. The most significant transaction that causes this negative variance was the issuance of over \$9,000,000 in long term debt to finance the construction of a water park.

Changes in net position

The following table summarizes the changes in net assets for the years ended June 30, 2013 and 2012:

TABLE 2

<i>Summary of Changes in Net Position As of June 30,</i>			
	Governmental Activities		
	2013	2012	
Program revenues:			
Fees, fines and charges for services	\$ 7,180,394	\$ 7,572,374	
Operating grants and contributions	1,798,221	2,424,242	
Capital grants and contributions	2,081,796	1,861,758	
General revenues:			
Property taxes	4,593,002	4,979,469	
Municipal license taxes	2,792,058	3,387,703	
Sales and use taxes	2,364,361	2,218,124	
Grants and contributions not restricted to specific programs	4,876,575	4,726,583	
Interest	429,715	164,474	
Other	243,155	926,481	
Total revenues	26,359,277	28,261,208	

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMÁN**

MANAGEMENT'S DISCUSSION AND ANALYSIS

YEAR ENDED JUNE 30, 2013

<i>Summary of Changes in Net Position As of June 30,</i>		
	Governmental Activities	
	2013	2012
Expenses:		
General government	6,451,932	5,765,560
Public safety	1,631,323	1,553,118
Public works	12,758,939	16,922,393
Sanitation	283,543	290,916
Health	786,763	786,763
Welfare	2,840,221	2,918,212
Culture and recreation	531,532	544,342
Education	811,986	1,116,963
Interest on long term debt	901,010	653,473
Total expenses	26,997,249	30,551,740
Change in net position	(637,973)	(2,290,532)
Net position - beginning of year	42,118,755	44,409,287
Net position - end of year	\$ 41,480,782	\$ 42,118,755

Approximately 27% of the Municipality's revenues came from fees and charges for services, 19% from unrestricted grants, 17% from property taxes and 11% from municipal license taxes. Program revenues of the Municipality covered 41% of total expenses.

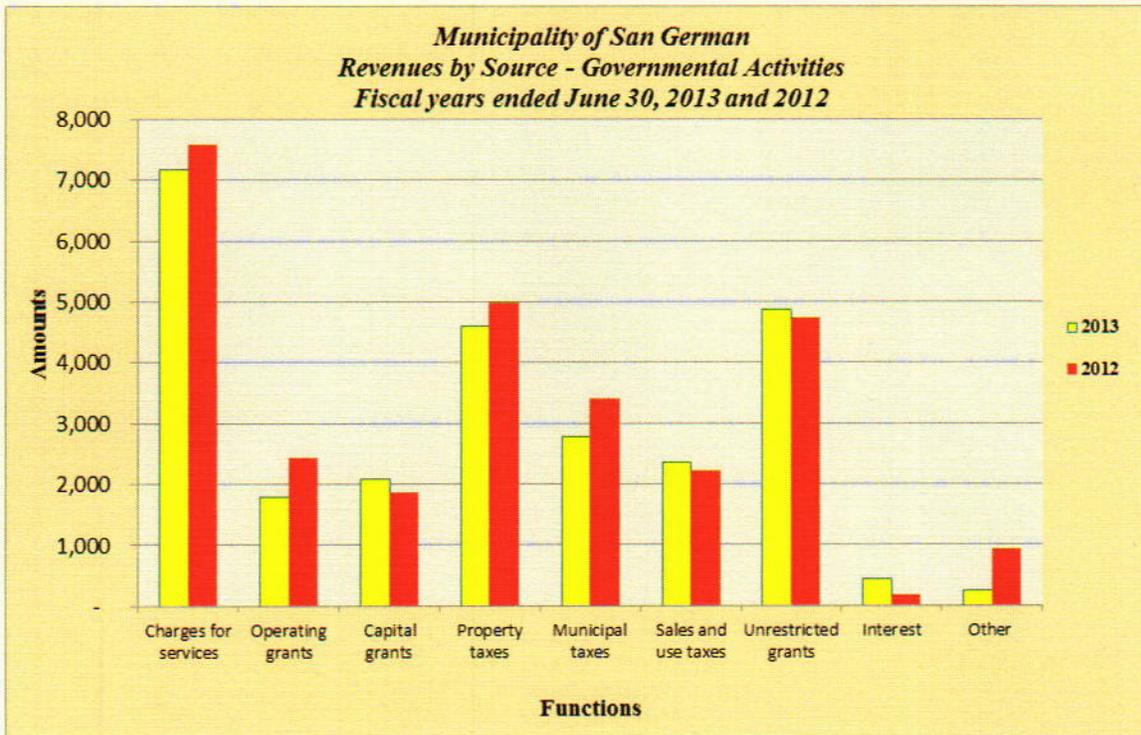
With respect to prior year, revenues reported a net decrease of approximately 7%. This net decrease is primarily the result of: (1) a 26% decrease in operating grants due to a decrease of \$511,792 in ARRA Funds for the Early Head Start program and a decrease of \$182,753 in HPRP Funds; (2) a 18% decrease in municipal license taxes due to deterioration of the local economy; (3) a 12% decrease in property taxes revenues due mainly from a non-recurrent property tax amnesty revenues received in previous year; (4) and a decrease in other revenues for a recognition in 2012 of a \$600,000 gain on sale on an expropriation of a Municipality's parcel of land from the P.R. Highways and Transportation Authority.

These decreases were partially offset by increases of 161% in interest revenues and a 12% increase in capital grants provided by the Commonwealth Government.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMÁN
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2013**

The following **Figure 1** illustrates the revenue comparison between 2013 and 2012:

FIGURE 1

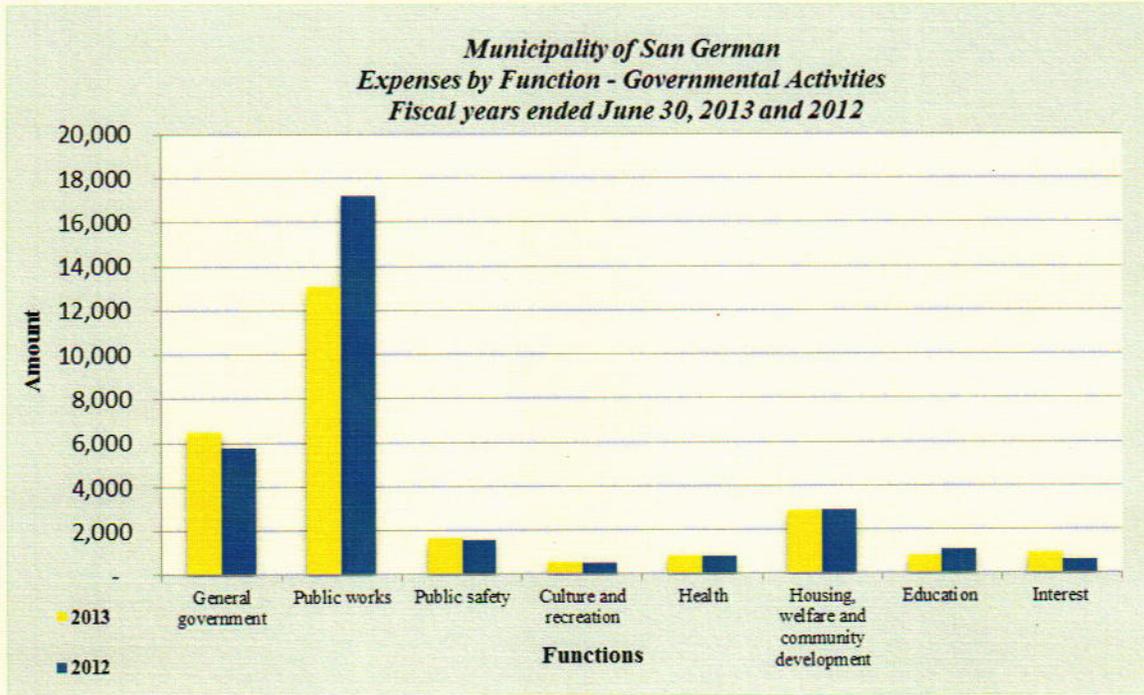


The largest expenses are public works with 48%, general government representing approximately 24% and welfare 11%. Expenses decreased 12% in comparison with the 2012 year. This net decrease is a combination of a 27% decrease in education since prior year expenses included the remaining expenses related to the ARRA Early Head Start Grant and a decrease of 24% in public works since the prior year expenses included the effect of a non-recurrent transfer of an infrastructure project to PRASA (\$3,818,543). The decrease in expenses was partially offset by an increase of 38% in interest expense caused by the additional long-term debt issued during 2013 for the construction of a water park and by an increase of 12% in general government expenses.

The following **Figure 2** illustrates the expenses comparison between 2013 and 2012:

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMÁN
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2013**

FIGURE 2



The Statement of Activities reports revenues and expenses in a format that focus on the net cost of each function of the Municipality. Both the gross and net cost of the function, which is otherwise being supported by the general government revenues, is compared to the revenues generated directly by the function. This Statement reduces gross direct expenses, including depreciation, by related program revenues, operating and capital grants, and contributions. The following table discloses 2013 and 2012 expenses net of program revenue and the general revenues available to finance remaining costs:

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMÁN
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2013**

TABLE 3

<i>Expenses Net of Program Revenues As of June 30, 2013</i>		
Net expenses	2013	2012
General government	\$ (4,373,078)	\$ (3,547,074)
Public Safety	(1,592,243)	(1,553,118)
Public works	(6,484,507)	(10,416,804)
Sanitation	(283,543)	(290,916)
Health	(786,763)	(786,763)
Housing, welfare and community development	(1,074,952)	(452,815)
Culture and recreation	(493,898)	(484,523)
Education	53,156	(507,880)
Interest on long term debt	(901,010)	(653,473)
Total expenses, net of program revenues	(15,936,838)	(18,693,366)
General revenues		
Taxes	9,749,421	10,585,296
Grants and contributions not restricted to specific programs	4,876,575	4,726,583
Interest and other	672,870	1,090,955
Total general revenues	15,298,866	16,402,834
Change in net position	\$ (637,973)	\$ (2,290,532)

Some of the costs of governmental activities were paid by those who directly benefited from the programs (\$7,180,394) and other governments and organizations that subsidized certain programs with grants and contributions (\$3,880,016). The remaining costs were financed with general revenues. Like in the previous year, the net cost of services \$(15,936,838) was not covered by other general revenues.

FINANCIAL ANALYSIS OF THE MUNICIPALITY'S FUNDS

Governmental funds

The focus of the Municipality's governmental funds is to provide information on near-term inflows, outflows and balances of resources available for spending. Such information is useful in assessing the Municipality's financing requirements. In particular, unassigned fund balance may serve as a useful measure of a Municipality's net resources available at the end of a fiscal year as they represent the portion of fund balance which has not yet been limited to use for a particular purpose by either an external party.

For the fiscal year ended June 30, 2013, the governmental funds reported combined ending fund balances of \$11,882,347, a net increase of 19% in comparison with the prior year. This increase was caused primarily by a net change in the Surf and Fun Water Park Fund of \$3,436,609 and \$610,018 in the Other Governmental Funds due mainly to the net proceeds of long term debt issuance. These increases were partially offset by decreases of \$1,887,171 and \$283,055 in the General and Debt Service Fund respectively. Of the total combined fund balances, a net deficit of \$2,195,383 (or -18%) constitutes unrestricted fund balance. A deficit of \$2,701,167 in unassigned fund balance represents (-23%) of total fund balance. The remainder of the fund balances is restricted to indicate that it is not available for new spending. Following is a summary of the financial analysis of the Municipality's major funds:

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMÁN
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2013**

- ***General Fund***

The general fund is the operating fund of the Municipality. The fund balance (deficit) of the general fund represents approximately 9% of total ending fund balances. The amount of \$772,026 of the fund balance of the general fund is non spendable and represents advances provided to other funds, which are expected to be recovered after the next fiscal year. Unassigned fund balance (deficit) increased 61% with respect to the prior year.

For the year ended June 30, 2013, the fund balance of the general fund decreased by \$1,887,171 in comparison with the prior year. There was a 2% net decrease in revenues due to decreases in (1) construction permits revenues; (2) license tax revenues; (3) and other revenues. This decrease was partially offset by a transfer of \$594,559 from the debt service fund related to excess funds in CAE fund which were recorded in a special fund as part of the general fund. There was only a net increase of 5% in the general fund expenditures due to increases in (1) public works due the increase electric power utilities expense; (2) capital outlays financed with excess funds transferred from the debt service fund discussed above; general government and public safety expenditures.

- ***Debt Service Fund***

The debt service fund had a decrease in fund balance during the current year of \$(283,065) to bring the year end fund balance to \$2,312,704 which represents 19% of total fund balances. The decrease results from transfers of \$594,559 to the general fund of excess funds deposited in the CAE fund. Revenues decreased 16% due to the combined effect of a decrease of \$489,577 in property tax revenues partially offset by an increase of \$96,123 in sales and use tax revenues of the Municipal Redemption fund.

- ***Surf and Fun Water Park***

This fund report revenue sources mostly from loans provided for the construction and future operation of a water park. During the 2013 the fund balance increased \$3,436,609. This increase was mostly affected by \$9,310,000 proceeds from bonds and notes issuance and interest revenue of \$200,512 generated during the year. These proceeds were partially offset by capital outlays expenditures of \$5,861,516 and by interest expenditures of \$153,931.

GENERAL FUND BUDGETARY HIGHLIGHTS

The general fund original budget for the fiscal period 2012-2013 presented an increase of 3% with respect to prior year budget. Amendments to the original budget are approved by the Municipal Legislature. During the fiscal year, budget revenues were increased by \$469,569 mainly in municipal license tax (\$133,208) and charges for services (\$336,361) revenues. Actual revenues were short of revised budget by \$1,472,708 (net) mainly due to unrealized charges for services revenues. The Municipality reported a positive variance of \$600,133 between revised budgeted appropriations and actual expenditures. This positive variance was due mainly to savings of \$395,080 in public works and \$228,143 in general government expenditures.

Actual expenditures and other financing uses exceeded actual revenues and other financing sources (deficit) by \$319,630.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMÁN
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2013**

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital assets

At the end of the fiscal year, the Municipality has invested \$56,735,879 (net of accumulated depreciation) in a broad range of capital assets, including buildings, parks, roads, bridges, land and equipment. This amount represents a net increase of approximately 16% from the prior year. The following table discloses the capital assets balances as of June 30, 2013:

TABLE 4

<i>Capital Assets, net As of June 30,</i>		
	Governmental Activities	
	2013	2012
Non-depreciable assets:		
Land	\$ 8,214,356	\$ 8,214,353
Construction in progress	8,392,971	2,301,960
Depreciable assets:		
Buildings and Buildings Improvements	25,190,652	24,374,918
Equipment	3,729,362	3,621,377
Roads	6,623,047	5,487,819
Bridges	4,585,491	4,739,879
Total	\$ 56,735,879	\$ 48,740,306

The Municipality's major capital projects that were still in construction and the related construction in progress cost as of June 30, 2013 are as follows:

1. "San Germán Surf and Fun Water Park," with \$7,030,112 costs incurred as of year-end. Costs incurred in prior years for a total amount of \$1,115,291 of Villa Paraíso ward and related to land improvements and other infrastructure transferred to this project were included within this amount. This construction is being financed through general and special obligation bonds and notes.
2. "Sabana Eneas Baseball Park," with \$814,232 costs incurred as of year-end. Project is currently financed through Commonwealth's agencies grants and long-term debt issuance.

During the year the Municipality completed the construction of a multipurpose center in the "Poblado Rosario" for a total cost of \$83,850 and the improvements to the Minillas basketball court for a total cost of \$54,345. Finally, the Municipality acquired equipment amounting to \$537,990, composed mainly of vehicles for \$182,934, a heavy equipment item for \$32,500, gym equipment for \$130,808, and emergency system equipment for \$53,630.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMÁN
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2013**

The Municipality's fiscal year 2013-2014 capital budget calls for a significant amount of projects including the continuance of the construction of the Surf and Fun Water Park, with an estimated total cost of over \$23,000,000; the continuance of the construction of the Sabana Eneas baseball park, with an estimated total cost of \$1,120,000; the completion of the construction of a Skateboard Plaza, with an estimated total cost of \$190,000; the construction of Laracuenta Bridge at Maresua ward and El Brujo Bridge at Guama ward at an estimated total costs of \$206,000 and \$94,000 respectively; the construction of a Multipurpose Center at Las Lomas Residential area, for a total estimated cost of \$250,000; improvements over the Multipurpose Center at Rosario ward, with an estimated cost of \$58,000; and the commencement of the construction of the Santa Maria Recreational Area, the improvement to the El Recreo Basketball Court and the construction of a Basketball Court in the Luis F. Sambolin Recreative Area at Maresua ward for estimated total costs of \$570,000, \$150,000 and \$93,000 respectively.

More detailed information about the Municipality's capital assets is presented in Note G to the financial statements.

Long-term debt

The following is a summary of the Municipality's outstanding debt as of June 30, 2013 and 2012:

TABLE 5

<i>Outstanding Long-term Debts As of June 30,</i>			
	Governmental Activities		
	2013	2012	
General and special obligation bonds and notes	\$ 25,199,000	\$ 14,552,000	
General obligation bond anticipation note	435,968	435,968	
Note payable to CRIM – prior years delinquent accounts	91,620	96,452	
Compensated absences	3,415,064	3,458,781	
Christmas Bonus	351,851	312,223	
Claims and judgments	8,500	196,377	
Note payable to P.R. Department of Labor	3,965	43,367	
Payable to PREPA	1,287,066	1,204,047	
Total	\$ 30,793,034	\$ 20,299,215	

At year-end, the Municipality maintains an outstanding balance of \$25,199,000 in general and special bonds and notes, an increase of 73% with respect to prior year. During the year 2012-2013 the Municipality entered into loan agreements with the Governmental Development Bank of P.R. ("GDB") which provides for the issuance of general and special obligation bonds and note for the following: \$8,305,000 and \$1,005,000 for the water park construction, \$865,000 and \$455,000 for property acquisitions, \$575,000, \$305,000 and \$230,000 for construction and/or permanent improvements, and \$3,402,000 and \$1,386,000 for debt refinance purpose. In addition, the increase in amount payable to the Puerto Rico Electric Power Authority (PREPA) is the result of an excess of the annual energy charges incurred by the Municipality over the contribution in lieu of taxes ("CELI") for the fiscal year 2011-2012, which was recorded both as a long term debt and a receivable from the agency.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMÁN
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2013**

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

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

The Municipality's selected and appointed officials considered many factors when setting the fiscal year 2012-2013 budget. One of these factors is the economy. Among economic areas considered are the population growth estimates, personal income, housing statistics and unemployment rates. The Municipality's unemployment rate now stands at 17.3%, which compares with the Commonwealth rate of 13.8%.

The Municipality applied a conservative approach in development budget estimates. Amounts available for appropriations in the General Fund for the fiscal year 2013-2014 is \$18,557,582, a decrease of approximately 2% with respect to prior year estimates. Budgeted expenditures are expected to be reduced accordingly to the decrease of budgeted revenues. In addition to the estimated budget for the general fund, the Municipality has submitted Federal and Commonwealth funds proposals for welfare as well as for capital improvements and public works funds.

As more fully described in Note P the Commonwealth of Puerto Rico is facing a financial crisis due to limited liquidity, general fund deficit, a sizeable amount of debt, an underfunded government pension system and an economy recession since 2006. As a result of these matters, credit ratings agencies have been consistently downgrading the Commonwealth's and certain public corporation's general obligation bonds ratings. In order to address these matters the Commonwealth began to make legislation to reform its governmental pension system, provide liquidity to the Governmental Development Bank of Puerto Rico ("GDB"), its fiscal agent, and strength sinking funds to assess financial markets. The Commonwealth estimates that these corrective actions, along others to be implemented, will have a positive impact on the Commonwealth itself, GDB, the municipalities and its citizens. Among other actions on January 24, 2014 the Commonwealth approved Act No. 18 and 19. Those Act's provides for the restructuring and creation of financing structures from sales and use tax sources to guarantee and pay municipal long term debt issuances. As a result of this legislation the municipalities of Puerto Rico may improve its credit capacity along with maintaining sufficient resources for operations.

On February 4, 2014, February 7, 2014 and February 11, 2014 Standard & Poor's Ratings Services ("S&P"), Moody's Investors Service ("Moody's") and Fitch Ratings ("Fitch") respectively, lowered its ratings on the Commonwealth of Puerto Rico's general obligation (GO) debt and other of its instrumentalities such as GDB, ERS and COFINA. The downgrades follow S&P's, Moody's and Fitch's evaluation of liquidity and access to markets. It is the opinion of the Municipality's management that the corrective actions taken and to be taken in current and fiscal periods thereafter will lower the impact of this decision and cause a positive turnaround on the Commonwealth's and the Municipality's finances.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMÁN
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2013**

CONTACTING THE MUNICIPALITY'S FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, taxpayers, and creditors with a general overview of the Municipality's finances and to demonstrate the Municipality's accountability for the money it receives. If you have questions about this report or need additional information, contact the Municipality's Director of Finance at P.O. Box 85, San Germán, Puerto Rico 00683.

BASIC FINANCIAL STATEMENTS

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMÁN
STATEMENT OF NET POSITION
JUNE 30, 2013**

		<u>Governmental Activities</u>
<u>ASSETS</u>		
Cash and cash equivalents	\$	25,876
Receivables (net of allowance for uncollectibles):		
Municipal license taxes		38,126
Sales and use taxes		153,061
Rents and construction permits		611,201
Due From:		
Commonwealth Government		2,160,131
Federal Government		367,335
Restricted Assets:		
Cash and cash equivalents		9,539,104
Cash with fiscal agents		7,482,101
Capital assets:		
Land and construction in progress		16,607,327
Other capital assets, net		40,128,552
Total capital assets, net		56,735,879
Total assets	\$	77,112,814
<u>LIABILITIES</u>		
Accounts payable and accrued liabilities	\$	2,238,868
Interest payable		431,989
Due to:		
Commonwealth Government		145,643
Federal Government		20,780
Unearned revenues		2,001,718
Long term liabilities:		
Due within one year		2,595,440
Due in more than one year		28,197,594
Total liabilities		35,632,032
<u>NET POSITION</u>		
Net investment in capital assets		40,102,889
Restricted for:		
Capital projects		1,710,101
Debt service		3,274,886
Other specified purposes		508,406
Unrestricted (deficit)		(4,115,500)
Total net position	\$	41,480,782

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN
STATEMENT OF ACTIVITIES
FISCAL YEAR ENDED JUNE 30, 2013**

Functions	Expenses	Program Revenues			Net (Expenses) Revenues and Change in Net Position
		Fees, Fines and Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	
Governmental activities:					
General government	\$ 6,451,932	\$ 1,909,790	\$ 169,064	\$ -	\$ (4,373,078)
Public safety	1,631,323	-	39,080	-	(1,592,243)
Public works	12,758,939	4,168,109	24,527	2,081,796	(6,484,507)
Sanitation	283,543	-	-	-	(283,543)
Health	786,763	-	-	-	(786,763)
Welfare	2,840,221	1,102,495	662,774	-	(1,074,952)
Culture and recreation	531,532	-	37,634	-	(493,898)
Education	811,986	-	865,142	-	53,156
Interest on long-term debt	901,010	-	-	-	(901,010)
Total government activities	\$26,997,249	\$7,180,394	\$1,798,221	\$2,081,796	(15,936,838)
General Revenues:					
Taxes:					
Property taxes					4,593,002
Municipal license taxes					2,792,058
Sales and use taxes					2,364,361
Grants and contributions not restricted to specific programs					4,876,575
Interest					429,715
Other					243,155
Total general revenues					15,298,865
Change in net position					(637,973)
Net position - beginning of year					42,118,755
Net position - end of year					\$ 41,480,782

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMÁN
BALANCE SHEET - GOVERNMENTAL FUNDS
JUNE 30, 2013**

	Major Funds				Total Governmental Funds
	General	Debt Service	Surf and Fun Water Park	Other Governmental Funds	
Assets					
Cash and cash equivalents	\$ 25,876	\$ -	\$ -	\$ -	\$ 25,876
Receivables (net of allowance for uncollectibles):					
Municipal license taxes	38,126	-	-	-	38,126
Sales and use taxes	153,061	-	-	-	153,061
Rents and construction permits	598,406	-	-	12,793	611,199
Due from:					
Commonwealth Government	1,576,722	243,208	-	340,201	2,160,131
Federal Government	-	-	-	367,335	367,335
Other funds	1,097,696	-	-	30,995	1,128,691
Advances to other funds	772,026	-	-	-	772,026
Restricted Assets:					
Cash and cash equivalents	-	-	5,001,507	4,537,597	9,539,104
Cash with fiscal agents	-	3,333,791	2,137,846	2,010,464	7,482,101
Total assets	\$ 4,261,913	\$3,576,999	\$7,139,353	\$7,299,385	\$22,277,650

Continue

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMÁN
BALANCE SHEET - GOVERNMENTAL FUNDS
JUNE 30, 2013**

	Major Funds					Total Governmental Funds
	General	Debt Service	Surf and Fun Water Park	Other Governmental Funds	Total Governmental Funds	
<u>Liabilities, Deferred Inflows of Resources and Fund Balances (deficit)</u>						
<u>Liabilities:</u>						
Accounts payable and accrued liabilities	\$ 1,160,572	-	\$ 621,260	\$ 457,034	\$ 2,238,866	
Matured bonds and interest payable	-	1,108,210	90,237	39,638	1,238,085	
Due to:						
Commonwealth Government	145,643	-	-	-	145,643	
Federal Government	-	-	-	20,780	20,780	
Other funds	30,645	-	43,363	1,054,683	1,128,691	
Advances from other funds	-	-	-	772,026	772,026	
Unearned revenues	1,882,488	-	-	131,095	2,013,583	
Total liabilities	3,219,348	1,108,210	754,860	2,475,256	7,557,674	
<u>Deferred Inflow of Resources</u>						
Unavailable revenues - Commonwealth Government Funds	1,450,490	-	-	339,912	1,790,402	
Unavailable revenues - Federal grants	-	-	-	171,974	171,974	
Unavailable revenues - Other	719,168	156,085	-	-	875,253	
Total deferred inflow of resources	2,169,658	156,085	-	511,886	2,837,629	
Fund balances (deficit):						
Nonspendable	772,026	-	-	-	772,026	
Restricted	-	2,312,704	6,384,493	4,609,107	13,306,304	
Committed	505,184	-	-	-	505,184	
Unassigned	(2,404,303)	-	-	(296,864)	(2,701,167)	
Total fund balances (deficit)	(1,127,093)	2,312,704	6,384,493	4,312,243	11,882,347	
Total liabilities, deferred inflows of resources and fund balances (deficit)	\$4,261,913	\$3,576,999	\$7,139,353	\$7,299,385	\$22,277,650	

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMÁN
RECONCILIATION OF THE BALANCE SHEET OF GOVERNMENTAL FUNDS
TO THE STATEMENT OF NET POSITION
JUNE 30, 2013**

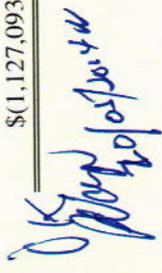
Total governmental fund balances:		\$11,882,347
Amounts reported for governmental activities in the Statement of Net Position are different because:		
Capital assets used in governmental activities are not current financial resources and, therefore, are not reported in the governmental funds balance sheet		56,735,879
Other assets are not available to pay current-period expenditures and, therefore, are reported as deferred inflows of resources in the funds:		
Receivables, due from Commonwealth and Federal Government:		
CRIM - Intergovernmental (General Fund)	\$ 88,138	
Municipal license taxes	38,126	
Rent - properties	556,528	
Rent - land lots	31,276	
CRIM - Property taxes (Debt Service Fund)	156,085	
P.R. Department of Labor- Law No. 52 and No. 82	67,905	
P.R. Department of Treasury - Christmas bonus reimbursement	163,424	
P.R. Electric Power Authority (PREPA)	1,287,067	
P.R. Office of Ombudsman for the Elderly	101,692	
P.R. Solid Waste Management Authority	5,100	
OCAM - Public Order Code	238,322	
Federal Grants - CDBG	11,864	
Federal Grants - ESG	18,110	
Federal Grants - FEMA	61,478	
Federal Grant - State and Community Highway Safety	<u>24,378</u>	2,849,493
Interest liabilities are not due and payable in the current period and, therefore, are not reported in the funds:		(69,903)
Long-term liabilities are not due and payable in the current period and, therefore, are not reported in the funds:		
General and special obligation bonds and notes	(24,323,000)	
General obligation bond anticipation note	(435,968)	
Compensated absences	(3,415,064)	
Claims and judgments	(8,500)	
Note payable to CRIM - delinquent accounts	(91,620)	
Payable to PREPA	(1,287,066)	
Christmas bonus	(351,851)	
Note payable to P.R. Department of Labor and Human Resources	<u>(3,965)</u>	<u>(29,917,034)</u>
Net position of governmental activities		<u>\$41,480,782</u>
The accompanying notes are an integral part of these financial statements.		

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES - GOVERNMENTAL FUNDS
FISCAL YEAR ENDED JUNE 30, 2013**

	Major Funds				Total Governmental Funds
	General	Debt Service	Surf and Fun Water Park	Other Governmental Funds	
Revenues:					
Taxes:					
Property taxes	\$ 2,951,474	\$ 1,501,401	\$ -	\$ -	\$ 4,452,875
Municipal license taxes	2,765,098	-	-	-	2,765,098
Sales and use taxes	1,838,204	526,157	-	-	2,364,361
Intergovernmental:					
Commonwealth Government	4,858,169	-	-	1,304,614	6,162,783
Federal Government	-	-	-	2,485,918	2,485,918
Rental income and charges for services	6,152,692	-	-	1,174,100	7,326,792
Fines and forfeitures	22,444	-	-	-	22,444
Interest	124,406	3,051	200,512	101,746	429,715
Other	51,331	-	-	98,305	149,636
Total Revenues	18,763,818	2,030,609	200,512	5,164,683	26,159,622
Expenditures:					
Current:					
General government	6,149,472	-	12,938	169,161	6,331,571
Public safety	1,501,835	-	-	62,587	1,564,422
Public works	9,385,437	-	-	499,674	9,885,111
Sanitation	198,243	-	-	19,188	217,431
Health	786,763	-	-	-	786,763
Welfare	587,214	-	-	3,018,994	3,606,208
Culture and recreation	567,768	-	-	42,330	610,098
Education	3,692	-	-	6,547	10,239
Capital outlays	826,249	-	5,861,516	3,166,079	9,853,844
Debt service:					
Principal	-	1,006,999	-	-	1,006,999
Interest	-	709,965	153,931	93,131	957,027
Bond issuance costs	-	-	52,019	36,144	88,163
Total expenditures	20,006,673	1,716,964	6,080,404	7,113,835	34,917,876

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMÁN
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES -
GOVERNMENTAL FUNDS (CONTINUE)
FISCAL YEAR ENDED JUNE 30, 2013

	Major Funds				Total Governmental Funds
	General	Debt Service	Surf and Fun Water Park	Other Governmental Funds	
Excess (deficiency) of revenues over expenditures	(1,242,855)	313,645	(5,879,892)	(1,949,152)	(8,758,254)
Other financing sources (uses):					
Proceeds from long term debt issuance	-	-	9,310,000	2,430,000	11,740,000
Proceeds from refunding bonds	-	-	-	4,788,000	4,788,000
Payment of long-term debt - refunding bonds	-	-	-	(4,770,000)	(4,770,000)
Payment of long-term debt - PREPA	(1,123,345)	-	-	-	(1,123,345)
Transfers - in	622,509	-	20,725	122,756	765,990
Transfers - (out)	(143,480)	(596,700)	(14,224)	(11,586)	(765,990)
Total other financing sources (uses)	(644,316)	(596,700)	9,316,501	2,559,170	10,634,655
Net change in fund balances (deficit)	(1,887,171)	(283,055)	3,436,609	610,018	1,876,401
Fund balance at beginning of year	760,078	2,595,759	2,947,884	3,702,225	10,005,946
Fund balance at end of year	\$(1,127,093)	\$ 2,312,704	\$ 6,384,493	\$ 4,312,243	\$11,882,347



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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMÁN
RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN
IN FUND BALANCES (DEFICIT) - GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES
FISCAL YEAR ENDED JUNE 30, 2013

Net change in fund balances (deficit) - total governmental funds: **\$ 1,876,401**

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

Governmental funds reports capital assets outlays as expenditures. However, in the Statement of Activities, the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense:

Expenditures for capital assets:	\$ 9,916,209	
Less: current year depreciation	<u>(1,920,639)</u>	7,995,570

Revenues in the statement of activities that do not provide current financial resources are not reported as revenue in the funds:

CRIM - Property taxes (General Fund)	88,138	
Municipal license tax (net change)	26,969	
CRIM - Property taxes (Debt Fund)	156,085	
P.R. Department of Treasury - Law No. 52	67,905	
P.R. Department of Treasury - Christmas bonus reimbursement	163,424	
P.R. Electric Power Authority (PREPA)	804,243	
P.R. Office of Ombudsman for the Elderly	101,692	
P.R. Solid Waste Management Authority	5,100	
OCAM - Public Order Code (current year)	13,779	
Federal Grants - CDBG	11,864	
Federal Grants - ESG	18,110	
Federal Grant - State and Community Highway Safety	24,378	
Federal Grants - FEMA	<u>61,481</u>	1,543,168

Revenues reported in funds which are not reported as revenues in the Statement of Activities:

CRIM - Property taxes (General Fund) (prior year)	(104,096)	
P.R. Electric Power Authority (PREPA) (prior year)	(721,224)	
P.R. Office of Ombudsman for the Elderly	(5,171)	
Construction permits	(186,579)	
Rent- land lots	(70,017)	
P.R. Department of Treasury - Christmas bonus reimbursement (prior year)	(145,018)	
P.R. Department of Treasury - Law No. 52	(19,655)	
P.R. Department of Treasury - Law No. 2212	(41,492)	
Federal Grants - CDBG	(59,664)	
Federal Grants - ESG	(4,001)	
Federal Grant - State and Community Highway Safety	(18,735)	
Federal Grants - Public Housing Capital Fund (prior year)	<u>(393)</u>	(1,376,045)

Expenditures reported in funds which are not reported as expenses in the Statement of Activities:

Matured bonds principal payments (net change)		(104,000)
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Continue

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMÁN
RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN
IN FUND BALANCES (DEFICIT) - GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES
(CONTINUED)
FISCAL YEAR ENDED JUNE 30, 2013**

Proceeds from general obligation bonds is another financing source in the governmental funds, but increase long-term liabilities in the Statement of Net Position:		(16,528,000)
Repayment of long-term debt consumes the current financial resources of governmental funds, but has no effect on net position of governmental activities:		
General obligation bonds and notes	5,881,000	
Other long term liabilities	2,023,210	7,904,210
Some expenses reported in the Statement of Activities do not require the use of current financial resources and, therefore, are not reported as expenditures in the governmental funds:		
Claims and judgments	(8,500)	
Accrued interest (net change)	66,721	
Compensated absences	(303,314)	
Christmas bonus	(351,851)	
P.R. Electric Power Authority (PREPA)	(1,206,364)	
Others	(145,969)	(1,949,278)
Change in net position of governmental activities		\$ (637,973)

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMÁN
NOTES TO FINANCIAL STATEMENTS
June 30, 2013

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Municipality of San Germán ("the Municipality") was founded in 1573. The Municipality is governed by the executive and the legislative branch elected for a four year term during the general elections in Puerto Rico. The Mayor is the executive officer and the legislative branch consists of fourteen (14) members of the Municipal Legislature. The Municipality engages in a comprehensive range of services to the community such as: general government administration, public works, health, environmental control, education, public security, welfare, housing, community development and culture and recreation activities.

The financial statements of the Municipality have been prepared in accordance with accounting principles generally accepted in the United States as applied to governmental units. The Governmental Accounting Standards Board (GASB) is the standard-setting body for governmental accounting and financial reporting. The GASB periodically updates its existing Governmental Accounting and Financial Reporting Standards, which, along with subsequent GASB pronouncements (Statements and Interpretations), constitutes GAAP for governmental units.

1. *Financial reporting entity*

The financial reporting entity included in this report consists of the financial statements of the Municipality of San Germán (primary government) and organizations for which the primary government is financially accountable. In addition, the primary government may determine, through exercise of management's professional judgment, that the inclusion of an organization that does not meet the financial accountability criteria is necessary in order to prevent the reporting entity's financial statements from being misleading. Other entities should be evaluated as potential component units if they are closely related to, or financially integrated with, the primary government. It is a matter of professional judgment to determine whether the nature and the significance of a potential component unit's relationship with the primary government warrant inclusion in the reporting entity. An entity should be considered a component unit if meets any of the following three conditions:

- a. The primary government appoints a voting majority of the entity's governing body, and either:
 - A financial benefit/ burden exist between the primary government and the entity or
 - The primary government can impose its will on the entity.
- b. The entity is fiscally dependent on the primary government and there is a financial benefit/burden between the primary government and the entity.
- c. It would be necessary to include the entity as a component unit since the primary government's financial statements would be misleading without it.

In addition, "*Special criteria*" apply when evaluating a legally separate, tax-exempt organization as potential component unit. Specifically, such entities must be treated as component units if they meet all of the following criteria:

- a. The economic resources received or held by the separate organization are entirely or almost entirely for the direct benefit of the primary government, its component units, or its constituents.

The primary government, or its component units, is entitled to, or has the ability to otherwise access, a majority of the economic resources received or held by the separate organization.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMÁN
NOTES TO FINANCIAL STATEMENTS
June 30, 2013

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

- b. The economic resources received or held by an individual organization that the specific primary government, or its component units, is entitled to, or has the ability to otherwise access, are significant to the primary government.

Legally separate, tax-exempt organizations that do not meet the above *special criteria* should still be included as a component unit if the financial statements of the primary government would be misleading without them.

There are two methods of presentation of the component unit in the financial statements: (a) *blending* the financial data of the component units' balances and transactions and (b) *discrete* presentation of the component unit's financial data. When a component unit functions as an integral part of the primary government, its data is *blended* with those of the primary government ("*blended component units*"). That is, the component unit's funds are treated just as though they were funds of the primary government with one exception: the general fund. Component units should be reported as *blended* if meets any of the following criteria:

- a. The component unit's governing body is substantively the same as the governing body of the primary government and there is either:
- A financial benefit/ burden exist between the primary government and the entity or
 - Management of the primary government has operational responsibility for the primary government.
- b. The component unit provides services entirely, or almost entirely, to the primary government or otherwise exclusively, or almost exclusively, benefits the primary government.
- c. The component unit's debt is expected to be paid by the primary government.

Otherwise, the component unit should be presented as discrete. Those component units does not function as an integral part of the primary government and its data is presented discretely (separately) from the data of the primary government ("*discretely component units*"). Legally separate, tax-exempt organizations that meet the *special criteria* should be included as *discretely component units*.

Based on the above criteria there are no potential component units which should be included as part of the financial statements.

2. *Basis of presentation, measurement focus and basis of accounting*

The financial report of the Municipality consists of the Management's Discussion and Analysis (MD&A), basic financial statements, notes to the financial statements and required supplementary information other than the MD&A. Following is a summary presentation of each, including the measurement focus and basis of accounting. Measurement focus is a term used to describe *which* transactions are recorded within the various financial statements. Basis of accounting refers to *when* transactions are recorded regardless of the measurement focus:

Management's Discussion and Analysis

This consists of a narrative introduction and analytical overview of the Municipality's financial activities. This analysis is similar to the analysis the private sector provides in their annual reports.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMÁN
NOTES TO FINANCIAL STATEMENTS
June 30, 2013

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Basic financial statements

Basic financial statements include both government-wide and fund financial statements. Both levels of statements categorize primary activities as governmental type, which are primarily supported by taxes and intergovernmental revenues.

Government-wide statements

The government-wide statements consist of a Statement of Net Position and a Statement of Activities. These statements are prepared using the economic resources measurement focus, which refers to the reporting of all of the net position available to the governmental unit for the purpose of providing goods and services to the public. The statements are reported on the accrual basis of accounting. Revenues are recognized in the period earned and expenses recognized in the period in which the associated liability is incurred. Fiduciary activities, if any, whose resources are not available to finance government programs, are excluded from the government-wide statements. The effect of inter-fund activities is eliminated.

The Statement of Net Position presents all of the reporting entity's non-fiduciary assets, deferred outflows, liabilities and deferred inflows, with the difference reported as net position. The Statement of Activities reports revenues and expenses in a format that focus on the net cost of each function of the Municipality. Both the gross and net cost of the function, which is otherwise being supported by the general government revenues, is compared to the revenues generated directly by the function. This Statement reduces gross direct expenses, including depreciation, by related program revenues, operating and capital grants, and contributions. Direct expenses are those that are clearly identifiable with a specific function. As a policy, indirect expenses are not allocated in the Statement of Activities. Program revenues must be directly associated with the function.

The types of transactions included as program revenues are: charges for services, fees, licenses and permits; operating grants which include operating-specific and discretionary (either operating or capital) grants; and capital grants which are capital-specific grants. Internally dedicated resources are reported as general revenues rather than as program revenues. Likewise, general revenues include all taxes. Property taxes (imposed nonexchange transactions) are recognized as revenues in the year for which they are levied and municipal license taxes and sales and use taxes (derived tax revenues) when the underlying exchange has occurred and time requirements are met. Revenues on both operating and capital grants are recognized when all eligibility requirements (including time requirements) imposed by the provider have been met. For certain expenditure-driven grants, revenue is recognized after allowable expenditures are incurred.

The Municipality reports unearned revenues in the government-wide statements. Unearned revenues arise when resources are received before the Municipality has a legal claim to them (such as advances of derived tax revenues) or before applicable eligibility requirements are met (in case of certain federal expenditure-driven grants if resources are received before allowable expenditures are incurred). In subsequent periods, when the Municipality has a legal claim to the resources, the liability for unearned revenues is removed from the statement of net position and the revenue is recognized.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMÁN
NOTES TO FINANCIAL STATEMENTS
June 30, 2013

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Fund Statements

The financial transactions of the Municipality are recorded in individual funds, each of which are considered an independent fiscal entity. Each fund is accounted for by providing a separate set of self-balancing accounts that comprise its assets, deferred outflows, liabilities, deferred inflows, fund equity, revenues and expenditures. Funds are segregated according to their intended purpose which helps management in demonstrating compliance with legal, financial and contractual provisions. Governmental Funds are those through which most governmental functions of the Municipality are financed. The governmental fund statements include a Balance Sheet and a Statement of Revenues, Expenditures and Changes in Fund Balances with one column for the general fund, one for each major fund and one column combining all non-major governmental funds. Major funds are determined based on a minimum criterion, that is, a percentage of the assets and deferred outflows; liabilities and deferred inflows; revenues or expenditures or based on the Municipality's official's criteria if the fund is particularly important to financial statement users.

The Municipality reports the following major governmental funds:

General Fund: This is the operating fund of the Municipality and is used to account for and report all financial resources not accounted for and reported in another fund.

Debt Service Fund: this fund is used to account for and report financial resources that are restricted, committed, or assigned to expenditures for principal and interest. This fund accounts for the resources of two individual funds including the "Fondo 10 - CAE Fund" (sinking fund which accounts for the 2% of property taxes collected by the CRIM and the "Municipal Redemption Fund" (.2% of the .5% from sales and use taxes will deposited in GDB to finance loans to Municipalities.

Surf and Fun Water Fund: This fund is used to account for and report financial resources that are restricted, committed, or assigned for the construction of a water park.

The governmental fund financial statements are accounted for using the current financial resources measurement focus and the modified accrual basis of accounting. Under this method of accounting, revenues are recognized when they are susceptible to accrual (i.e. 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 Municipality considers revenues to be available if they are collected within 60 days of the end of the current fiscal period.

Revenues susceptible to accrual include property taxes, recognized as revenues in the year for which they are levied; municipal license taxes and sales and use taxes, recognized when the underlying exchange has occurred and time requirements are met; and interest. In applying the susceptible to accrual concept to intergovernmental revenues, revenues are recognized when all eligibility requirements (including time requirements) imposed by the provider have been met and revenue becomes available. There are, however, essentially two types of these revenues. In the first case, on expenditure-driven grants, monies must be expended on the specific project or purpose (eligibility requirement), before any amounts are paid to the Municipality.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMÁN
NOTES TO FINANCIAL STATEMENTS
June 30, 2013

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Revenue is, therefore, recognized as expenditures are incurred to the extent available. In the other cases, monies are virtually unrestricted and are generally revocable only for failure to comply with prescribed compliance requirements. In these cases revenues are recognized as the time of receipt or earlier if the susceptible to accrual criteria is met. Licenses and permits, charges for services, rent, fines and miscellaneous revenues are generally recorded as revenues when received or are recognized earlier if the susceptible to accrual criteria is met.

The Municipality reports unearned revenues in the governmental funds statements. Unearned revenues arise when resources are received before the Municipality has a legal claim to them (such as advances of derived tax revenues) or before applicable eligibility requirements are met (in case of certain federal expenditure-driven grants if resources are received before allowable expenditures are incurred). In subsequent periods, when the Municipality has a legal claim to the resources, the liability for unearned revenues is removed from the balance sheet and the revenue is recognized.

Expenditures are generally recognized when the related liability is incurred as under accrual basis of accounting. Certain exceptions to this fundamental concept include the following: (1) payments of principal and interest on general long-term debt, which are recorded as expenditures when due, except for principal and interest due on July 1 (in this case amounts are recorded as liabilities and expenditures on June 30 since amounts have been accumulated or transferred to the debt service fund before July 1 payments are made) and (2) vested compensated absences, claims and judgments and special termination benefits which are recorded as expenditures only to the extent that they are expected to be liquidated with expendable financial resources (in the government-wide statements the expense and related accrual liability for long-term portions of debt must be included).

Since the governmental fund statements are presented on a different measurement focus and basis of accounting than the government-wide statements, reconciliation is necessary to explain the adjustments needed to transform the fund financial statements into the government-wide statements. This reconciliation is part of the financial statements.

Notes to Financial Statements

The notes to financial statements provide information that is essential to a user's understanding of the basic financial statements.

Required Supplementary Information:

Required supplementary information consists of the Budgetary Comparison Schedule – General Fund as required by GASB.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMÁN
NOTES TO FINANCIAL STATEMENTS
June 30, 2013

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

3. *Deposits and investments*

Cash and cash equivalents consist of cash on hand, demand deposits and short-term investments with original maturities of three months or less from the date of acquisition. Nonnegotiable certificates of deposits with original maturity of more than three months are considered time deposits as required by current standards. The Municipality follows the practice of pooling cash of all funds except for certain Commonwealth's grants, restricted funds generally held by outside custodians and federal grants. Available pooled cash balance beyond immediate needs is invested in certificates of deposits. Cash and cash equivalents related to Commonwealth and Federal grants (including Commonwealth Legislature Resolutions) are restricted since their use is limited by applicable agreements or required by law.

The laws and regulations of the Commonwealth of Puerto Rico authorize the Municipality to invest only in obligations of the Commonwealth, obligations of the United States of America, certificates of deposits, commercial paper, bankers' acceptances, or in pools of obligations of the municipalities of Puerto Rico, which are managed by the Governmental Development Bank for Puerto Rico ("GDB").

4. *Restricted assets*

Restricted assets are liquid assets which have third-party limitations on their use. Cash and cash equivalents related to Commonwealth and Federal grants (including Commonwealth Legislature Resolutions) are restricted since their use is limited by applicable agreements or required by law. Restricted cash with fiscal agent in the debt service fund consists of the undisbursed balance of property and sales tax collections retained by the Commonwealth of Puerto Rico which are restricted for the repayment of the Municipality's general and special obligation bonds and notes as established by law. Restricted cash with fiscal agent of the other governmental funds represent the undisbursed proceeds of certain bonds, loans or grants which are maintained in a cash custodian account by the GDB or a federal government agency.

5. *Receivables and due from governmental entities*

Receivables are stated net of estimated allowances for uncollectible accounts, which are determined upon past collection experience and current economic conditions.

Amounts due from federal government represent amounts owed to the Municipality for the reimbursement of expenditures incurred pursuant to federally funded programs. Amounts reported in the debt service fund represent property and sales tax revenues of current fiscal year collected by the CRIM (property tax) and the Puerto Rico Department of Treasury (sales tax) on the subsequent fiscal year.

6. *Interfund receivables and payables*

Activity among funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as either "due from/to other funds" (i.e., the current portion of interfund loans) or "advances to/from other funds" (i.e., the non-current portion of interfund loans). All other outstanding balances among funds are reported as "due from/to other funds".

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMÁN
NOTES TO FINANCIAL STATEMENTS
June 30, 2013**

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

7. Inventories

The Municipality purchases gasoline, oil and other expendable supplies held for consumption. The cost of those purchases is recorded as expenditure when incurred in the appropriate fund but the year-end inventory is not recorded in the Statement of Net Position, as management believes is not significant.

8. Capital assets

Capital assets reported in the governmental activities in the Statements of Net Position include property, plant, equipment and infrastructure, (e.g., roads, bridges, sidewalks, and similar items). The Municipality defines capital assets (except for infrastructure assets) as assets that have an individual cost of \$100 or more and have a useful life of one or more years. Infrastructure assets are capitalized based on a percentage of the estimated useful life. The cost of normal maintenance and repairs that do not add to the value of the assets or materially extend assets lives are not capitalized. Major outlays for capital assets and improvements are capitalized as projects are constructed.

Capital assets are capitalized at historical cost or estimated historical cost if historical cost is not available. Donated assets are recorded as capital assets at their estimated fair market value at the date of donation.

All capital assets, other than land and construction in progress, are depreciated using the straight-line method over the following useful lives:

Description	Years
Buildings	40
Improvements	10-20
Vehicles, machinery and equipment	5-10
Infrastructure	2-50

In accordance with current accounting standards capital assets are reviewed for impairment. Impairment occurs when there is a significant decline in asset service utility due to the occurrence of a prominent event or change in circumstances affecting the asset. Current standards provide guidance for accounting and reporting for impairment and for insurance recoveries.

9. Deferred outflows/inflows of resources

In addition to assets, the statement of net position will sometimes report a separate section for deferred outflows of resources. This separate financial statement element, deferred outflows of resources, represents a consumption of net position that applies to a future period(s) and so will not be recognized as an outflow of resources (expense/ expenditure) until then.

In addition to liabilities, the statement of financial position will sometimes report a separate section for deferred inflows of resources. This separate financial statement element, deferred inflows of resources, represents an acquisition of net position that applies to a future period(s) and so will not be recognized as an inflow of resources (revenue) until that time. The government has only one item, which arises only under a modified accrual basis of accounting that qualifies for reporting in this category. Accordingly, the item, *unavailable revenue*, is reported only in the governmental funds balance sheet. The governmental funds report *unavailable revenue* from one source: unavailable intergovernmental revenues. These amounts are deferred and recognized as an inflow of resources in the period that the amounts become available.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMÁN
NOTES TO FINANCIAL STATEMENTS
June 30, 2013

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

10. Long-term obligations

Long-term debt and other long-term obligations, which are reported as liabilities in the governmental activities column in the Statement of Net Position, consist of general and special obligation bonds, liabilities for compensated absences, claims and judgments, and long-term liabilities to other governmental entities. Related bond issuance costs, whenever rise, are reported as current outflows of resources in the Statement of Activities, as required by current standards. Governmental fund types recognize bond issuance costs as expenditures during the current period. Those issuance costs, whether or not withheld from the actual debt proceeds received, are reported as expenditures in the appropriate fund.

11. Compensated absences

The Municipality's employees accumulate vacation, sick leave and compensatory time based on continuous service. Compensated absences are recorded as a liability if (1) are earned on the basis of services already performed by employees, (2) it is probable that will be paid (in the form of paid time off, cash payments at termination or retirement, or some other means) and (3) are not contingent on a specific event (such as illness).

The compensated absences are accumulated on the basis of 2½ days per month of vacation and 1½ days per month of sick pay and compensatory time up to a maximum of 60 days of vacations and 90 days of sick leave. Upon separation from employment the accumulated vacations are liquidated up to the maximum number of days. Accumulated sick leave, which is accrued based on all vesting amounts for which payment is probable, is liquidated to employees with 10 years or more service up to the maximum number of days. The accrual of compensated absences includes estimated payments that are related to payroll. The entire compensated absence liability is reported on the government-wide financial statements. For governmental fund financial statements, the current portion of unpaid compensated absences is the amount that is normally expected to be paid using expendable available financial resources. The non-current portion of the liability is not reported.

Pursuant to Law No. 152 of August 20, 1996 effective July 1, 1997 the Municipality is required to pay any excess of vacations and sick leave accumulated over 90 days as of December 31 of each year. Payments should be made on or before March 31 of the following year.

12. Net Position

In the government-wide statements, assets plus deferred outflows of resources less liabilities and deferred inflows of resources equal net position, and should be displayed in three components: net investment in capital assets, restricted, and unrestricted, as follows:

Net investment in capital assets:	Consists of capital assets, net of accumulated depreciation, reduced by the outstanding balances of bonds, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets. Deferred outflows of resources and deferred inflows of resources that are attributable to the acquisition, construction, or improvement of those assets or related debt also should be included in this component of net position. The portion of the debt or deferred inflows of resources attributable to the unspent debt proceeds is not included in the calculation of net investment in capital assets. Instead, the portion of the debt or deferred inflows of resources is included in the same net position component (restricted or unrestricted) as the unspent amount.
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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMÁN
NOTES TO FINANCIAL STATEMENTS
June 30, 2013

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Restricted net position:	The restricted component of net position consists of restricted assets (subject to restrictions beyond the Municipality's control) reduced by liabilities and deferred inflows of resources related to those assets. Generally, a liability relates to restricted assets if the asset results from a resource flow that also results in the recognition of a liability or if the liability will be liquidated with the restricted assets reported. Restrictions are externally imposed (by creditors, grantors, contributors, or laws and regulations of other governments) or imposed by the law through constitutional provisions or enabling legislation.
Unrestricted net position:	Unrestricted net position is the net amount of the assets, deferred outflows of resources, liabilities, and deferred inflows of resources that are not included in the determination of net investment in capital assets or the restricted component of net position. Unrestricted net position is often designated to indicate that management does not consider them to be available for general operations. These types of constraints are internal and management can remove or modify them.

13. Net Position flow assumption

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

14. Fund Balances

The GASB Statement No. 54 *Fund Balance Reporting and Governmental Fund Type Definitions* ("GASB No. 54") establishes accounting and reporting standards for all governments that report governmental funds. It also establishes criteria for classifying fund balances into specifically defined classifications and clarifies definitions for governmental fund types. These classifications comprise a hierarchy based primarily on the extent to which the Municipality is bound to observe constraints upon the use of the resources reported. The classifications are as follows:

Nonspendable:	Amounts that cannot be spent because are either (a) not in spendable form or (b) legally or contractually required to be maintained intact.
Restricted:	Amounts constrained by external parties (creditors, grantors, contributors, or laws and regulations of other governments), imposed by law through constitutional provisions or by enabling legislation. Enabling legislation authorizes the Municipality to assess, levy, charge or otherwise mandate payment or resources (from external resource providers) and includes a legally enforceable requirement that those resources be used only for the specific purposes stipulated in the legislation. Legally enforceability means that the Municipality can be compelled by an external party such as citizens, public interest groups, or the judiciary to use resources created by enabling legislation only for the purposes specified by the legislation.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMÁN
NOTES TO FINANCIAL STATEMENTS
June 30, 2013

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

- Committed:** Amounts that can be used only for the specific purposes pursuant to constraints imposed through formal action (ordinance or resolution) by consent of the government's highest level of decision-making authority, which in the case of the Municipality is the Mayor and the Municipal Legislature. Those committed amounts cannot be used for any other purposes unless the Mayor and the Municipal Legislature removes or changes the specified use by taking the same type of action (ordinance or resolution) it employed to commit those amounts. Formal action to commits fund balance to a specific purpose should occur prior to the end of the fiscal year, but the amount, if any, which will be subject to the constraint, may be determined in the subsequent period.
- Assigned:** Amounts that are constrained by the Municipality's intent to be used for specific purposes, but are neither restricted nor committed. In distinction to committed balances, the authority for making an assignment is not required to be the government's highest level of decision-making authority, (both the Mayor and the Municipal Legislature). It is the Municipality's policy that intent can be expressed by the Mayor, the Finance Director (the official to which the Mayor has also delegated the authority to assign amounts) or by any other official or body to which the Mayor delegates. Furthermore, the nature of the actions necessary to remove or modify an assignment is not as prescriptive as it is with committed fund balances. With the exception of the general fund, this is the residual fund balance of the classification of all governmental funds with positive fund balances. Action taken to assign fund balance may be made after year-end.
- Unassigned:** Is the residual classification for the general fund and includes all spendable amounts not restricted, committed or assigned. The general fund is the only fund that reports a positive unassigned fund balance amount. For all other governmental funds the unassigned classification is used only to report a deficit balance resulting for the overspending for specific purposes for which amounts had been restricted, committed or assigned.

15. Fund Balance flow assumptions

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMÁN
NOTES TO FINANCIAL STATEMENTS
June 30, 2013

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

16. *Interfund transactions*

The Municipality reports certain transactions as transfers, which are legally required transfers that are reported when incurred as "Transfers-in" by the recipient fund and as "Transfers-out" by the disbursing fund.

17. *Risk financing*

The Puerto Rico Department of Treasury (PRDT) acts as an agent, obtaining and determining the coverage for the municipalities of Puerto Rico. The coverage for the Municipality of San Germán consists of professional, public responsibility, property and theft, auto and fidelity bond coverage. Insurance policies costs are allocated by PRDT among all the municipalities of Puerto Rico. Payment of the Municipality's insurance premiums is monthly deducted from advances of property tax and amounts of municipal equalization fund send to the Municipality by the Municipal Revenue Collection Center (CRIM). Workers compensation insurance is also deducted from the monthly advances by the CRIM. Settled cases have not exceeded insurance coverage for any of the past three years.

18. *Use of estimates*

The preparation of the basic financial statements in accordance 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 basic financial statements and the reported amounts of revenues and expenditures during the reporting period. Actual results could differ from those estimates.

19. *Reclassifications*

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

20. *Future adoption of accounting pronouncements Financial Statements June 30, 2013*

The GASB has issued the following statements, which the Municipality has not yet adopted:

- ***GASB Statement No. 66*** "Technical Corrections—2012—an amendment of GASB Statements No. 10 and No. 62". The provisions of this Statement are effective for financial statements for periods beginning after December 15, 2012 (fiscal year ended June 30, 2014).
- ***GASB Statement No. 67*** "Financial Reporting for Pension Plans—an amendment of GASB Statement No. 25". The provisions of this Statement are effective for financial statements for fiscal years beginning after June 15, 2013 (fiscal year ended June 30, 2014).
- ***GASB Statement No. 68*** "Accounting and Financial Reporting for Pensions—an amendment of GASB Statement No. 27". The provisions of this Statement are effective for fiscal years beginning after June 15, 2014 (fiscal year ended June 30, 2015).

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMÁN
NOTES TO FINANCIAL STATEMENTS
June 30, 2013

NOTE A- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

- **GASB Statement No. 69** “*Government Combinations and Disposals of Government Operations*”. The provisions of this Statement are effective for government combinations and disposals of government operations occurring in financial reporting periods beginning after December 15, 2013, and should be applied on a prospective basis (fiscal year ended June 30, 2015).
- **GASB Statement No. 70** “*Accounting and Financial Reporting for Nonexchange Financial Guarantees*”. The provisions of Statement 70 are effective for financial statements for reporting beginning after June 15, 2013 (fiscal year ended June 30, 2015).
- **GASB Statement No. 71** “*Pension Transition for Contributions Made Subsequent to the Measurement Date*”. The provisions of this Statement should be applied simultaneously with the provisions of Statement 68 (fiscal year ended June 30, 2015).

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

NOTE B- DEPOSITS

Custodial credit risk on Deposits. This is the risk that in the event of a bank failure, the government’s deposits may not be returned to it. The Municipality maintains cash deposits in commercial and governmental banks located in Puerto Rico. Under Commonwealth of Puerto Rico statutes, public funds deposited in commercial banks must be fully collateralized for the amount deposited in excess of federal deposit insurance. All securities pledged as collateral by the Municipality are held by the Secretary of Treasury of Puerto Rico in the Municipality’s name.

At year-end the Municipality’s bank balance of deposits in commercial banks amounting to \$9,726,606 was covered by federal depository insurance or by collateral held by the Secretary of Treasury of Puerto Rico in the Municipality’s name. Deposits in governmental banks (all of which are uninsured and uncollateralized), are exposed to custodial credit risk. At year-end the Municipality’s bank balance in governmental banks amounts to \$9,004,568.

NOTE C – RECEIVABLES

1. *Municipal license taxes*

Municipal License taxes are assessed annually by the Municipality to all organizations or entities subject to the tax doing business in the Municipality’s location except for entities totally or partially exempt pursuant to certain Commonwealth’s statutes. This tax is based generally on volume of business or gross sales as shown in a tax return that should be submitted on or before April 15. During the Fiscal year ended June 30, 2013 the tax rates were as follows:

Financial business - 1.50% of gross revenues
Other organizations - .50% of gross revenues

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMÁN
NOTES TO FINANCIAL STATEMENTS
June 30, 2013**

NOTE C – RECEIVABLES - Continued

Municipal license tax receivable and corresponding deferred revenues as of June 30, 2013 follows:

Description	Amount
Total municipal license tax receivable:	\$ 694,063
Less: allowance for uncollectibles	(655,937)
	\$ 38,126

As required by current standards the \$38,126 net balance is recorded as deferred inflows of resources since is not available are required by current standards.

The tax is due in two equal installments on July 1 and January 1 of each fiscal year. Resources are intended to finance the operations of the applicable fiscal year. At this moment the Municipality recognizes revenues on municipal license taxes. A discount of 5% is allowed when full payment is made on or before April 15. Municipal license taxes collected prior to June 30 but pertaining to the next fiscal year in the amount of \$1,882,488 are recorded as unearned revenues.

2. Sales and use taxes (as of June 30, 2013)

On July 4, 2006 the Commonwealth Legislature approved Act No. 117 (“Act 117”) which amends the Puerto Rico Internal Revenue Code of 1994 to provide, among other things, for a sale and use tax of 5.5% to be imposed by the Commonwealth Government. Act 117 also authorizes each municipal government to impose a municipal sale and use tax of 1.5%. This municipal sales and use tax has in general the same tax base and limitations (except for unprocessed foods) as those provided by the Commonwealth’s sales and use tax. The Municipal Legislature approved the imposition of the municipal sales and use tax, effective on November 15, 2006.

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

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

- a. .2% of the .5% will be deposited in a Municipal Development Fund to be distributed among all the municipalities in accordance with a formula created by the Act,
- b. .2% of the .5% will be deposited in a Municipal Redemption Fund to finance loans to Municipalities and,
- 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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMÁN
NOTES TO FINANCIAL STATEMENTS
June 30, 2013**

NOTE C – RECEIVABLES - Continued

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

Individuals, organizations and entities subject to collect the municipal sales and use tax must file a tax return to the PRDT. The tax is due the 10th day of each month based on tax collected in the preceding month. The Municipality recorded as revenue \$1,838,204 in the general fund (of which \$1,618,479 corresponds to the 1% imposition) and \$219,725 corresponds to the Municipal Development Fund) and \$526,157 in the debt service fund corresponding to the Municipal Redemption Fund.

Individuals, organizations and entities subject to collect the municipal sales and use tax must file a tax return to the Municipality. The tax is due the 10th day of each month based on tax collected in the preceding month. Municipal sales and use tax receivable of \$153,061 represents the tax collected on June by individuals, organizations and entities but reported and paid to the Municipality on or before July 10, net of uncollectible accounts; \$17,693 and \$62,141 represents amounts of “Municipal Development Fund” and “Municipal Redemption Fund” respectively collected on June from individuals, organizations and entities but paid by the PRDT subsequent to June 30.

On June 30, 2013 the Commonwealth approved Act No. 40 which among other things, reduces the municipal sales and use tax from 1.5% to 1% and increasing the Commonwealth sales and use tax from 5.5% to 6% effective December 1, 2013. This Act was subsequently amended to change this effective date from December 1, 2013 to February 1, 2014. In addition, subsequent to June 30, 2013 the Commonwealth approved Act No. 18 and 19 of January 24, 2014 for the restructuring and creation of financing structures from sales and use tax sources to guarantee and pay municipal long term debt issuances. See related Note P.

3. Rents and construction permits

A detail of rents and construction permits’ receivable as of June 30, 2013 follows:

<u>Description</u>	<u>Amount</u>
Rent-land lots	\$ 55,167
Rent-properties	809,234
Construction permits	6,585
Other	13,152
	<u>884,138</u>
Less: allowance for uncollectibles	(272,939)
	<u><u>\$ 611,199</u></u>

Of the total amount of \$611,199 the Municipality recorded \$587,804 as deferred inflows of resources in the governmental funds statements since they are not available as required by current standards.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMÁN
NOTES TO FINANCIAL STATEMENTS
June 30, 2013**

NOTE D - DUE FROM (TO) GOVERNMENTAL ENTITIES

1. *Amounts due from governmental entities as of June 30, 2013 follows:*

	Commonwealth Government	Federal Government
<u>Major fund - General fund:</u>		
P.R. Electric Power Authority (PREPA)	\$ 1,287,067	\$ -
P.R. Department of Treasury – Christmas bonus reimbursement	163,424	-
Municipal Revenue Collection Center (CRIM) – intergovernmental subsidy (general fund)	88,138	-
P.R. Department of Treasury – sales and use taxes – Municipal Development fund	17,693	-
Solid Waste Authority	20,400	-
<u>Major fund – Debt service fund:</u>		
Municipal Revenue Collection Center (CRIM) – intergovernmental subsidy (debt service fund)	181,067	-
P.R. Department of Treasury – sales and use taxes- Municipal Redemption Fund	62,141	-
<u>Other governmental funds:</u>		
P.R. Office of the Commissioner of Municipal Affairs – Public Order Code	238,322	-
P.R. Department of Labor – Law No. 52	67,905	-
P.R. Office of Ombudsman Administration (OAP)	33,685	70,990
U.S. Department of Housing and Urban Development – CDBG	-	82,670
P.R. Public Housing Administration (PRPHA) – Low Rent and Capital Fund Programs	-	26,647
P.R. Traffic Safety Commission	-	32,271
P.R. Governor’s Office – Disaster Grants	-	61,478
P.R. Department of Family – Emergency Shelter Grants	-	18,110
Others	289	75,169
	\$ 2,160,131	\$ 367,335

Certain amounts are recorded as deferred inflows of resources in the governmental funds statements since they are not available as required by current standards. See related note H.

2. *Amounts due to governmental entities as of June 30, 2013 follows:*

Description	Commonwealth Government
<u>General Fund:</u>	
P.R. Employees Retirement System (ERS)	\$ 103,675
P.R. Department of Labor – unemployment	2,962
P.R. Aqueduct and Sewer Authority (PRASA)	39,006
	\$ 145,643

**COMMONWEALTH OF PUERTO RICO
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NOTE E - INTERFUND TRANSACTIONS

1. Due from/to other funds:

Amounts due from/to other funds represent advances to other funds for payroll and payroll taxes expenditures, as follows:

Receivable Fund	Payable Fund	Amount
General Fund:	Major fund: Surf and Fun Water Park	\$ 43,362
	Other governmental funds: Law No. 52	67,905
	Public and Indian Housing	65,708
	Improvements to Villa Auxerre	53,291
	Basketball Court (EMP \$1,585,000)	31,409
	2006 Permanent Improvements	21,726
	Sale of Bonds special fund	45,865
	Elderly affairs - Alzheimer	28,133
	Elderly affairs - Luis Ufret Ctr.	81,994
	Early Head Start	45,928
	CDBG	53,385
	Transit Safety Commission	238,322
	Public Order Code	320,668
	Others	1,097,696
		1,097,696
Other governmental funds: \$1,695,000 Bond issuance	Major fund: General Fund	\$ 20,873
\$1,310,000 Bond issuance	General Fund	7,607
Early Head Start	General Fund	2,259
Others	General Fund	256
		30,995
TOTAL		\$ 1,128,691

2. Advances to(from) other funds:

Advances to (from) other funds represent long term advances to other funds by the general fund for payroll, payroll taxes and other expenditures, as follows:

Receivable Fund	Payable Fund	Amount
General Fund	Other governmental funds: P.R. Department of Transportation	\$ 470,079
	\$3,500,000 Loan Fund	51,141
	\$1,695,000 Loan Fund	19,391
	Special Communities Fund	25,061
	Rural Development Fund	60,419
	Others	145,935
		\$ 772,026

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMÁN
NOTES TO FINANCIAL STATEMENTS
June 30, 2013**

NOTE E - INTERFUND TRANSACTIONS - Continued

3. Transfers in (out):

Transfers among individual funds were made for operational purposes. Transfers include (1) interest earned on restricted cash with fiscal agent in the debt service fund and operating and capital improvement bonds and loans in other governmental funds which is transferred to the general fund (2) excess resources from debt service fund (CAE Fund) transferred to the general fund, (3) resources transferred from the general fund to other governmental funds to finance uncollected receivables and (4) resources transferred from the general fund to major and other governmental funds to pay interest on capital improvement bonds and loans.

NOTE F- FUND BALANCE

1. Fund balance classifications

The governmental fund balance classifications and amounts at June 30, 2013 are shown in the following table:

	<u>General Fund</u>	<u>Debt Service</u>	<u>Surf and Fun Water Park</u>	<u>Other Governmental Funds</u>	<u>Total</u>
<u>Nonspendable:</u>					
Advances to other funds	\$ 772,026	\$ -	\$ -	\$ -	\$ 772,026
	<u>772,026</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>772,026</u>
<u>Restricted:</u>					
General public works and sanitation	-	-	-	22,233	22,233
Public safety	-	-	-	7,817	7,817
Housing, Welfare and Community Development	-	-	-	123,335	123,335
Debt Service	-	2,312,704	-	-	2,312,704
Capital outlays	-	-	6,384,493	4,455,721	10,840,215
	<u>-</u>	<u>2,312,704</u>	<u>6,384,493</u>	<u>4,609,107</u>	<u>13,306,304</u>
<u>Committed:</u>					
General public works and sanitation	42,185	-	-	-	42,185
Culture and recreation	24,803	-	-	-	24,803
Housing, Welfare and Community Development	62,132	-	-	-	62,132
Education	11,371	-	-	-	11,371
Capital outlays	272,347	-	-	-	272,347
General Government and other purposes	92,346	-	-	-	92,346
	<u>505,184</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>505,184</u>
<u>Unassigned</u>	<u>(2,404,303)</u>	<u>-</u>	<u>-</u>	<u>(296,864)</u>	<u>(2,701,167)</u>
	<u>\$ (1,127,093)</u>	<u>\$ 2,312,704</u>	<u>\$ 6,384,493</u>	<u>\$ 4,312,243</u>	<u>\$ 11,882,347</u>

**COMMONWEALTH OF PUERTO RICO
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NOTE F- FUND BALANCE - Continued

2. Fund balance deficits

Certain special funds included as other governmental funds in the fund statements disclosed fund balance deficits as follows:

Funds	Fund balance - unassigned amount
Law No. 52	\$ 63,984
Elderly Affairs Funds (P.R. Office of Ombudsman Administration)	86,931
Disaster Grants Funds	61,477
Traffic Safety Commission	24,378
Permanent Improvements Fund	31,465
ESG Fund	18,110
Others	10,519
	\$ 296,864

The deficits results from the accrual of expenditures without accruing intergovernmental revenues for reimbursement of expenditures. As required by current standards, the Municipality recorded intergovernmental revenues for these reimbursement (expenditure-driven) grants on fund statements when all applicable eligibility requirements have been met and the resources are available.

**COMMONWEALTH OF PUERTO RICO
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June 30, 2013**

NOTE G - CAPITAL ASSETS

Capital assets and depreciation activity as of and for the year ended June 30, 2013 is as follows:

	<u>Beginning balance July 1, 2012</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending balance June 30, 2013</u>
<u>Governmental activities:</u>				
Capital assets, not being depreciated:				
Land	\$ 8,214,353	\$ 3	\$ -	\$ 8,214,356
Construction in progress	<u>2,301,960</u>	<u>6,229,206</u>	<u>138,195</u>	<u>8,392,971</u>
Total capital assets not being depreciated:	10,516,313	6,229,209	138,195	16,607,327
Capital assets, being depreciated:				
Buildings and improvements	33,988,105	1,667,757	-	35,655,862
Equipment	10,464,079	537,990	-	11,002,069
Roads	14,803,245	1,596,592	373,671	16,026,166
Bridges	<u>7,192,256</u>	<u>22,859</u>	<u>-</u>	<u>7,215,115</u>
Total capital assets being depreciated	66,447,685	3,825,198	373,671	69,899,212
Less accumulated depreciation for:				
Buildings and improvements	9,613,187	852,023	-	10,465,210
Equipment	6,842,702	430,005	-	7,272,707
Roads	9,315,426	461,364	373,671	9,403,119
Bridges	<u>2,452,377</u>	<u>177,247</u>	<u>-</u>	<u>2,629,624</u>
Total accumulated depreciation	28,223,692	1,920,639	373,671	29,770,660
Total capital assets being depreciated, net	<u>38,223,993</u>	<u>1,904,559</u>	<u>-</u>	<u>40,128,552</u>
Governmental activities capital assets, net	<u>\$ 48,740,306</u>	<u>\$ 8,133,768</u>	<u>\$ 138,195</u>	<u>\$ 56,735,879</u>

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

Governmental activities:

General government	\$ 71,410
Public safety	66,901
Public works	1,681,365
Sanitation	66,112
Culture and recreation	13,698
Welfare	21,153
Total depreciation expense, governmental activities	<u>\$ 1,920,639</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMÁN
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June 30, 2013**

NOTE H - DEFERRED INFLOW OF RESOURCES – GOVERNMENTAL FUNDS

As required by current standards, revenues and other governmental fund financial resources should be recognized in the accounting period in which they become both measurable and available. When an asset is recorded in governmental fund's financial statements but the revenue is not available, the Municipality should report a deferred inflow of resources until such time as the revenue becomes available. A detail of these balances follows:

	<u>General fund</u>	<u>Debt Service Fund</u>	<u>Other Governmental Funds</u>
<u>Major fund - General fund:</u>			
Municipal license taxes – receivable	\$ 38,126	\$ -	\$ -
Rents and construction permits	587,804	-	-
P.R. Electric Power Authority (PREPA)	1,287,066	-	-
P.R. Department of Treasury – Christmas bonus reimbursement	163,424	-	-
Municipal Revenue Collection Center (CRIM) – property taxes	88,138	-	-
P.R. Solid Waste Authority	5,100	-	-
<u>Debt Service fund:</u>			
Municipal Revenue Collection Center (CRIM) – property taxes	-	156,085	-
<u>Other governmental funds:</u>			
P.R. Department of Labor – Law No. 52	-	-	67,905
P.R. Traffic Safety Commission	-	-	24,378
P.R. Office of the Commissioner of Municipal Affairs – Public Order Code	-	-	238,324
P.R. Office of Ombudsman Administration	-	-	101,692
P.R. Governor's Office – Disaster Grants	-	-	61,477
P.R. Department of Family – Emergency Shelter Grants	-	-	18,110
	<u>\$ 2,169,658</u>	<u>\$ 156,085</u>	<u>\$ 511,886</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMÁN
NOTES TO FINANCIAL STATEMENTS
June 30, 2013**

NOTE I – LONG-TERM DEBT

1. Summary of long-term debt activity

The following summarizes activity in long-term debt for the fiscal year ended June 30, 2013:

	<u>Balance at July 1, 2012</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance at June 30, 2013</u>	<u>Due within one year</u>
General, Special Obligations Bonds and Notes	\$ 14,552,000	\$ 16,528,000	\$ 5,881,000	\$ 25,199,000	\$ 1,009,000
General obligation bond anticipation note	435,968	-	-	435,968	-
Note payable to CRIM- financing of delinquent accounts	96,452	-	4,832	91,620	4,822
Note payable to P.R. Department of Labor	43,367	-	39,402	3,965	3,965
Compensated absences	3,458,781	303,314	347,031	3,415,064	332,356
Christmas Bonus	312,223	351,851	312,223	351,851	351,851
Claims and judgments	196,377	8,500	196,377	8,500	8,500
Payable to PREPA	1,204,047	1,206,364	1,123,345	1,287,066	884,946
	<u>\$ 20,299,215</u>	<u>\$ 18,398,029</u>	<u>\$ 7,904,210</u>	<u>\$ 30,793,034</u>	<u>\$ 2,595,440</u>

2. General and special obligation bonds and notes payable

The Municipality's outstanding general and special obligation bonds and notes at June 30, 2013 amount to \$25,199,000. All these bonds are serviced by the Governmental Development Bank for Puerto Rico (GDB) maturing at various dates. As required by law, the Commonwealth Government is obligated to collect property taxes for payment of principal and interest on bonds and notes. In addition, .2% of the .5% municipal sales and use tax collected by the P.R. Department of Treasury is deposited in a "Municipal Redemption Fund" to finance loans to Municipalities subject to restrictions imposed by law.

Debt service funds has been established for the bonds and notes at GDB with the proceeds of those property and sales and use taxes ("IVU"), whereby sufficient funds must be set aside in order to cover the projected debt service requirement before any new bonds are issued. Principal and interest payments of special obligation notes of \$996,000, \$505,000, and \$1,005,000 and special obligation refunding bonds of \$1,386,000 are made through the Municipal Redemption Fund (IVU). Interest payments of \$1,310,000 and \$3,000,000 rental bonds are financed with project's revenues or Municipality's operating revenues.

A detail of the general and special obligation bonds and notes as of June 30, 2013 follows:

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMÁN
NOTES TO FINANCIAL STATEMENTS
June 30, 2013**

NOTE I - LONG-TERM DEBT - Continued

	Outstanding Amount
1996 public improvement bonds of \$3,500,000 due in annual installments ranging from \$70,000 to \$330,000 through July 1, 2015; bearing interest at rates ranging from 4.70% to 6.58% (6.58% at June 30, 2013)	\$ 920,000
2000 general obligation bonds of \$2,100,000 due in annual installments ranging from \$85,000 to \$235,000 through July 1, 2013; bearing interest at rates ranging from 2.70% to 7.81% (4.61% at June 30, 2013)	235,000
2002 general obligation bonds of \$130,000 due in annual installments ranging from \$5,000 to \$10,000 through July 1, 2026; bearing interest at rates ranging from 2.70% to 5.60% (4.61% at June 30, 2013)	75,000
2002 general obligation bonds of \$830,000 due in annual installments ranging from \$10,000 to \$75,000 through July 1, 2026; bearing interest at rates ranging from 2.70% to 5.60% (4.61% at June 30, 2013)	640,000
2003 general obligation bonds of \$320,000 due in annual installments ranging from \$9,000 to \$22,000 through January 1, 2030; bearing interest at 4.25%	271,000
2004 general obligation bonds of \$355,000 due in annual installments ranging from \$5,000 to \$30,000 through July 1, 2028; bearing interest at rates ranging from 2.36% to 5.28% (4.36% at June 30, 2013)	280,000
2006 general obligation bonds of \$3,000,000 due in annual installments ranging from \$67,000 to \$194,000 through January 1, 2031; bearing interest at 4.50%	2,460,000
2008 special obligation bond of \$780,000 due in annual installments ranging from \$50,000 to \$105,000 through July 1, 2018; bearing interest at rates ranging from 1.53% to 7.50% (1.53% at June 30, 2013)	535,000
2008 special obligation note of \$996,000 due in annual installments ranging from \$16,000 to \$86,000 through July 1, 2032; bearing interest at rates ranging from 1.53% to 7.50% (1.53% at June 30, 2013)	925,000
2012 rental bond of \$3,000,000 due in annual installments ranging from \$60,000 to \$265,000 through July 1, 2036; bearing interest at Prime plus 1.5% with a minimum of 6% (7.50% at June 30, 2013)	3,000,000

**COMMONWEALTH OF PUERTO RICO
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June 30, 2013**

NOTE I - LONG-TERM DEBT – Continued

	Outstanding Amount
2012 special obligation notes of \$505,000 due in annual installments ranging from \$55,000 to \$95,000 through July 1, 2018; bearing interest at Prime plus 1.5% with a minimum of 6% (6% at June 30, 2013)	450,000
2012 rental bond of \$1,310,000 due in annual installments ranging from \$25,000 to \$109,000 through July 1, 2036; bearing interest at Prime plus 1.5% with a minimum of 6% (7% at June 30, 2013)	1,310,000
2012 general obligation note of \$8,305,000 due in annual installments ranging from \$115,000 to \$695,000 through July 1, 2037; bearing interest at rates ranging from 3.47% to 7.50% (3.44% at June 30, 2013)	8,305,000
2012 special obligation note of \$1,005,000 due in annual installments ranging from \$10,000 to \$85,000 through July 1, 2037; bearing interest at rates ranging from 3.47% to 7.50% (3.44% at June 30, 2013)	1,005,000
2013 general obligation refunding bond of \$3,402,000 due in annual installments ranging from \$45,000 to \$287,000 through July 1, 2037; bearing interest at rates ranging from 3.42% to 7.50% (3.94% at June 30, 2013)	3,402,000
2013 special obligation refunding bond of \$1,386,000 due in annual installments ranging from \$20,000 to \$121,000 through July 1, 2037; bearing interest at rates ranging from 3.94% to 7.50% (3.94% at June 30, 2013)	1,386,000
	\$ 25,199,000

In order to achieve a reduction in the future annual amount of debt service payments, during fiscal year 2012-2013 the Municipality issued general obligation refunding bonds of \$3,402,000 and special obligation refunding bonds of \$1,386,000 to currently refund 2010, 2012 and 2013 general obligation bonds with outstanding balances of \$4,770,000 including related issuance costs of \$18,000. The new bonds bear interest at rates ranging from 3.42% to 7.50% and 3.94% to 7.50% respectively (3.94% at June 30, 2013 for both). The refinancing was undertaken to benefit from lower interest rates decreasing the near prospective future debts service requirements. The annual requirements to amortize general and special obligation bonds and notes as of June 30, 2013 follows:

June 30,	Principal	Interest
2014	\$ 1,009,000	\$ 999,540
2015	856,000	1,642,925
2016	981,000	1,602,656
2017	706,000	1,556,874
2018	757,000	1,507,324
2019-2023	3,745,000	6,548,937
2024-2028	4,859,000	5,371,159
2029-2033	5,798,000	3,498,176
2034-2038	6,488,000	1,227,906
Totals	\$ 25,199,000	\$ 23,955,497

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMÁN
NOTES TO FINANCIAL STATEMENTS
June 30, 2013**

NOTE I - LONG-TERM DEBT - Continued

3. Other long-term liabilities

**Outstanding
Amount**

General obligation bond anticipation notes – The Municipality has issued \$435,968 in general obligation bond anticipation notes to Rural Development (“RD”). They are part of a total note of \$457,000 to be issued to finance the construction of a sanitary sewer system financed by RD. The notes bears interest at 2.3750%, due on the date of the final payment issued by RD to the Municipality, but not exceeding 10 years from the date of the notes. The Municipality intends to refinance these notes on a long term basis through a \$457,000 general obligation bond issuance approved by the Municipal Legislature and the Governmental Development Bank for Puerto Rico, payable from sales and used taxes deposited in the Municipal Redemption Fund. Issuance will occur after the construction project is finished.

\$ 435,968

Note payable to CRIM (Financing of delinquent accounts)– On March 26, 2002, the Municipality entered into a financing agreement with the CRIM in the amount of \$470,818, to finance delinquent property tax accounts sold to private investors, under the provision of Law No. 146 of October 11, 2001. The agreement is in the form of a non-revolving line of credit bearing interest of 6.5% for the first five years and variable for the next twenty-five years at 125 points over London Interbank Offered Rate (LIBOR) and is due on December 1, 2032. As described in Law No. 146, interest payments for the first five years were financed through .48% of the net increase of subsidy provided by the Commonwealth of Puerto Rico’s general fund. Also, during the first five years any collection from those delinquent accounts was credited to the loan principal. After the five year period the loan outstanding balance was restructured for a twenty-five years period. Debt service requirements in future years are as follows:

91,620

<u>June 30</u>	<u>Principal</u>	<u>Interest</u>
2013	\$ 4,822	\$ 2,294
2014	4,822	2,174
2015	4,822	2,052
2016	4,822	1,932
2017	4,822	1,812
2018-2022	24,110	7,244
2023-2027	24,110	4,226
2028-2032	19,290	1,206
Totals	\$ 91,620	\$ 22,940

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMÁN
NOTES TO FINANCIAL STATEMENTS
June 30, 2013**

NOTE I - LONG-TERM DEBT - Continued

	<u>Outstanding Amount</u>
<p>Note payable, Department of Labor - In December 22, 2010 the Municipality entered into a payment plan agreement to finance debt for unemployment benefits paid by the Commonwealth of Puerto Rico in behalf of the Municipality matured and outstanding at June 30, 2010. In April 5, 2011 the Municipality entered in an additional payment plan agreement to refinance the previous agreement and to cover additional debt for unemployment benefits of the current year. The Municipality made a down payment of \$16,000 and issued a \$75,788 non-interest bearing note (imputed interest of 7.62%) due on April 5, 2014. Amount will be totally repaid through withholdings from the property tax advances sent to the Municipality by the Municipal Revenue Collection Center.</p>	3,965
<p>Compensated absences - includes accrued vacations, sick leave benefits and other benefits with similar characteristics such as compensatory time; represents the Municipality's commitment to fund such costs from future operations. Amount is paid with unrestricted funds.</p>	3,415,064
<p>Christmas Bonus - represents the accrued portion corresponding to fiscal year 2013 of the Christmas bonus to be paid in December 2013.</p>	351,851
<p>Claims and judgments - represents the estimated loss of legal cases to be paid subsequent to June 30, 2013. The awarded amount, if any, will be paid with unrestricted funds.</p>	8,500
<p>Payable to PREPA - As required by Act No. 83 of May 2, 1941 the Puerto Rico Electric Power Authority ("PREPA") should annually pay to the Municipalities of Puerto Rico a contribution in lieu of tax ("CELI") based on certain requirements as specified by the mentioned Act. The amount of CELI obligation is used by the Municipalities to finance the annual electric utility expense payment to PREPA. For fiscal year 2012 the Municipality's annual energy charges amounted to \$3,114,778 but the CELI obligation amounted to \$1,908,413. The excess amount of \$1,206,364 was recorded as a payable and a receivable for the same amount and will be amortized over a three-year period. As of June 30, 2013 the outstanding amount of \$1,287,000 includes the unamortized balances of \$804,243 and \$482,823 from fiscal years 2012 and 2011 respectively and is recognized by the Municipality as a receivable and a liability to PREPA. Debt service requirements in future years are as follows:</p>	1,287,066

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMÁN
NOTES TO FINANCIAL STATEMENTS
June 30, 2013**

NOTE I - LONG-TERM DEBT – Continued

<u>June 30</u>	<u>Principal</u>
2014	\$ 884,945
2015	402,121
Totals	<u>\$ 1,287,066</u>

NOTE J - PROPERTY TAXES

The Municipal Revenue Collection Center (CRIM) of the Commonwealth of Puerto Rico is responsible for the assessment, collection and distribution of real and personal property taxes. The tax on personal property is self-assessed by the taxpayer. The assessment is made on a return, which must be filed with the CRIM by May 15 of each year and is based on the current value at the date of the assessment. Real property is assessed by the CRIM. The tax is general assessed on January 1 on all taxable property located within the Municipality and is based on the current value existing in the year 1957. For personal property the tax is due with the return filed on or before May 15. Taxes on real property may be paid on two equal installments, July 1st and January 1st. Total tax rates in force as of June 30, 2013 are 7.78% for personal property and 10.28% for real property. The distribution of these rates follows:

<u>Description</u>	<u>Personal Property</u>	<u>Real Property</u>
Basic property tax rate, which is appropriated for general purposes and accounted in the Municipality's general fund:	4.00%	6.00%
Percent that belongs to the Commonwealth's debt service fund:	1.03%	1.03%
Percent that belongs to the Municipality's debt service fund:	<u>2.75%</u>	<u>3.25%</u>
Total tax rate:	7.78%	10.28%
Discount granted by law to the taxpayers but reimbursed to the Municipality by the P.R. Treasury Department:	<u>(.20%)</u>	<u>(.20%)</u>
Total percent to be paid by taxpayers:	<u>7.58%</u>	<u>10.08%</u>

Residential real property occupied by its owner is exempt by law from property taxes on the first \$15,000 of the assessed value. For such exempted amounts, the Puerto Rico Department of Treasury assumes payment of the basic tax to the Municipality, except for residential units assessed at less than \$3,500 on which a complete exemption is granted. Revenue related to exempt property is recorded in the General Fund. The Municipality grants a complete exemption from personal property taxes up to an assessment value of \$50,000 to retailers with annual net sales of less than \$150,000.

The CRIM advances funds to the Municipality based on an estimate of special governmental subsidies and the property taxes to be levied and which are collected in subsequent periods. This distribution includes advances of property tax and amounts of municipal equalization fund from the Commonwealth government.

**COMMONWEALTH OF PUERTO RICO
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NOTES TO FINANCIAL STATEMENTS
June 30, 2013**

NOTE J - PROPERTY TAXES - Continued

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. The CRIM prepares a preliminary settlement not later than three months after fiscal year-end and a final settlement not later than six months after fiscal year-end. If actual collections exceed the advances a receivable from CRIM is recorded. However, if advances exceed actual collections, a payable to CRIM is recorded. This amount is recorded as long term debt. The Municipality has a net receivable of \$88,138 resulting from the final settlement of fiscal year 2013 recorded as deferred inflows of resources in the governmental funds statements since is not available as required by current standards.

NOTE K - INTERGOVERNMENTAL REVENUES AND FEES, FINES AND CHARGES FOR SERVICES - GENERAL FUND

1. Intergovernmental revenues in the General Fund are comprised of the following:

	Amount
Amount of municipal equalization fund sent by CRIM	\$ 4,605,881
Reimbursement from P.R. Department of Treasury - Christmas Bonus reimbursement	252,288
	\$ 4,858,169

2. Fees, fines and charges for services revenues reported in the general fund are comprised of the following:

	Amount
Compensation in lieu of tax from the Puerto Rico Electric Power Authority (PREPA)	\$ 4,085,090
P.R. Department of Education – transportation services to students	447,723
Construction excise tax	1,014,209
Rental income	136,799
Licenses and permits	92,537
Land lots sales	263,023
Other	113,311
	\$ 6,152,692

NOTE L - RETIREMENT PLAN

1. *Plan description*

As of June 30, 2013 regular employees of the Municipality contribute to a cost-sharing multiple employer defined benefit retirement plan administered by the Employee's Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS). ERS covers all regular full-time public employees working for the central government, the municipalities of Puerto Rico and certain public corporations not having their own retirement systems. The system provides retirement pensions, death, and disability benefits. Retirement benefits depend upon age at retirement and number of years of credited service. Disability retirement benefits are available to members of occupational and non-occupational disabilities. Benefits vest after ten years of plan participation.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMÁN
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June 30, 2013

NOTE L – RETIREMENT PLAN - Continued

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

Act No. 305 of September 24, 1999 amended *Act. No. 447 of 1951* and *Act 1 of February 16, 1990* to establish a new pension program (System 2000). The new pension program became effective on January 1, 2000. Employees participating in the current system as of December 31, 1999 may elect either to stay in the defined benefit plan or transfer to the new program. Persons joining the government on or after January 1, 2000 will only be allowed to become members of the new program.

System 2000 is a hybrid defined contribution plan, also known as a cash balance plan. There will be a pool of pension assets, which will be invested by the System, together with those of the current defined benefit plan. Benefits at retirement age will not be guaranteed by the State government and will be subjected to the total accumulated balance of the savings account. 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 up 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 a rate equal to 75% of the return of the System's investment portfolio (net of management fees), or (3) earn a combination of both alternatives. If the savings accounts balance is \$10,000 or less at time of retirement, the balance will be distributed by the System to the participant as a lump sum. Participants receive periodic account statements similar to those of defined contribution plans showing their accrued balances. Disability pensions have not been granted under the new program. The employer contributions (11.275% of the employee's salary) will be used to fund the current plan. Under System 2000 the retirement age is reduced from 65 years to 60 for those employees who joined the current plan on or after April 1, 1990.

2. Funding policy

The Act 447, as amended, is the authority under which obligations to contribute to the Plan by the Plan members, employers and other contributing entities are established or may be amended. Plan members are required to contribute 5.775% of gross salary up to \$6,600 plus 8.275% of gross salary in excess of \$6,600 except for the Mayor or employee under a supplementation plan, which contributes 8.275% of gross salary.

As of June 30, 2013, the ERS has an unfunded actuarial accrued liability of approximately \$26.4 billion. In the opinion of management if measures are not implemented to deal with this situation, the ERS's net assets will be exhausted by the fiscal year 2015. In order to address this issue, among other measures, on July 6, 2011(effective July 1, 2011) the Commonwealth Legislature approved Act No. 116 increasing the employers' contributions rate from 9.275% to 10.275% of employee compensation for fiscal year 2012, an additional 1% annually for each of the next four years, and 1.25% annually for each of the five years thereafter, reaching an aggregate contribution rate of 20.525% effective July 1, 2020. The purpose of this Act is to provide cash flow and strength the System to adequately cover administrative expenses and payment of benefits.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMÁN
NOTES TO FINANCIAL STATEMENTS
June 30, 2013**

NOTE L – RETIREMENT PLAN - Continued

The Municipality is required to contribute 11.275% of gross salary for fiscal year 2013. As stated in the Act, percent increases applicable to municipalities for fiscal years 2011-2012, 2012-2013 y 2013-2014 would be financed through the Commonwealth's budget approved by the Commonwealth's Legislature. The Municipality's actual contribution for the current and the previous two fiscal years, which is equal to the required contribution, follows:

Fiscal year ended:	Law No. 447	System 2000
2013	\$ 165,537	\$ 338,181
2012	\$ 193,703	\$ 304,632
2011	\$ 185,126	\$ 278,995

In order to address its unfunded liability and rescue the System from insolvency, on April 4, 2013 the Commonwealth of Puerto Rico enacted Act No. 3 of 2013, representing a comprehensive reform of the ERS. See related Note P.

NOTE M – POSTEMPLOYMENT BENEFITS

In addition to the pension benefits described in Note L, the Municipality is required to cover annually the 3% increase in the retirement plan of its retired employees, as required by Commonwealth's laws. Also, the Municipality is required to finance costs related to the application of certain "Special Laws" issued by the Commonwealth Government. Those Special Laws granted increases in pensions and other benefits to retired employees of the Municipality such as medicines bonus, Christmas bonus and death benefits. For the fiscal year 2013, costs related to these post-employment benefits amounted to \$191,702. These benefits are recorded as expenditures in the general fund.

NOTE N - COMMITMENTS

1. *Operating leases*

The Municipality leases office space and office equipment under operating lease agreements, which generally have terms of one year or less and are automatically renewed for the same terms. Rental expenses amounted to \$131,653. Management believes that the summary of the future minimum rental commitments under non-cancelable equipment leases with terms exceeding one year is not significant.

2. *Construction*

The Municipality has commitments at June 30, 2013 of \$3,857,348 for construction, improvements or renovation of certain municipal facilities.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMÁN
NOTES TO FINANCIAL STATEMENTS
June 30, 2013**

NOTE N – COMMITMENTS - Continued

3. Encumbrances

As of June 30, 2013 the Municipality has encumbrances outstanding totaling \$229,358 which represent the estimated amount of expenditures required to complete contracts, purchase orders and other commitments in process of completion at fiscal year-end. As required by current standards, outstanding encumbrances as of June 30, 2013 are reported as unassigned amounts in the general fund. Purpose classification follows:

Purpose	General Fund- unassigned fund balance
General public works and sanitation	\$ 62,058
Culture and recreation	4,072
Public Safety	2,028
Welfare	7,787
General government and other purposes	153,413
	\$ 229,358

Fund balance of major and other governmental funds (special revenue, capital project and debt service funds) is classified as restricted, some or all of which may be encumbered. Encumbrances of restricted fund balance are not reported separately from this classification because the encumbrance does not further restrict the purpose for which the resources may be used.

NOTE O - CONTINGENCIES

1. Federal and State grants

Projects financed by Federal and State Grants are subject to audits by grantors and other governmental agencies in order to determine that the expenditures to comply with the conditions of such grants. It is the Municipality's opinion that no additional material unrecorded liabilities will arise from audits previously performed or to perform.

2. Litigations

The Municipality is, at present, a defendant in a number of legal matters that arise in the ordinary course of the Municipality's activities. There are cases whereby the Municipality is a defendant or codefendant that will be covered by insurance, certain cases whereby the legal counsel has not determined an outcome and other cases that will not be covered by insurance. As a result of one legal case as of June 30, 2013 and not to be covered by insurance, the Municipality accrued an estimated loss of \$8,500 in the government-wide statements. However, it is the opinion of the Municipality and the legal counsels that based on their experience, such actions and the potential liabilities will not impair the Municipality financial position.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMÁN
NOTES TO FINANCIAL STATEMENTS
June 30, 2013

NOTE P – SUBSEQUENT EVENTS

Subsequent to June 30, 2013 the Municipality entered into the following long-term obligations:

1. On September 27, 2013 the Municipality entered into a Loan Agreement (“the Agreement”) with the Governmental Development Bank of P.R. (“GDB”) to finance the completion of the construction of the recreational facility “San Germán Surf & Fun Water Park”. The Agreement provides for the issuance of 2013 Municipal Special Obligation Bond in the amount of \$11,110,000 with maturities of July 1 of each year through its maturity date of July 1, 2025, although amortized through July 1, 2038. No principal and payments will be made for the first two years of the loan, the estimated construction period. The Bond will bear interest at 1.50% over prime rate (with a minimum of 6%) payable semiannually in January 1 and July 1 of each year. Principal and interest will be financed by resources provided by the general fund through withholdings from the property tax advances sent to the Municipality by the Municipal Revenue Collection Center (CRIM). The loan can be refinanced with a rental bond prior to its due date at the option of the Municipal Legislature.
2. On December, 2013 the Municipal Legislature approved the Ordinance No. 13 Series 2013-2014 to authorize the restructuring of the 2008 special obligation notes of \$996,000 in accordance with the provisions of Act 19 of 2009. This Act amends Act No. 64 of 1996 to eliminate the limitation of the eight year due date term on special obligation notes. In accordance with this restructuring process the 2008 special obligation notes will be substituted with a 2008 special obligation bond with a twenty-five years due date term, through July 1, 2032.

The Commonwealth of Puerto Rico is facing a financial crisis due to limited liquidity, general fund deficit, a sizeable amount of debt, an underfunded government pension system and an economy recession since 2006. As a result of these matters, credit ratings agencies have been consistently downgrading the Commonwealth’s and certain public corporation’s general obligation bonds ratings. In order to address these matters the Commonwealth began to make legislation to reform its governmental pension system, provide liquidity to the Governmental Development Bank of Puerto Rico (“GDB”), its fiscal agent, and strength sinking funds to assess financial markets. The Commonwealth estimates that these corrective actions, along others to be implemented, will have a positive impact on the Commonwealth itself, GDB, the municipalities and its citizens:

1. Pension System Reform

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

- a. Moves all participants (employees) under the defined benefit pension plans (Act 447 and Act 1) and the defined contribution plan (System 2000) to a new hybrid plan (“New Plan”).
- b. For active participants of the contributory defined benefit programs under Act No. 447 of 1951 and Act No. 1 of 1990, all retirement benefits accrued through June 30, 2013 will be frozen, and thereafter, all future benefits will accrue under the New Plan. Participants will receive a pension at retirement age equivalent to what they have accrued under Act 447 and Act 1 up to June 30, 2013, and a supplemental annuity corresponding to contributions made after July 1, 2013.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMÁN
NOTES TO FINANCIAL STATEMENTS
June 30, 2013**

NOTE P – SUBSEQUENT EVENTS – Continued

- c. Participants under System 2000 will no longer receive a lump-sum payment upon retirement, but rather a lifetime annuity calculated at retirement based on a factor that will incorporate the individual's life expectancy and a rate of return.
- d. New participants under the New Plan will receive a lifetime annuity based on the accumulated balance of their individual accounts (employees' contributions plus a return on investment)
- e. Eliminates the possibility of accruing a merit pension (payable once the participant has achieved 30 years of creditable service) after June 30, 2013.
- f. Increases employee contributions from 8.275% to a minimum of 10.000%.
- g. After July 1, 2013 all employers must contribute 12.275% of employee contribution with an additional 1% annually up to June 30, 2016; after July 1, 2016 an additional 1.25% annually for each of the five years thereafter, reaching an aggregate contribution rate of 20.525% effective July 1, 2020. These contributions will be used to increase the System's assets, reduce the actuarial deficit and enable the System to comply with future obligations.
- h. Retirement age will be modified as follows:
 - 1) Act 447 regular employees: age 58 to 61,
 - 2) Act 447 high risk employees (state and municipal police, firefighters and custody officials): from age 50 to 55 years,
 - 3) Act 305 (System 2000) regular employees: age 60 to 65; high risk employees remains the same (55 years).

Act 1 employees will remain the same (65 years for regular employees and 55 for high risk employees. For new employees under the New Plan will retire after 67 years (retirement age will be 67 for regular employees and 58 for high risk employees.

- i. Modifies Special Law benefits as follows:
 - 1) Reduction in Christmas bonus from \$600 to \$200 (current retirees),
 - 2) Elimination of summer bonus of \$100 (current retirees),
 - 3) No change in medical plan contribution of up to \$1,200 and medicine bonus of \$100 (current retirees)
 - 4) Eliminates Special Law benefits to future retirees.

Employers will contribute \$2,000 per retiree and future retiree (originally under Act 447 and Act 1); the System will benefit from the savings generated between this employer contribution and the Special Law benefits paid out to retirees.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMÁN
NOTES TO FINANCIAL STATEMENTS
June 30, 2013**

NOTE P – SUBSEQUENT EVENTS – Continued

- j. Given these changes to Special Laws, the minimum monthly pension for current retirees was increased from \$400 to \$500.
- k. Disability benefits will be eliminated and substituted for a mandatory disability insurance policy.
- l. Survivor benefits will be modified.

In addition to the previously scheduled measures, the ERS reform plan also assumes an estimated \$140 million incremental contribution from the general fund (1.4% of general fund expenses for fiscal year 2014) to be included in the Commonwealth's proposed budget for the fiscal year 2014 and thereafter. The Commonwealth projects that the combined impact of these measures will allow the retirement system to increase the liquidity and solvency and meet the revised future obligations.

2. Sales and use taxes – Act No. 18 and 19 of 2014

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

a. Act No. 18 of January 24, 2014

The purpose of this Act is to create a special fund called "Municipal Administration Fund" ("FAM") under custody of the Governmental Development Bank of Puerto Rico ("GDB") that permits the Municipalities to guarantee and pay long term debt and provide funds for its general operations. In addition, this Act improves the financing capacity of the Puerto Rico Sales Tax Financing Corporation ("COFINA"), a Commonwealth fund administered by GDB and the P.R. Secretary of Treasury. The Act includes provisions for municipalities that do not want to be covered by the Act. Special rules apply for those municipalities. The Act is effective on February 1, 2014.

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

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMÁN
NOTES TO FINANCIAL STATEMENTS
June 30, 2013

NOTE P – SUBSEQUENT EVENTS – Continued

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

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

- .2% will be deposited in the Municipal Development Fund to be distributed to the municipalities,
- .2% will be deposited in a Municipal Redemption Fund to then be deposited in the municipalities general fund (the municipalities has the option to maintain funds in the Municipal Redemption Fund or to transfer funds from the Municipal Development Fund to increase its debt margin and issue loans to be obtained from financial institutions)
- .1% will be deposited in a Municipal Improvement Fund to finance capital improvement projects; these funds will be distributed based on legislation from the Commonwealth's Legislature.

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

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

b. Act No. 19 of January 24, 2014

The purpose of this Act is to create the "Municipal Finance Corporation" ("COFIN") a public corporation and a component unit of the Governmental Development Bank of Puerto Rico ("GDB") which may issue, pay or refinance long-term debt of municipalities. Principal and interest of these bonds and loans will be guaranteed with the municipal sales and use tax (1%). The Act includes provisions for municipalities that do not want to be covered by the Act. Special rules apply for those municipalities. The Act is effective on February 1, 2014.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMÁN
NOTES TO FINANCIAL STATEMENTS
June 30, 2013

NOTE P – SUBSEQUENT EVENTS – Continued

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

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

As stated above the purpose of Act 18 and 19 of 2014 is to provide a financial structure to guarantee and pay long term debt to the municipalities while maintaining adequate cash flows for its operations, as well as provide liquidity to the GDB.

Notwithstanding the above corrective actions, on February 4, 2014 Standard & Poor's Ratings Services ("S&P") lowered its rating on the Commonwealth of Puerto Rico's general obligation (GO) debt to 'BB+' from 'BBB-' and the Commonwealth's appropriation secured debt and Employee Retirement System (ERS) debt to 'BB'. In addition, S&P downgraded the GDB to 'BB', and the rating remains on CreditWatch with negative implications. S&P have not taken a rating action on sales tax-secured debt of COFINA, but have retained their negative outlook on their COFINA ratings reflecting S&P's view of the economic outlook and that COFINA sales tax is not subject to the prior diversion of revenue for general obligation debt service payments. The downgrades follow S&P's evaluation of liquidity for the Commonwealth, including what they believe is a reduced capacity to access liquidity from GDB. S&P also believe that the Commonwealth's access to liquidity and to the market either through GDB or other means will remain constrained in the medium term. As S&P, the rating is not lower due to the progress the current administration has made in reducing operating deficits and recent success with reform of the public employee and teacher pension systems. They view those reforms as significant which could contribute to a sustainable path to fiscal stability.

In addition, on February 7, 2014 Moody's Investors Service ("Moody's") has downgraded the general obligation (GO) rating of the Commonwealth of Puerto Rico, the Pension funding bonds and GDB senior notes to Ba2 from Baa3. Other ratings that are capped by or linked to the Commonwealth's GO rating were also downgraded two notches, with the exception of the Puerto Rico Aqueduct and Sewer Authority (PRASA) Revenue Bonds, which were downgraded to Ba2 from Ba1. At the same time, Moody's downgraded the Puerto Rico Sales Tax Financing Corporation's (COFINA's) senior-lien bonds to Baa1 from A2 and its junior-lien bonds to Baa2 from A3. The outlooks for ratings on the GO and the related bonds, as well as the COFINA bonds, are negative. Downgrade is based among other Commonwealth's problems in years of deficit financing, pension underfunding, budgetary imbalance and seven years of economic recession. As a result, Commonwealth's debt load and fixed costs are high, its liquidity is narrow, and its market access has become constrained. Moody's recognizes major actions taken to stabilize Commonwealth finances, including significant reform to main pension system, and tax increases to reduce budget deficit

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMÁN
NOTES TO FINANCIAL STATEMENTS
June 30, 2013

NOTE P – SUBSEQUENT EVENTS – Continued

Furthermore, on February 11, 2014 Fitch Ratings has downgraded the ratings, among other instrumentalities, for the Commonwealth general obligation (GO) bonds and ERS pension funding bonds from BB from BBB-. The current action does not affect the ratings that Fitch assigns to bonds issued by COFINA, since those bonds are secured by the Commonwealth's sales and use tax and insulated from the Commonwealth's general credit strain. Fitch reported that recent downgrades have triggered new liquidity requirements and lowered expectations for the market available for the Commonwealth's debt going forward, though there have been no significant negative developments regarding the Commonwealth's finances or economy since November 2013. In addition, the report recognizes that the Commonwealth's management has responded quickly and decisively to challenges that have arisen in recent years and the current administration has made significant progress in addressing longstanding credit issues.

These downgrades may have a significant impact in the economic environment of Puerto Rico and the Commonwealth Government, its instrumentalities and the municipalities in critical areas such as access to markets and liquidity for the current fiscal year and thereafter. It is the opinion of the Commonwealth's and Municipality of San Germán's management that the corrective actions taken and to be taken in current and fiscal periods thereafter will lower the impact of this decision and cause a positive turnaround on the Commonwealth's and the Municipality's finances.

REQUIRED SUPPLEMENTARY INFORMATION

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMÁN
BUDGETARY COMPARISON SCHEDULE - GENERAL FUND
FISCAL YEAR ENDED JUNE 30, 2013

	Budgeted amounts		Actual amounts	Variance with final budget
	Original	Final	(Budgetary basis)	Positive (Negative)
Revenues:				
Taxes:				
Property taxes	\$ 4,109,200	\$ 4,109,200	\$ 4,251,599	\$ 142,399
Municipal license taxes	2,494,627	2,627,835	2,903,136	275,301
Sales and use taxes	1,774,000	1,774,000	1,830,599	56,599
Intergovernmental	3,580,756	3,580,756	3,558,044	(22,712)
Rental income and charges for services	6,457,050	7,011,202	5,235,723	(1,775,479)
Fines and forfeitures	30,000	30,000	22,444	(7,556)
Interest	141,600	141,600	168,768	27,168
Other	397,701	180,000	11,572	(168,428)
Total Revenues	<u>18,984,934</u>	<u>19,454,593</u>	<u>17,981,885</u>	<u>(1,472,708)</u>
Expenditures:				
Current:				
General government	6,242,682	6,115,929	5,887,785	228,144
Public safety	1,584,254	1,488,858	1,488,361	497
Public works	8,964,563	9,267,448	8,872,368	395,080
Sanitation	201,015	197,860	198,243	(383)
Health	786,764	786,764	786,763	1
Welfare	616,299	595,922	595,002	920
Culture and recreation	589,357	549,793	548,276	1,517
Debt service- Interest	-	66,109	91,752	(25,643)
Total expenditures	<u>18,984,934</u>	<u>19,068,683</u>	<u>18,468,550</u>	<u>600,133</u>
Excess (deficiency) of revenues over expenditures	-	385,910	(486,665)	(872,575)
Other financing sources (uses)				
Transfers - in	-	-	552,944	552,944
Transfers - out	-	(385,910)	(385,910)	-
Total other financing sources (uses)	<u>-</u>	<u>(385,910)</u>	<u>167,034</u>	<u>552,944</u>
Excess (deficiency) of revenues and other financing sources over expenditures and other financing uses	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (319,631)</u>	<u>\$(319,631)</u>

The accompanying notes to required supplemental information are an integral part of this schedule.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMÁN
NOTES TO REQUIRED SUPPLEMENTARY INFORMATION -
BUDGETARY COMPARISON SCHEDULE – GENERAL FUND
June 30, 2013

NOTE A – BUDGET PROCESS AND BUDGETARY BASIS OF ACCOUNTING

The Municipal budget is prepared for the General Fund following the requirements of the Autonomous Municipal Law of 1981, as amended. It is developed utilizing elements of performance-based program budgeting and zero-based budgeting and includes estimates of revenues and other sources for ensuing fiscal year under laws existing at the time the budget is prepared.

Budget amendments are approved by the Municipal Legislature. Certain budget transfers within the limitations and restrictions of the Municipal Law can be approved by the Mayor or by the Municipal Legislature. The budget comparison schedule provides information about the original budget, the amended budget and the actual results, under the budgetary basis of accounting.

The budgetary basis of accounting is different from GAAP. Revenues are generally recorded when cash is received and expenditures are generally recorded when the related expenditure is incurred or encumbered. The encumbrances (that is, purchase orders, contracts) are considered expenditures when a commitment is made. On a GAAP basis encumbrances outstanding at year-end are reported in the governmental funds statements as assigned fund balance since they do not constitute expenditures or liabilities while on a budgetary basis encumbrances are recorded as expenditures of the current year. Encumbrance appropriations lapse one year after the end of the fiscal year. Unencumbered appropriations are lapsed at year-end. The legal level of budgetary control (the level at which expenditures may not legally exceed appropriations) is at the function level.

The presentation of the budgetary data excludes other appropriations such as capital projects, debt service and special revenue funds because projects are funded on a multi-year nature, generally requiring several years to complete or effective budgetary control is alternatively achieved through general obligation bond indentures and legal and contractual grant agreement provisions.

NOTE B - BUDGET TO GAAP RECONCILIATION

The accompanying budgetary comparison schedule presents comparisons of the original and final legally adopted budget with actual data on a budgetary basis. Since accounting principles applied for the purposes of developing data on a budgetary basis differ significantly from those used to present accounting principles generally accepted in the United States, the following budget to GAAP reconciliation is presented:

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMÁN
NOTES TO REQUIRED SUPPLEMENTARY INFORMATION-
BUDGETARY COMPARISON SCHEDULE - GENERAL FUND
June 30, 2013**

NOTE B - BUDGET TO GAAP RECONCILIATION - Continued

Excess of revenues and other financing sources over expenditures and other financing uses (budgetary basis):	\$ (319,631)
Budget to GAAP differences:	
Entity differences:	
Non-budgeted funds recorded as revenues for financial reporting purposes:	85,463
Non-budgeted funds recorded as expenditures for financial reporting:	(1,515,655)
Non budgeted transfers in:	980,470
Non budgeted transfers out:	(553,134)
Basis of accounting differences:	
Revenues recorded for financial reporting purposes but not in budgetary basis:	1,321,562
Revenues recorded for budgetary basis purposes but not in financial reporting:	(596,952)
Expenditures recorded in budgetary basis but not for financial reporting purposes:	147,831
Expenditures recorded for financial reporting purposes but not in budgetary basis:	(1,298,229)
Timing differences:	
Current year encumbrances recorded as expenditures for budgetary reporting purposes:	229,358
Prior year encumbrances recorded as expenditures for financial reporting purposes:	(368,254)
Net change in fund balance (GAAP basis):	\$ (1,887,171)

SUPPLEMENTARY INFORMATION

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMÁN
SUPPLEMENTARY INFORMATION - FINANCIAL DATA SCHEDULE
BALANCE SHEET AND STATEMENT OF REVENUES AND EXPENSES INFORMATION
JUNE 30, 2013

Line Item No.	Description	14.871 Housing Choice Vouchers
Balance Sheet		
111	Cash - unrestricted	\$ 53,547
113	Cash - other restricted	\$ 32,054
100	Total cash	\$ 85,601
121	Accounts receivable - PHA projects	\$ 2,733
125	Accounts receivable - miscellaneous	\$ 3,774
126.2	Allowance for doubtful accounts - other	\$(1,265)
128	Fraud recovery	\$ 11,447
128.1	Allowance for doubtful accounts - fraud	\$(4,235)
120	Total receivables, net of allowance for doubtful accounts	\$ 12,454
150	Total Current Assets	\$ 98,055
164	Furniture, equipment and machinery - administration	\$ 67,451
166	Accumulated depreciation	\$(37,892)
160	Total capital assets, net of accumulated depreciation	\$ 29,559
180	Total Non-current Assets	\$ 29,559
190	Total Assets	\$ 127,614
200	Deferred Outflows of Resources	\$ -
290	Total Assets and Deferred Outflows of Resources	\$ 127,614
312	Accounts payable <= 90 days	\$ 977
313	Accounts payable > 90 days past due	\$ 2,664
322	Accrued compensated absences - current portion	\$ 1,825
332	Accounts Payable - PHA Projects	\$ 7,748
333	Accounts payable - other government	\$ 17,774
310	Total Current Liabilities	\$ 30,988
353	Non-current liabilities - other	\$ 4,759
354	Accrued compensated absences - non current	\$ 13,072
350	Total Non-current Liabilities	\$ 17,831
300	Total Liabilities	\$ 48,819
300	Deferred Inflows of Resources	\$ -
508.1	Net Investment in Capital Assets	\$ 29,559
511.1	Restricted Net Position	\$ 30,901
512.1	Unrestricted Net Position	\$ 18,335
513	Total Equity/Net Position	\$ 78,795
600	Total Liabilities, Deferred Inflows of Resources and Equity/Net Position	\$127,614

Continue

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMÁN
SUPPLEMENTARY INFORMATION - FINANCIAL DATA SCHEDULE
BALANCE SHEET AND STATEMENT OF REVENUES AND EXPENSES INFORMATION
JUNE 30, 2013

Line Item No.	Description	14.871 Housing Choice Vouchers
Income Statement		
70600-010	Housing assistance payments	\$ 336,968
70600-020	Ongoing administrative fees earned	\$ 56,279
70600-031	FFS Coordinator Grant	\$ 44,256
70600	HUD PHA operating grants	\$ 437,503
71100	Investment income - unrestricted	\$ 11
71400-010	Housing Assistance Payment	\$ 894
71400-020	Administrative Fee	\$ 894
71400	Fraud recovery	\$ 1,788
71500	Other revenue	\$ 55,805
700	Total Revenue	\$ 495,107
91100	Administrative salaries	\$ 41,054
91200	Auditing fees	\$ 1,500
91500	Employee benefit contributions- administrative	\$ 10,500
91600	Office expenses	\$ 10,441
91000	Total Operating - Administrative	\$ 63,495
92100	Tenant services - salaries	\$ 16,376
92300	Employee benefit contributions- tenant services	\$ 3,757
92400	Tenant services - other	\$ 29,504
96000	Total Tenant Services	\$ 49,637
96200	Other general expenses	\$ 2,218
96000	Total Other General Expenses	\$ 2,218
96900	Total Operating Expenses	\$ 115,350
97000	Excess Revenue Over Operating Expenses	\$ 379,757
97300-050	All Other	\$ 349,857
97300	Housing assistance payments	\$ 349,857
97350	HAP Portability-in	\$ 48,269
97400	Depreciation expense	\$ 156
900	Total Expenses	\$ 513,632
10000	Excess (Deficiency) of Revenue Over (Under) Expenses	\$(18,525)
11030	Beginning equity	\$ 96,062
11040-010	Prior period adjustments and correction of errors - Editable	\$ 1,258
11040	Prior period adjustments, equity transfers, and correction of errors	\$ 1,258

Continue

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMÁN
SUPPLEMENTARY INFORMATION - FINANCIAL DATA SCHEDULE
BALANCE SHEET AND STATEMENT OF REVENUES AND EXPENSES INFORMATION
JUNE 30, 2013

Line Item No.	Description	14.871 Housing Choice Vouchers
Income Statement		
11770-001	Administrative Fee Equity - Beginning Balance	\$ 60,810
11170-010	Administrative Fee Revenue	\$ 56,279
11170-021	FSS Coordinator Grant	\$ 44,256
11170-040	Investment Income	\$ 11
11170-045	Fraud Recovery Revenue	\$ 894
11170-050	Other Revenue	\$ 49,419
11170-051	Comment For Other Revenue	Administrative fees earned on the portability-in vouchers administered by the Municipality (\$1,150) plus the reimbursement received from the initial PHAs of the HAP rent payments made on behalf of the portability-in units during 12-13 (\$48,269).
11170-060	Total Admin Fee Revenues	\$ 150,859
11170-080	Total Operating Expenses	\$ 115,350
11170-090	Depreciation	\$ 156
11170-095	Housing Assistance Portability In	\$ 48,269
11170-110	Total Expenses	\$ 163,775
11170-002	Net Administrative Fee	\$(12,916)
11170-003	Administrative Fee Equity - Ending Balance	\$ 47,894
11170	Administrative Fee Equity	\$ 47,894
11170-005	Pre-2004 Administrative Fee Reserves	\$ 15,980
11170-006	Post-2003 Administrative Fee Reserves	\$ 31,914
11180-001	Housing Assistance Payments Equity - Beginning Balance	\$ 36,510
11180-010	Housing Assistance Payments Revenues	\$ 336,968
11180-015	Fraud Recovery Revenue	\$ 894
11180-020	Other Revenue	\$ 6,386
11180-021	Comment For Other Revenue	Amount corresponds to Family Self Sufficiency Escrow account forfeitures.
11180-030	Total HAP Revenues	\$ 344,248
11180-080	Housing Assistance Payments	\$ 349,857
11180-100	Total Housing Assistance Payments Expenses	\$ 349,857
11180-002	Net Housing Assistance Payments	\$ (5,609)
11180-003	Housing Assistance Payments Equity - Ending Balance	\$ 30,901
11180	Housing Assistance Payments Equity	\$ 30,901
11190-210	Total ACC HCV Units	1,053
11190	Unit Months Available	1,053
11210	Unit Months Leased	1,031

The accompanying notes are an integral part of this schedule.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMÁN
NOTES TO SUPPLEMENTARY INFORMATION - FINANCIAL DATA SCHEDULE
June 30, 2013

NOTE A – BASIS OF PRESENTATION

The accompanying financial data schedule (FDS) is a trial balance of the Section 8 Housing Choice Voucher Program, administered by the Municipality. The FDS was created in order to standardize the financial information reported by Public Housing Authorities (PHA) to the Real Estate Assessment Center (REAC), as required by the Uniform Financial Reporting Standards (UFRS). REAC is the US Department of Housing and Urban Development (HUD) national management center created to assess the condition of HUD owned and assisted properties. The UFRS are rules to implement requirements of 24 CFR, Part 5, Subpart H, for the electronic filing of financial information to HUD.

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

In accordance with the guidelines for reporting and attestation requirements of UFRS, the accompanying FDS is included as information supplementary to the financial statements. It was prepared using the accrual basis of accounting, as required by REAC regulations.



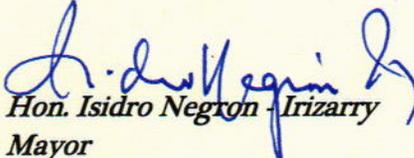
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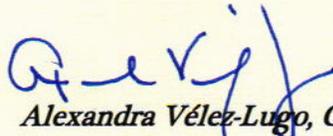
COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN

SINGLE AUDIT REPORT

*AS OF AND FOR THE FISCAL YEAR ENDED
JUNE 30, 2013*




Hon. Isidro Negron - Irizarry
Mayor


Alexandra Vélez-Lugo, CPA
Finance Director

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN, PUERTO RICO
SINGLE AUDIT REPORT
FISCAL YEAR ENDED JUNE 30, 2013

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

Honorable Mayor and Members of the
Municipal Assembly
San Germán, Puerto Rico

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of Municipality of San Germán, Puerto Rico as of and for the year ended June 30, 2013, and the related notes to the financial statements, which collectively comprise Municipality of San Germán, Puerto Rico's basic financial statements, and have issued our report thereon dated May 15, 2014.

Internal Control Over Financial Reporting

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

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

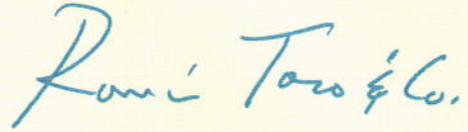
Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or, significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

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

Purpose of this Report

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



ROMAN TORO & CO., CPA, C.S.P.
LICENSE # 35 - IN FORCE

Yauco, Puerto Rico
May 15, 2014

Stamp #E115195 was affixed to
the original report



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

Honorable Mayor and Members of the
Municipal Assembly
San Germán, Puerto Rico

Report on Compliance for Each Major Federal Program

We have audited Municipality of San Germán, Puerto Rico's compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of Municipality of San Germán, Puerto Rico's major federal programs for the year ended June 30, 2013. Municipality of San Germán, Puerto Rico's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

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

Auditor's Responsibility

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

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

Opinion on Each Major Federal Program

In our opinion, Municipality of San Germán, Puerto Rico, complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2013.

Report on Internal Control Over Compliance

Management of Municipality of San Germán, Puerto Rico, is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered Municipality of San Germán, Puerto Rico's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of Municipality of San Germán, Puerto Rico'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. *A significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

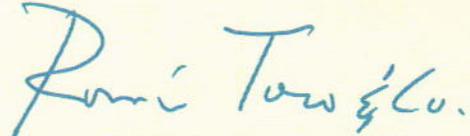
Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. We did not identify any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

Report on Schedule of Expenditures of Federal Awards Required by OMB Circular A-133

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of Municipality of San Germán, Puerto Rico, as of and for the year ended June 30, 2013, and the related notes to the financial statements, which collectively comprise Municipality of San Germán, Puerto Rico's basic financial statements. We issued our report thereon dated May 15, 2014, which contained unmodified opinions on those financial statements. Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the schedule of expenditures of federal awards is fairly stated in all material respects in relation to the basic financial statements as a whole.

Purpose of this Report

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



ROMAN TORO & CO., CPA, C.S.P.
LICENSE # 35 – IN FORCE

Yauco, Puerto Rico
May 15, 2014

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the original report



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN**

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

FISCAL YEAR ENDED JUNE 30, 2013

<u>Federal Grantor/Pass Through Grantor/Program Title</u>	<u>Federal CFDA Number (note B)</u>	<u>Pass-Through Entity Identifying Number (note B)</u>	<u>Federal Expenditures (notes A and B)</u>
<u>U.S. Department of Agriculture</u>			
Passed-through program from:			
<u>P.R. Department of Education</u>			
Child and Adult Care Food Program	10.558	CCC-269	\$ <u>36,654</u>
<u>U.S. Department of Housing and Urban Development</u>			
Direct programs:			
Community Development Block Grants / Entitlement Grants	14.218	N/A	908,660
Community Development Block Grants - Program Income	14.218	N/A	465,024
Shelter Plus Care	14.238	N/A	46,134
Section 8 Housing Choice Vouchers Program	14.871	N/A	437,503
Passed-through programs from:			
<u>Office of Commissioner of Municipal Affairs:</u>			
Community Development Block Grant / State's Program (State-Administered Small Cities Program)	14.228	FD-57 AB-57, FC-57	52,626
<u>P.R. Department of Family:</u>			
Emergency Shelter Grants Program	14.231	S08DC720001, S09DC720001	24,969
<u>P.R. Department of Health:</u>			
Housing Opportunities for Persons with AIDS (HOPWA)	14.241	2008-DS 0618	42,928
<u>P.R. Department of Housing - (Puerto Rico Public Housing Administration "PRPHA"):</u>			
Public and Indian Housing	14.850	RQ003091, RQ005145	<u>1,030,560</u>
Subtotal U.S. Department of Housing and Urban Development			<u>3,008,404</u>
<u>U.S. Department of Justice</u>			
Passed-through program from:			
<u>P.R. Department of Justice:</u>			
ARRA - Eward Byrne Memorial Justice Assistance Grant (JAG) Program/ Grants to States and Territories	16.803	2009-SU- CSSAG-01	<u>30,012</u>

Continue

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN**

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
(CONTINUED)**

FISCAL YEAR ENDED JUNE 30, 2013

U.S. Department of Transportation

Passed-through program from:

P.R. Traffic Safety Commission

State and Community Highway Safety	20.600	10-06-28, 10-03-76	<u>20,101</u>
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U.S. Department of Health and Human Services

Direct programs:

Early Head Start	93.600	N/A	820,708
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Passed-through programs from:

P.R. Office of the Ombudsman for the Elderly:

Special Programs for the Aging-Title III, Part C-Nutrition Services	93.045	N/AV	<u>191,822</u>
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Subtotal U.S. Department of Health and Human Services:

1,012,530

U.S. Department of Homeland Security

Passed-through programs from:

P.R. Governor's Office - Governor's Authorized Representative (GAR):

Disaster Grants - Public Assistance (Presidentially Declared Disasters)	97.036	125-99-125	<u>53,928</u>
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Total Expenditures of Federal Awards

\$ 4,161,629

See notes to Schedule of Expenditures of Federal Awards.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN**

NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

JUNE 30, 2013

NOTE A – BASIS OF PRESENTATION

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of the Municipality under programs of the federal government for the year ended June 30, 2013. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments and Nonprofit Organizations*. Therefore, some amounts presented in this schedule may differ from the amounts presented in, or used in the preparation of, the basic financial statements. Because the schedule presents only a selected portion of the operations of the Municipality, it is not intended to and does not present the financial position and changes in net assets of the Municipality.

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Expenditures reported on the Schedule are reported on the modified accrual basis of accounting, except for Section 8 Housing Choice Voucher Program (HCV). Such expenditures are recognized when the related liability is incurred following the cost principles contained in OMB Circular A-87 *Cost Principles for State, Local and Indian Tribal Governments*, wherein certain types of expenditures are not allowable or are limited as to reimbursement. Expenditures for HCV Program are reported on a statutory basis as required by the U.S. Department of Housing and Urban Development. Such expenditures should equal the net ACC subsidy for the PHA's fiscal period.

The Catalog of Federal Domestic Assistance (CFDA) Number is a program identification number. The first two digits identify the federal department or agency that administers the program and the last three numbers are assigned by numerical sequence.

State or local government redistributions of federal awards to the Municipality, known as "pass-through awards", should be treated by the Municipality as though they were received directly from the federal government. OMB Circular A-133 requires the schedule to include the name of the pass-through entity and the identifying number assigned by the pass-through entity for the federal awards received as a subrecipient. Numbers identified as N/A are not applicable and numbers identified as N/AV are not available.

NOTE C – RECONCILIATION OF EXPENDITURES PRESENTED IN THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS TO THE EXPENDITURES PRESENTED IN THE BASIC FINANCIAL STATEMENTS

<u>CFDA No. / Description</u>	<u>Other Governmental Funds</u>
10.558	\$ 36,654
14.871	437,503
14.218	908,660
14.218 (Program Income)	465,024
14.238	46,134
14.228	52,626
14.231	24,969
14.241	42,928

Continue

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN**

NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

JUNE 30, 2013

NOTE C - RECONCILIATION OF EXPENDITURES PRESENTED IN THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS TO THE EXPENDITURES PRESENTED IN THE BASIC FINANCIAL STATEMENTS - Continued

CFDA No. / Description	Other Governmental Funds
14.850	1,030,560
16.803	30,012
20.600	20,101
93.045	191,822
93.600	820,708
97.036	53,928
Total federal awards expenditures:	4,161,629
Additional amount recorded as expenditures under modified accrual basis for Section 8 HCV Program:	100,524
Total non-federal awards expenditures:	2,848,147
Total expenditures, fund statements:	\$ 7,110,300

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2013**

SECTION I – SUMMARY OF AUDITORS' RESULTS

Financial Statements

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

Internal control over financial reporting:

- Significant control deficiency identified? Yes None reported
- Material weakness (es) identified? Yes No

Noncompliance material to financial statements noted? Yes No

Federal Awards

Internal control over major programs:

- Significant control deficiency identified? Yes None reported
- Material weakness (es) identified? Yes No

Type of auditor's report issued on compliance for Major Programs: Unqualified Opinion Qualified Opinion
 Adverse Opinion Disclaimer Opinion

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

Identification of Major Programs:

CFDA Number	Name of Federal Program or Cluster
14.218	Community Development Block Grants/ Entitlement
14.850	Public and Indian Housing
14.871	Section 8 Rental Housing Choice Vouchers
93.600	Early Head Start Program

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

Auditee qualified as low-risk auditee? Yes No

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN GERMAN
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)
FOR THE YEAR ENDED JUNE 30, 2013**

SECTION II – FINANCIAL STATEMENT FINDINGS

None.

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

None.

END OF SECTION

COMMONWEALTH OF PUERTO RICO
 MUNICIPALITY OF SAN GERMAN
 SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
 FOR THE YEAR ENDED JUNE 30, 2013

Year	Finding Number	Finding	CFDA Number	Questioned Costs	Comments
		(1) Audit Findings that have been fully corrected or not noted during our audit:			
		NONE.			
		(2) Audit Findings not corrected or partially corrected:			
		NONE.			
		(3) Corrective action taken is significantly different from corrective action previously reported:			
		NONE.			
		(4) Audit findings are no longer valid:			
		NONE.			
END OF SCHEDULE					