

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

**MUNICIPIO DE SAN SEBASTIAN
AUDITORÍA 2011-2012
30 DE JUNIO DE 2012**

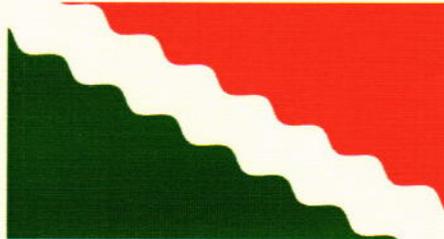
**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN**

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Oficina del Comisario
de Asuntos Municipales

FISCAL YEAR ENDED JUNE 30, 2012



**BASIC FINANCIAL STATEMENTS ACCOMPANIED BY
REQUIRED SUPPLEMENTARY INFORMATION**

**HON. JAVIER JIMENEZ PEREZ
MAYOR**

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN

BASIC FINANCIAL STATEMENTS ACCOMPANIED BY
REQUIRED SUPPLEMENTARY INFORMATION

FISCAL YEAR ENDED JUNE 30, 2012

TABLE OF CONTENTS

| | Pages |
|--|-------|
| <u>PART I – FINANCIAL:</u> | |
| Independent Auditors' Report | 1-2 |
| Required Supplementary Information (Part I): Management's Discussion and Analysis | 3-13 |
| <u>BASIC FINANCIAL STATEMENTS:</u> | |
| Governmental Wide Financial Statements: | |
| Statement of Net Assets | 14 |
| Statement of Activities | 15 |
| Governmental Funds Financial Statements: | |
| Balance Sheet | 16 |
| Statement of Revenues, Expenditures and Changes in Fund Balances | 17 |
| Reconciliation of the Balance Sheet- Governmental Funds to Statement of Net Assets | 18 |
| Reconciliation of Statement of Revenues, Expenditures and Changes in Fund Balances to the Statement of Activities | 19 |
| <u>PROPRIETARY FUND FINANCIAL STATEMENTS:</u> | |
| Statement of Net Assets | 20 |
| Statement of Activities | 21 |
| Statement of Cash Flows | 22-23 |
| Notes to the Basic Financial Statements | 24-54 |
| Required Supplementary Information: | |
| Required Supplementary Information (Part II): | |
| Budgetary Comparison Schedule – General Fund | 55 |
| Note to Budgetary Comparison Schedule – General Fund | 56 |

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN

BASIC FINANCIAL STATEMENTS ACCOMPANIED BY
REQUIRED SUPPLEMENTARY INFORMATION

FISCAL YEAR ENDED JUNE 30, 2012

TABLE OF CONTENTS (Continued)

Federal Awards and Single Audit Section

| | |
|---|-----------|
| Supplementary Information | |
| Schedule of Expenditures of Federal Awards | 57 |
| Notes to Schedule of Expenditures of Federal Awards..... | 58 |
| 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..... | 59-60 |
| Independent Auditor's Report on compliance with Requirements that could have a Direct and Material Effect on Each Major Program and on Internal Control over Compliance in Accordance with OMB Circular A-133 | 61-62 |
| Schedule of Findings and Questioned Costs..... | 63-64 |
| Summary Schedule of Prior Audit Findings | 65 |

INDEPENDENT AUDITOR'S REPORT

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

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of **Municipality of San Sebastián, Puerto Rico**, as of and for the year ended June 30, 2012, which collectively comprise the Municipality of San Sebastián, Puerto Rico's basic financial statements as listed in the table of contents. These financial statements are the responsibility of Municipality of San Sebastián, Puerto Rico's management. Our responsibility is to express opinions on these financial statements based on our audit.

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

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

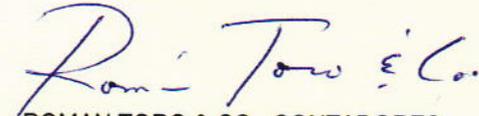
In accordance with *Government Auditing Standards*, we have also issued our report dated January 28, 2013, on our consideration of the Municipality of San Sebastián, Puerto Rico's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, 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* and should be considered in assessing the results of our audit.

INDEPENDENT AUDITOR'S REPORT

(CONTINUED)

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 13 and 55 through 56 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Municipality of San Sebastián, Puerto Rico's financial statements as a whole. The accompanying schedule of expenditures of federal awards on page 57 is presented for purposes of additional analysis as required by U.S. Office of Management and Budget *Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the financial statements. The schedule of expenditures of federal awards is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated, in all material respects, in relation to the financial statements as a whole.


ROMAN TORO & CO., CONTADORES
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Yauco, Puerto Rico
January 28, 2013

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the original of this report

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN**

MANAGEMENT'S DISCUSSION AND ANALYSIS

FOR THE FISCAL YEAR ENDED JUNE 30, 2012

The management of **Municipality of San Sebastián**, Puerto Rico (**Municipality**) offers this narrative overview and analysis of the financial activities of the Municipality for the fiscal year ended June 30, 2012. The Management's Discussion and Analysis (MD&A) is designed to focus on the current year activities, resulting changes and currently known facts, and much of the information is comparable to prior year. This MD&A should be read in conjunction with the accompanying basic financial statements and the accompanying notes to those financial statements.

The new reporting model required by Governmental Accounting Standards Board Statement No. 34 was implemented during fiscal 2003-2004. This MD&A is prepared in order to comply with such pronouncement and, among other purposes, to provide the financial statements users with the following major information:

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

GOVERNMENTAL ACTIVITIES – FINANCIAL HIGHLIGHTS

The following are key financial highlights for the fiscal year:

- The Municipality's assets exceeded its liabilities at June 30, 2012 by \$45,189,327, and at June 30, 2011 by \$40,196,426, as restated;
- The Municipality's total net assets increase by \$4,992,901 during fiscal year 2011-2012;
- As of June 30, 2012, the Municipality's governmental funds reported combined ending fund balance of \$13,862,361, a decrease of \$859,014 from the prior year;
- At June 30, 2012, the Statement of Net Asset presented an unrestricted deficit of \$5,297,832;
- The Municipality's capital assets inventory increase as a result of this year's operations. Capital assets as of June 30, 2012 were \$54,068,322 (net of accumulated depreciation);
- The investment in capital assets for this year was \$38,921,322 (net of related debt);
- Loans principal payments were \$2,115,000 and \$1,330,000 in 2012 and 2011, respectively.

BUSINESS-TYPE ACTIVITIES – FINANCIAL HIGHLIGHTS

- The total net assets of the proprietary fund amounted to \$1,072,965, of which \$368,486 are invested in capital assets, net of related debt, while \$538,376 are restricted for the operations of federally funded programs.
- The total net assets of the proprietary fund increased by \$61,195 during the fiscal year ended on June 30, 2012.

OVERVIEW OF THE BASIC FINANCIAL STATEMENTS

This discussion and analysis are intended to serve as an introduction to the Municipality's financial statements. The Municipality's basic financial statements comprise three components: government-wide financial statements; fund financial statements; and notes to the financial statements. This report also contains other supplementary information in addition to the basic financial statements themselves.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN**

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

FOR THE FISCAL YEAR ENDED JUNE 30, 2012

GOVERNMENT-WIDE FINANCIAL STATEMENTS

The government-wide financial statements are composed of: (1) the statement of net assets and (2) the statement of activities. These financial statements can be found immediately following this MD&A. These financial statements are designed to provide readers with a broad overview of the Municipality's finances, in a manner similar to a private-sector business.

STATEMENT OF NET ASSETS

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

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

STATEMENT OF ACTIVITIES

The statement of activities presents information showing how the Municipality's net assets changed during the fiscal year ended June 30, 2012, by presenting all of the Municipality's revenues and expenses. As previously discussed, the items reported in the statement of activities are measured in a manner similar to the approach used by a commercial enterprise in that revenues are recognized when earned or established criteria are satisfied, and expenses are recorded when incurred by the Municipality. Consequently, revenues are reported even when they may not be collected for several months after the end of the fiscal year and expenses are recorded even though they may not have used cash during the current year.

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

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

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN**

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

FOR THE FISCAL YEAR ENDED JUNE 30, 2012

GOVERNMENT-WIDE FINANCIAL STATEMENTS (CONTINUED)

Both of the government-wide financial statements of the Municipality are principally supported by taxes and intergovernmental revenues. The Municipality's activities include; general government, public safety, public works, culture, recreation, health and welfare, and interests. Property taxes, volume of business taxes, sales taxes, and state and federal grants finance most of these activities.

FUND FINANCIAL STATEMENTS

The Municipality's fund financial statements consist of: (1) the balance sheet – governmental funds, (2) the statement of revenues, expenditures and changes in fund balances – governmental funds, (3) the statement of net assets – proprietary fund, (4) the statement of revenues, expenses and changes in fund net assets – proprietary fund, and (5) the statement of cash flows – proprietary fund. These financial statements report the financial position, the results of operations and cash flows of the Municipality's governmental and proprietary funds, with an emphasis on the Municipality's major governmental and proprietary funds.

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The Municipality, like most other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. Each fund is considered an independent fiscal entity accounted for within a set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenue, and expenditures. Fund accounting segregates funds according to their intended purpose and is used to aid management in demonstrating compliance with legal, financial and contractual provisions.

GOVERNMENTAL FUNDS

The Municipality's basic services are reported in the government fund financial statements. The government funds are reported using an accounting method called modified accrual accounting, which measures cash and all other financial assets that can readily be converted into cash. Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on near-term inflows and outflows of spendable resources, as well as on balances of spendable resources available at the end of the fiscal year. Such information may be useful in evaluating a government's near-term financing requirements. Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions.

The Municipality adopts an annual appropriated budget for its general fund. A budgetary comparison statement has been provided for the general fund to demonstrate compliance with this budget.

PROPRIETARY FUND

The proprietary fund is a fund used to report the financial position, results of operation and cash flows of Villa Soigal (Project No. 63-29-665705492,01-3), is a housing development consisting of 120 dwelling units located in San Sebastian.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

FOR THE FISCAL YEAR ENDED JUNE 30, 2012

FUND FINANCIAL STATEMENTS (CONTINUED)

PROPRIETARY FUND (CONTINUED)

The project is owned by the Municipality, but its operations are carried out by a private management agent unrelated to the Municipality. The housing development project of Villas Soigal has been designed to assist various segments of the general public in obtaining adequate and reasonable priced rental housing. The project operates under financing through the Section 8 New Construction and Substantial Rehabilitation Program of the U.S. Department of Housing and Urban Development and the Section 515 Rural Rental Housing Loans Program of the U.S. Department of Agriculture. The purpose of Villas Soigal is to provide adequate housing to low-income residents of the Municipality.

The activities of Villas Soigal have been reported as a proprietary fund in the accompanying basic financial statements since GAAP permits the use of enterprise funds to report any activity for which a fee is charged to external users of goods or services, regardless of whether the government intends to fully recover the cost of the goods or services provided. Thus, it is common to use proprietary fund reporting to account for services where the government intends to recover only a portion of its costs through fees or user charges.

Proprietary funds provide the same type of information as the GWFS, but in more detail.

NOTES TO THE BASIC FINANCIAL STATEMENTS

The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements.

OTHER INFORMATION

In addition to the basic financial statements and accompanying notes, this report also presents certain required supplementary information containing budget to actual comparisons for the general and major funds.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN**

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

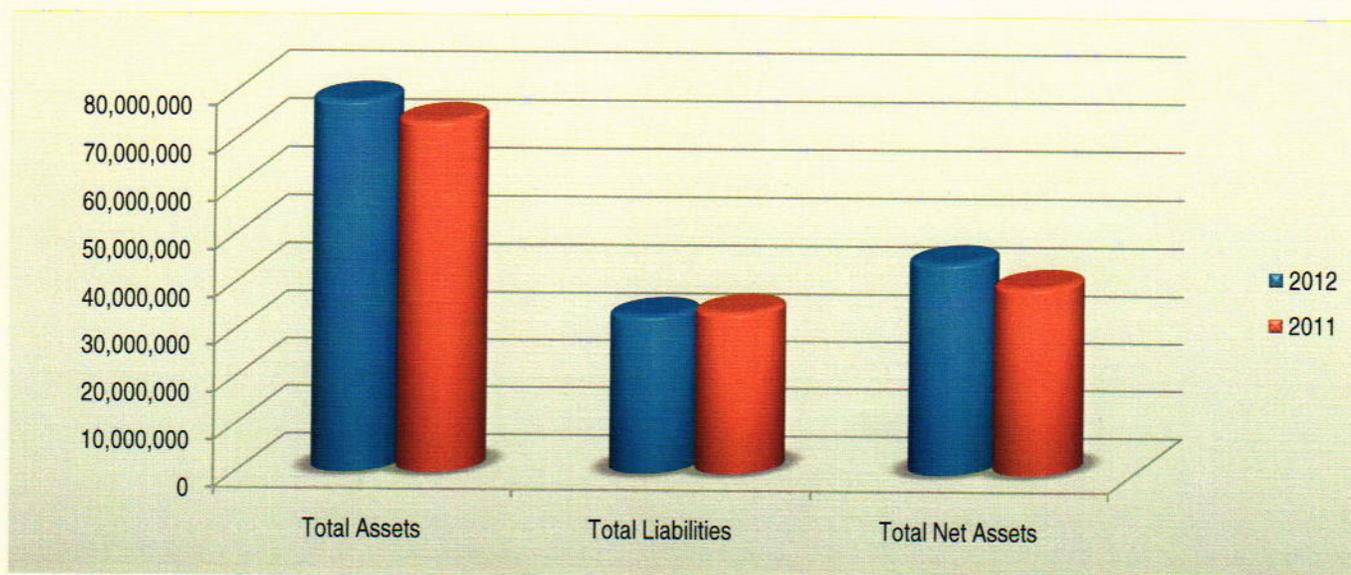
FOR THE FISCAL YEAR ENDED JUNE 30, 2012

GOVERNMENT-WIDE FINANCIAL ANALYSIS

GOVERNMENTAL NET ASSETS

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. In the case of the Municipality, governmental activities assets exceeded liabilities by \$45,189,327 as of June 30, 2012, versus \$40,196,426 as of June 30, 2011, as restated, and business-type activities assets exceeded liabilities by \$1,072,965 as of June 30, 2012, versus \$1,011,770 as of June 30, 2011. Our analysis below focuses on the net assets (**Table 1**) and changes in net assets of the Municipality's governmental activities and business-type activities.

| Table 1 Statement of Net Assets | Governmental Activities | | Business-type Activities | | Total | |
|---|-------------------------|-----------------------|--------------------------|---------------------|----------------------|-----------------------|
| | 2012 | 2011 (as restated) | 2012 | 2011 | 2012 | 2011 (as restated) |
| Current and non-current assets | \$ 21,616,710 | \$ 20,549,144 | \$ 711,702 | \$ 623,448 | \$ 22,328,412 | \$ 21,172,592 |
| Capital assets | 54,068,322 | 50,830,850 | 1,267,874 | 1,387,792 | 55,336,196 | 52,218,642 |
| Total Assets | 75,685,032 | 71,379,994 | 1,979,576 | 2,011,240 | 77,664,608 | 73,391,234 |
| Current liabilities | 7,235,240 | 5,827,769 | 134,581 | 124,121 | 7,369,821 | 5,951,890 |
| Long-term liabilities | 23,260,465 | 25,355,799 | 772,030 | 875,349 | 24,032,495 | 26,231,148 |
| Total Liabilities | 30,495,705 | 31,183,568 | 906,611 | 999,470 | 31,402,316 | 32,183,038 |
| Net assets: | | | | | | |
| Investment in capital assets, net of related debt | 38,921,322 | 38,946,163 | 368,486 | 431,680 | 39,289,808 | 39,377,843 |
| Restricted | 11,565,837 | 7,435,176 | 538,376 | 491,290 | 12,104,213 | 7,926,466 |
| Unrestricted (Deficit) | (5,297,832) | (6,184,913) | 166,103 | 88,800 | (5,131,729) | (6,096,113) |
| Total Net Assets | \$ 45,189,327 | \$ 40,196,426 | \$ 1,072,965 | \$ 1,011,770 | \$ 46,262,292 | \$ 41,208,196 |



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN**

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

FOR THE FISCAL YEAR ENDED JUNE 30, 2012

GOVERNMENT-WIDE FINANCIAL ANALYSIS (CONTINUED)

The largest portion of the Municipality's net assets reflects its investment in capital assets (e.g. land, buildings, machinery and equipment), less any related debt used to acquire those assets still outstanding. These capital assets are used to provide services to citizens; consequently these assets are not available for future spending. It should also be noted that the resources required to repay the related debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities. An additional portion of the Municipality's net assets represents resources that are subject to external restrictions on how they may be used.

GOVERNMENTAL ACTIVITIES

Governmental activities increased the Municipality's net assets. Key elements of this increase are as follows: the Municipality's governmental activities had net expenses of \$13,379,466. However, these services are intended to be primarily funded by taxes, as opposed to charges for services and grants, and those taxes and other general revenues exceed net expenses by \$4,992,901. In addition, business-type activities increased the Municipality's net assets by \$61,195.

The cost of all governmental activities and business-type activities this year was \$27,868,930 and \$565,854, respectively. **Table 2** presents the cost of each of the Municipality's largest programs.

| Table 2 Statement of Activities | Governmental Activities | | Business-type Activities | | Total | |
|--|--------------------------------|----------------------|---------------------------------|---------------------|----------------------|----------------------|
| | 2012 | 2011 | 2012 | 2011 | 2012 | 2011 |
| Revenues | | | | | | |
| Program revenues: | | | | | | |
| Grants and contributions | \$ 20,066,076 | \$ 17,594,992 | \$ 622,224 | \$ 616,893 | \$ 20,688,300 | \$ 18,211,885 |
| Charge for services | 743,231 | 765,782 | | | 743,231 | 765,782 |
| General revenues: | | | | | | |
| Property taxes | 6,207,154 | 6,070,049 | | | 6,207,154 | 6,070,049 |
| Municipal license tax | 1,840,202 | 1,850,609 | | | 1,840,202 | 1,850,609 |
| Sales and use tax | 2,195,810 | 2,118,170 | | | 2,195,810 | 2,118,170 |
| Other local taxes | 688,132 | 437,089 | | | 688,132 | 437,089 |
| Interest and investment earnings | 687,703 | 400,931 | 3,275 | 8,878 | 690,978 | 409,809 |
| Miscellaneous | 433,523 | 571,814 | 1,550 | 2,065 | 435,073 | 573,879 |
| Total revenues | 32,861,831 | 29,809,436 | 627,049 | 627,836 | 33,488,880 | 30,437,272 |
| Expenses | | | | | | |
| General government | 8,613,046 | 11,375,522 | | | 8,613,046 | 11,375,522 |
| Public safety | 940,695 | 1,343,478 | | | 940,695 | 1,343,478 |
| Public works | 8,575,857 | 3,480,357 | | | 8,575,857 | 3,480,357 |
| Culture and recreation | 1,471,368 | 1,560,460 | | | 1,471,368 | 1,560,460 |
| Health and welfare | 7,372,087 | 7,942,272 | | | 7,372,087 | 7,942,272 |
| Public Housing and Welfare | | | 505,779 | 520,336 | 505,779 | 520,336 |
| Interest on long-term debts | 895,877 | 883,157 | 60,075 | 69,256 | 955,952 | 952,413 |
| Total expenses | 27,868,930 | 26,585,246 | 565,854 | 589,592 | 28,434,784 | 27,174,838 |
| Changes in net assets | 4,992,901 | 3,224,190 | 61,195 | 38,244 | 5,054,096 | 3,262,434 |
| Net assets – beginning, as restated | 40,196,426 | 36,972,236 | 1,011,770 | 973,526 | 41,208,196 | 37,945,762 |
| Net assets – ending | \$ 45,189,327 | \$ 40,196,426 | \$ 1,072,965 | \$ 1,011,770 | \$ 46,262,292 | \$ 41,208,196 |

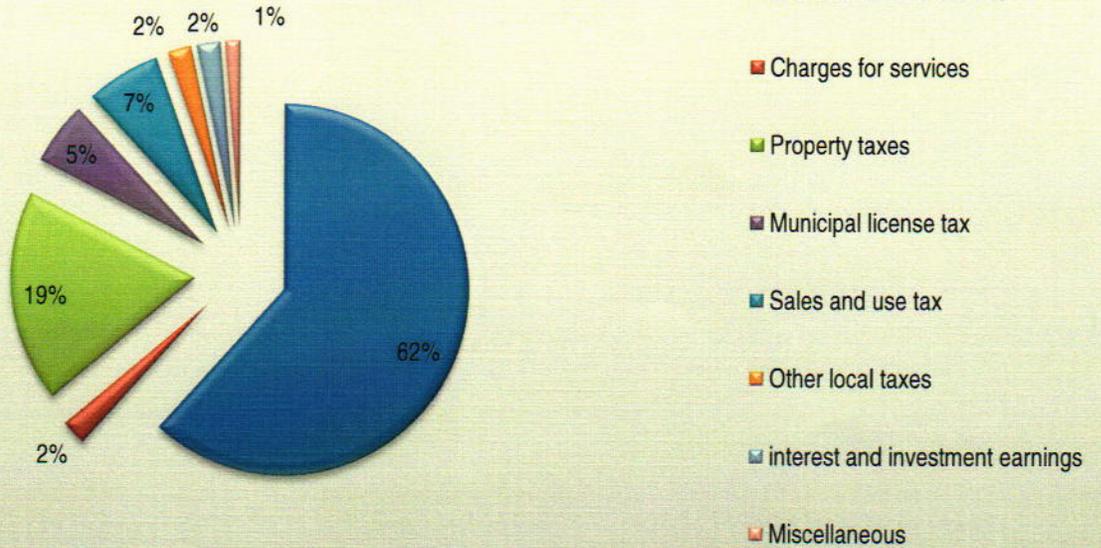
COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

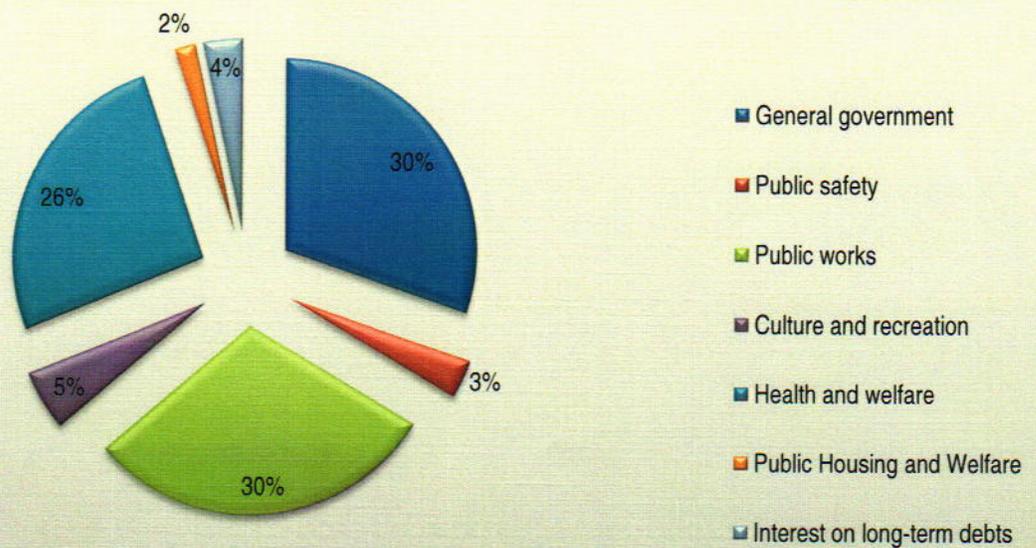
FOR THE FISCAL YEAR ENDED JUNE 30, 2012

GOVERNMENT-WIDE FINANCIAL ANALYSIS (CONTINUED)

2012 Revenues



2012 Expenditures



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN**

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

FOR THE FISCAL YEAR ENDED JUNE 30, 2012

GOVERNMENT-WIDE FINANCIAL ANALYSIS (CONTINUED)

Approximately thirty-three percent (33%) of the Municipality's governmental activities and business-type activities total revenue came from taxes, while sixty-two percent (62%) resulted from grants and contributions. Federal grants represent nineteen percent (19%) of the Municipality grants revenues. The Municipality's governmental activities and business-type activities expenses included items such as general government, public safety, public works, culture and recreation, health and welfare, public housing and welfare, and interest on long term debts.

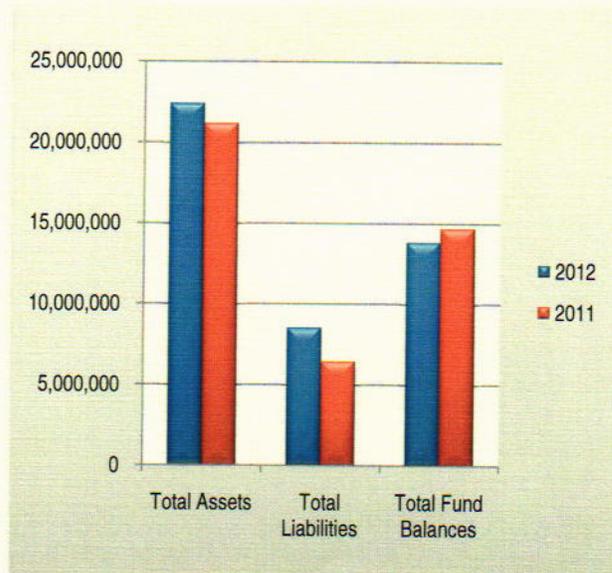
Approximately thirty percent (30%) of total expenses resulted from general government, thirty percent (30%) from public works, five percent (5%) from culture and recreation and twenty-six percent (26%) from health and welfare.

GOVERNMENT FUND FINANCIAL ANALYSIS

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

**Table 3
Balance Sheet**

| | 2012 | 2011 (as restated) |
|--|----------------------|-------------------------------|
| Assets: | | |
| Total assets – Major Funds | \$ 18,044,620 | \$ 17,197,409 |
| Total assets – Other Funds | 4,386,236 | 4,000,073 |
| Total assets | \$ 22,430,856 | \$ 21,197,482 |
| Liabilities: | | |
| Total liabilities – Major Funds | \$ 7,102,521 | \$ 5,217,741 |
| Total liabilities – Other Funds | 1,465,974 | 1,258,366 |
| Combined total liabilities | 8,568,495 | 6,476,107 |
| Fund Balances: | | |
| Restricted | 11,434,737 | 12,536,206 |
| Assigned | 503,647 | 584,956 |
| Unassigned | 1,923,977 | 1,600,213 |
| Combined total fund balances | 13,862,361 | 14,721,375 |
| Total liabilities and fund balances | \$ 22,430,856 | \$ 21,197,482 |



The focus of the Municipality's governmental funds is to provide information on near-term inflows, outflows, and balances of spendable resources. Such information is useful in assessing the Municipality's financing requirements. In particular, unreserved fund balance may serve as a useful measure of a government's net resources available for spending at the end of its fiscal year. At June 30, 2012, the Municipality's governmental funds reported combined ending fund balances of \$13,862,361, a decrease of \$859,014 from the prior year.

The Municipality has an unassigned fund balance of \$1,923,977 in its General Fund. The remainder of the balance is assigned and restricted to indicate that it is not available for new spending because it has already been committed; (a) to liquidate prior year obligations (\$372,547) and others (\$131,100), (b) to pay debt service (\$2,575,111) and (c) for other restricted purposes (\$8,859,626).

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN**

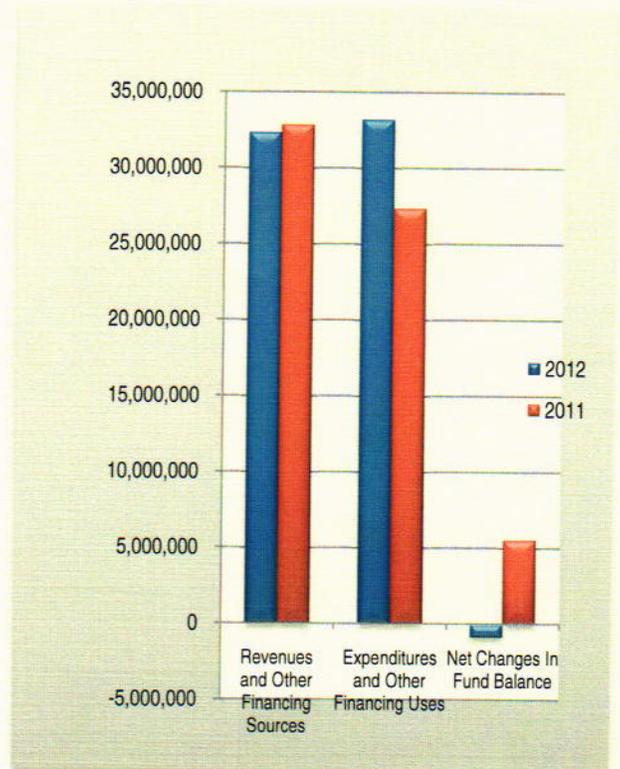
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

FOR THE FISCAL YEAR ENDED JUNE 30, 2012

GOVERNMENT FUND FINANCIAL ANALYSIS (CONTINUED)

Table 4

| <u>Changes in Fund Balances</u> | <u>2012</u> | <u>2011</u> |
|--|----------------------|----------------------|
| Revenues: | | |
| Total revenues – Major Funds | \$ 26,219,509 | \$ 22,328,926 |
| Total revenues – Other Funds | 6,123,213 | 7,480,510 |
| Combined total revenues | 32,342,722 | 29,809,436 |
| Expenditures: | | |
| Total expenditures – Major Funds | 24,665,881 | 20,555,229 |
| Total expenditures – Other Funds | 8,535,855 | 6,778,069 |
| Combined total expenditures | 33,201,736 | 27,333,298 |
| Other financing sources (uses): | | |
| Other financing sources – Major Funds | - | 3,045,000 |
| Other financing sources – Other Funds | - | - |
| Combined other financing sources (uses), net | - | 3,045,000 |
| Net changes in fund balance | (859,014) | 5,521,138 |
| Fund Balance – beginning, as restated | 14,721,375 | 9,200,237 |
| Fund Balance – ending | \$ 13,862,361 | \$ 14,721,375 |



PROPRIETARY FUND FINANCIAL ANALYSIS

At June 30, 2012, the total assets of proprietary fund amounted to \$1,979,576, which consisted principally of: (1) restricted cash in commercial banks of \$538,376, and (2) capital assets of \$1,267,874, net of accumulated depreciation.

At June 30, 2012, the total liabilities of the proprietary fund amounted to \$906,611, which consisted principally of: (1) mortgage notes payable of \$857,709, and (2) accounts payable and accrued liabilities of \$35,385.

The total net assets of proprietary fund amounted to \$1,072,965 at June 30, 2012, of which \$368,486 are invested in capital assets, and \$538,376 are reserved for program activities.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN**

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

FOR THE FISCAL YEAR ENDED JUNE 30, 2012

BUDGETARY HIGHLIGHTS

Budget and actual comparison schedules are provided in the Basic Financial Statements for the General Fund. The Budgetary Comparison Schedule of the General Fund shows the original adopted budgets, the final revised budget, actual results, and variance between the final budget and actual results for the general and major special revenue funds. **Table 5** summarizes the results of the General Fund's Budgetary Comparison Schedule:

| Table 5 | Final Budget | Actual Amounts | Variance |
|---|---------------------|-----------------------|-------------------|
| Total revenues | \$ 15,043,886 | \$ 14,650,808 | \$(393,078) |
| Total expenditures, encumbrances and other financing uses | <u>15,043,886</u> | <u>14,501,321</u> | <u>542,565</u> |
| Excess or deficiency | \$ - | \$ 149,487 | \$ 149,487 |

The original and the final budget of the General Fund for the fiscal year ended June 30, 2012 amounted to \$ 13,990,426 and \$15,043,886, respectively. Over the course of the fiscal year, the Municipality revised the General Fund's budget in order to include increases and decreases in revenues that were identified during the course of the fiscal year based on current developments that positively affected the Municipality's finances. The laws and regulations of the Commonwealth mandate a balanced budget.

The total actual revenues (budgetary basis) of the general fund for the fiscal year ended June 30, 2012 were \$14,650,808, which is approximately two percent (2%), or \$(393,078) less than the budgeted revenues. In addition, the total actual expenditures and other financing sources (budgetary basis) of the general fund for the fiscal year ended June 30, 2012 were \$14,501,321, which is approximately four percent (4%), or \$542,565 less than the budgeted expenditures.

CAPITAL ASSETS AND DEBT ADMINISTRATION

The Municipality's investment in capital assets for its governmental type activities as of June 30, 2012 amounted to \$54,068,322 (net of accumulated depreciation). This investment in capital assets includes land, buildings, improvements, furniture and fixtures, vehicles and equipment, and infrastructure. The total increase in the Municipality's investment in capital assets for the current fiscal year was \$3,247,409. **Table 6** present the major classes of capital assets.

| Table 6 Capital Assets | Amount |
|-------------------------------------|----------------------|
| Construction in progress | \$ 5,295,782 |
| Land | 5,737,776 |
| Buildings and building improvements | 29,316,005 |
| Furniture and fixtures | 536,610 |
| Vehicles and equipment | 893,361 |
| Infrastructure | <u>12,288,788</u> |
| Total Assets | \$ 54,068,322 |

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

FOR THE FISCAL YEAR ENDED JUNE 30, 2012

LONG-TERM DEBT

At June 30, 2012, the Municipality had total of \$25,060,465 in general obligations and others outstanding debts, as shown in **Table 7**. Of this amount, \$17,157,000 comprises debt backed by the full faith and credit of the government and \$7,903,465 is other obligations.

| Table 7 | |
|-------------------------------------|----------------------------|
| Long Term Debts | Amount |
| General obligations bonds and notes | \$17,157,000 |
| Others | <u>6,103,465</u> |
| Total Long Term Debts | <u>\$23,260,465</u> |

The Municipality is required to limit the amount of general obligation debt to 10% of the total assessment of property located within the Municipality in order for the bonds to be repaid with the proceeds of property taxes restricted for debt services. Other obligations include accrued vacation and sick leave and advances of property taxes. More detailed information about the Municipality's long-term liabilities is presented in the notes to the financial statements. The Municipality continues to meet its financial needs through prudent use of its revenues and creative debt financing programs.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

Local, national and international economic factors influence the Municipality's revenues. Positive economic growth is correlated with increased revenues from property taxes, volume of business taxes, sales taxes, charges for services, as well as state and federal grants. Economic growth in the local economy may be measured by a variety of indicators such as employment growth, unemployment, new construction, assessed valuation, and other revenues.

All of these factors were considered in preparing the Municipality's budget for the 2012 fiscal year. Some cost reductions helped fund improvements of existing facilities, public safety and works, economic development initiatives and human service improvements.

REQUESTS FOR INFORMATION

This financial report is designed to provide a general overview of the Municipality's finances for all those with an interest in the government's finances. Questions concerning any of the information provided in this report or requests for additional information contact the Municipality's Finance Department at (787)896-1550.

**Commonwealth of Puerto Rico
Municipality of San Sebastian
Statement of Net Assets
June 30, 2012**

| | Governmental Activities |
|--|------------------------------------|
| ASSETS: | |
| Cash and investments | \$ 11,918,392 |
| Cash with fiscal agent | 7,603,396 |
| Receivables: | |
| Sales and use taxes | 196,692 |
| Property taxes | 330,834 |
| Rent, licenses and permits | 212,711 |
| Intergovernmental | 943,727 |
| Interest, fines and penalties | 202,335 |
| Federal grants | 200,785 |
| Others | 7,838 |
| | 21,616,710 |
| Capital assets: | |
| Land, improvements, and construction in progress | 11,033,558 |
| Other capital assets, net of depreciation | 43,034,764 |
| Total capital assets | 54,068,322 |
| TOTAL ASSETS | 75,685,032 |
| LIABILITIES: | |
| Accounts payable and accrued liabilities | 1,888,957 |
| Bonds and notes payable | 1,025,000 |
| Accrued interests | 413,425 |
| Due to governmental units | 2,363,134 |
| Deferred revenues: | |
| Municipal license taxes | 1,374,679 |
| Federal grants | 170,045 |
| Long-term liabilities: | |
| Due within one year | 1,462,194 |
| Due in more than one year | 21,798,271 |
| TOTAL LIABILITIES | 30,495,705 |
| NET ASSETS | |
| Invested in capital assets, net of related debt | 38,921,322 |
| Restricted for: | |
| Debt service | 2,575,111 |
| Other purposes | 8,990,726 |
| Unrestricted (deficit) | (5,297,832) |
| TOTAL NET ASSETS | \$ 45,189,327 |

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

Commonwealth of Puerto Rico
Municipality of San Sebastian
Statement of Activities
For the Year Ended June 30, 2012

| Functions/Programs | Expenses | Program Revenues | | | Net (Expense) Revenue |
|--------------------------------------|----------------------|----------------------|------------------------------------|----------------------------------|------------------------|
| | | Charges for Services | Operating Grants and Contributions | Capital Grants and Contributions | |
| Governmental Activities: | | | | | |
| General government | \$ 8,613,046 | \$ 51,538 | \$ - | \$ - | \$ (8,561,508) |
| Public safety | 940,695 | | 71,842 | | (868,853) |
| Public works | 8,575,857 | | 544,430 | 3,736,539 | (4,294,888) |
| Culture and recreation | 1,471,368 | | 221,562 | 2,650,000 | 1,400,194 |
| Health and welfare | 7,372,087 | 691,693 | 5,153,564 | 1,368,296 | (158,534) |
| Interest on long-term debt | 895,877 | | | | (895,877) |
| Total governmental activities | \$ 27,868,930 | \$ 743,231 | \$ 5,991,398 | \$ 7,754,835 | \$ (13,379,466) |

| | |
|---|-----------------------------|
| General revenues: | |
| Property taxes | \$ 6,207,154 |
| Municipal license tax | 1,840,202 |
| Sales and use tax | 2,195,810 |
| Other local taxes | 688,132 |
| Grant and contributions not restricted to specific programs | 6,319,843 |
| Interest and investment earnings | 687,703 |
| Miscellaneous | <u>433,523</u> |
| Total general revenues | <u>18,372,367</u> |
| Change in net assets | 4,992,901 |
| Net assets - beginning-as restated | <u>40,196,426</u> |
| Net assets - ending | <u>\$ 45,189,327</u> |

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

**Commonwealth of Puerto Rico
Municipality of San Sebastian
Balance Sheet
Governmental Funds
June 30, 2012**

| | State Assignment - State Assignment - | | | | Debt | Other | | Total |
|--|---------------------------------------|------------------------------------|--------------------------|--------------------|---------------------|---------------------|-----------------------|-----------------------|
| | General Fund | Public Works and Transportation | Recreation Facilities | Head Start Fund | Service Fund | Loans Fund | Governmental Funds | Governmental Funds |
| Assets | | | | | | | | |
| Cash and investments | \$ 5,263,581 | \$ 248,316 | \$ 2,672,510 | \$ 2,616 | \$ - | \$ - | \$ 3,731,369 | \$ 11,918,392 |
| Cash with fiscal agent | | | | | 3,923,623 | 3,679,773 | | 7,603,396 |
| Receivables: | | | | | | | | |
| Sales and use taxes | | | | | 67,221 | | 129,471 | 196,692 |
| Property taxes | 308,142 | | | | 22,692 | | | 330,834 |
| Rent, licenses and permits | 212,711 | | | | | | | 212,711 |
| Intergovernmental | 667,364 | 182,558 | | | | | 93,805 | 943,727 |
| Interest, fines and penalties | 202,335 | | | | | | | 202,335 |
| Federal grants | | | | 20,449 | | | 180,336 | 200,785 |
| Others | 2,167 | | | 808 | | | 4,863 | 7,838 |
| Due from other funds | 567,754 | | | | | | 246,392 | 814,146 |
| Total assets | \$ 7,224,054 | \$ 430,874 | \$ 2,672,510 | \$ 23,873 | \$ 4,013,536 | \$ 3,679,773 | \$ 4,386,236 | \$ 22,430,856 |
| Liabilities and Fund Balances | | | | | | | | |
| Liabilities : | | | | | | | | |
| Accounts payable and accrued liabilities | \$ 424,216 | \$ 430,874 | \$ - | \$ 23,345 | \$ - | \$ 251,718 | \$ 758,804 | \$ 1,888,957 |
| Bonds and notes payable | | | | | 1,025,000 | | | 1,025,000 |
| Accrued interests | | | | | 413,425 | | | 413,425 |
| Due to governmental units | 2,363,134 | | | | | | | 2,363,134 |
| Due to other funds | 246,392 | | | 528 | | 30,101 | 537,125 | 814,146 |
| Deferred revenues: | | | | | | | | |
| Municipal license taxes | 1,374,679 | | | | | | | 1,374,679 |
| Property taxes | 308,142 | | | | | | | 308,142 |
| Rent, licenses and permits | 13,511 | | | | | | | 13,511 |
| Interest, fines and penalties | 197,456 | | | | | | | 197,456 |
| Federal grants | | | | | | | 170,045 | 170,045 |
| Total liabilities | 4,927,530 | 430,874 | - | 23,873 | 1,438,425 | 281,819 | 1,465,974 | 8,568,495 |
| Fund balances: | | | | | | | | |
| Restricted | | - | 2,672,510 | - | 2,575,111 | 3,397,954 | 2,789,162 | 11,434,737 |
| Assigned | 372,547 | | | | | | 131,100 | 503,647 |
| Unassigned | 1,923,977 | | | | | | - | 1,923,977 |
| Total fund balances | 2,296,524 | - | 2,672,510 | - | 2,575,111 | 3,397,954 | 2,920,262 | 13,862,361 |
| Total liabilities and fund balances | \$ 7,224,054 | \$ 430,874 | \$ 2,672,510 | \$ 23,873 | \$ 4,013,536 | \$ 3,679,773 | \$ 4,386,236 | \$ 22,430,856 |

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

Commonwealth of Puerto Rico
Municipality of San Sebastian
Statement of Revenues, Expenditures and Changes in Fund Balances
Governmental Funds
For the Year Ended June 30, 2012

| | General Fund | State Assignment - Public Works and Transportation | State Assignment - Recreation Facilities | Head Start Fund | Debt Service Fund | Loans Fund | Other Governmental Funds | Total Governmental Funds |
|---|---------------------|--|--|------------------|---------------------|---------------------|--------------------------|--------------------------|
| Revenues | | | | | | | | |
| Property taxes | \$ 4,366,440 | - | \$ - | \$ - | \$ 1,532,572 | \$ - | \$ - | \$ 5,899,012 |
| Municipal license taxes | 1,840,202 | | | | | | | 1,840,202 |
| Sales and use taxes | | | | | 694,503 | | 1,501,307 | 2,195,810 |
| Charges for services | 743,231 | | | | | | | 743,231 |
| Federal grants and contributions | | | | 2,953,832 | | | 3,426,886 | 6,380,718 |
| State contributions | 6,319,843 | 3,736,539 | 2,650,000 | | | | 978,976 | 13,685,358 |
| Licenses and permits | 688,132 | | | | | | | 688,132 |
| Interest, fines and penalties | 481,933 | | | 8 | 1,247 | | 7,059 | 490,247 |
| Other revenues | 211,027 | | | | | | 208,985 | 420,012 |
| Total revenues | 14,650,808 | 3,736,539 | 2,650,000 | 2,953,840 | 2,228,322 | - | 6,123,213 | 32,342,722 |
| Expenditures | | | | | | | | |
| Current: | | | | | | | | |
| General government | 8,467,950 | | | | | 2,964 | 5,463 | 8,476,377 |
| Public safety | 809,162 | | | | | | 71,864 | 881,026 |
| Public works | 2,633,905 | 3,622,832 | | | | | 1,501,692 | 7,758,429 |
| Culture | 178,577 | | | | | | | 178,577 |
| Recreation | 336,246 | | | | | | 121,720 | 457,966 |
| Health and welfare | 708,133 | | | 2,953,840 | | | 3,496,928 | 7,158,901 |
| Capital outlay | | | | | | 1,941,395 | 3,338,188 | 5,279,583 |
| Debt service: | | | | | | | | |
| Principal | | | | | 2,115,000 | | | 2,115,000 |
| Interest and other charges | | | | | 895,877 | | | 895,877 |
| Total expenditures | 13,133,973 | 3,622,832 | - | 2,953,840 | 3,010,877 | 1,944,359 | 8,535,855 | 33,201,736 |
| Excess (deficiency) of revenues over (under) expenditures | 1,516,835 | 113,707 | 2,650,000 | - | (782,555) | (1,944,359) | (2,412,642) | (859,014) |
| Other fin. sources (uses) | | | | | | | | |
| Transfers in | | | | | 1,164,197 | | | 1,164,197 |
| Transfers out | (1,164,197) | | | | | | | (1,164,197) |
| Total other fin sources (uses) | (1,164,197) | - | - | - | 1,164,197 | - | - | - |
| Net change in fund balances | 352,638 | 113,707 | 2,650,000 | - | 381,642 | (1,944,359) | (2,412,642) | (859,014) |
| Fund balance (deficit), beginning-as restated | 1,943,886 | (113,707) | 22,510 | - | 2,193,469 | 5,342,313 | 5,332,904 | 14,721,375 |
| Fund balance (deficit), ending | \$ 2,296,524 | \$ - | \$ 2,672,510 | \$ - | \$ 2,575,111 | \$ 3,397,954 | \$ 2,920,262 | \$ 13,862,361 |

O. K. Kelly
8/10/2013

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN**

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

FOR THE FISCAL YEAR ENDED JUNE 30, 2012

TOTAL FUND BALANCES – GOVERNMENTAL FUNDS..... \$ 13,862,361

Amounts reported for Governmental Activities in the Statement of Net Assets are different because:

Capital Assets used in governmental activities are not financial resources and therefore, are not reported in the funds. In the current period, these amounts are:

| | | |
|--------------------------------------|---------------------|----------------|
| Non Depreciable Capital Assets | \$11,033,558 | |
| Depreciable Capital Assets..... | 62,160,776 | |
| Accumulated Depreciation..... | <u>(19,126,012)</u> | |
| Total Capital Assets..... | | 54,068,322 |

| | |
|--|---------|
| Some of the Municipality's revenues will be collected after year end, but not available soon enough to pay for current period's expenditure and therefore, are deferred in the funds.... | 519,109 |
|--|---------|

Some liabilities are not due and payable in the current period and therefore, are not reported in the funds. Those liabilities consist of:

| | | |
|--|------------------|-------------------------|
| General Bonds and Notes Payable | (17,157,000) | |
| Compensated Absences..... | (2,727,913) | |
| Property Tax Debt – Law 42 | (936,834) | |
| Property Tax Debt – Law 146..... | (151,354) | |
| Claims and Judgments | (1,800,000) | |
| State Health Insurance Administration | (256,266) | |
| Landfill Closure and Post-Closures Costs | <u>(231,098)</u> | |
| Total Long-Term Liabilities | | <u>(23,260,465)</u> |

TOTAL NET ASSETS OF GOVERNMENTAL ACTIVITIES..... \$ 45,189,327

See accompanying Notes to Basic Financial Statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN**

**RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES
IN FUND BALANCE OF GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES**

FOR THE FISCAL YEAR ENDED JUNE 30, 2012

NET CHANGE IN FUND BALANCES – TOTAL GOVERNMENTAL FUNDS \$ (859,014)

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

Governmental funds report capital outlays as expenditures. However, in the Statement of Activities the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense. In the current period, these amounts are:

| | | |
|--|--------------------|-----------|
| Capital Assets Additions | 5,131,509 | |
| Depreciation Expense | <u>(1,884,100)</u> | |
| Excess of Capital Assets Additions over Depreciation Expense | | 3,247,409 |

Disposal of capital assets require removal of cost of the capital assets from the capital asset account on the Statement of Net Assets, resulting in a loss on disposal of capital assets on the Statement of Activities (9,937)

Some of the Municipality's revenues will be collected after year end, but are not available soon enough to pay for the current period's expenditures and therefore, are deferred in the funds..... 519,109

Repayment of debt proceeds principal is expenditure in the governmental funds, but the repayment reduces Long-Term Liabilities in the Statement of Net Assets. In the current year the repayments were..... 2,115,000

Repayment of long-term principal is expenditure in the governmental funds, but the repayment reduces Long-Term Liabilities in the Statement of Net Assets. In the current year, the repayments were:

| | | |
|---|---------------|--------|
| Property Tax Debt – Law 42 | 22,264 | |
| Property Tax Debt – Law 146 | 7,567 | |
| Estimated Landfill Closure and Post-closure Care Cost | 15,492 | |
| LIMS Repayment Plan | <u>32,272</u> | |
| Total Additional Expenditures | | 77,595 |

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

Increase in compensated absences (97,261)

CHANGE IN NET ASSETS OF GOVERNMENTAL ACTIVITIES \$4,992,901

See accompanying Notes to Basic Financial Statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN
STATEMENT OF NET ASSETS – PROPRIETARY FUND
JUNE 30, 2012**

| | <u>Business- type Activities</u> |
|--|--|
| ASSETS: | |
| Current Assets: | |
| Cash | \$ 151,871 |
| Accounts receivables | 419 |
| Miscellaneous prepaid expenses | <u>3,482</u> |
| Total current assets | <u>155,772</u> |
| Restricted Assets: | |
| Restricted cash | <u>538,376</u> |
| Capital Assets: | |
| Land | 58,350 |
| Building and other depreciable assets, net of accumulated depreciation | <u>1,209,524</u> |
| Total capital assets | <u>1,267,874</u> |
| Other assets | <u>17,554</u> |
| Total Assets | <u><u>\$1,979,576</u></u> |
| LIABILITIES: | |
| Current Liabilities: | |
| Mortgage payable | \$ 99,196 |
| Accounts payable | 22,673 |
| Accrued liabilities | 12,712 |
| Tenant security deposits | <u>13,517</u> |
| Total current liabilities | 148,098 |
| Non-current liabilities: | |
| Mortgage payable | <u>758,513</u> |
| Total liabilities | <u>906,611</u> |
| NET ASSETS | |
| Invested in Capital Assets, Net of Related Debt | 368,486 |
| Restricted deposits | 538,376 |
| Unrestricted | <u>166,103</u> |
| Total net assets | <u>1,072,965</u> |
| Total Liabilities and Net Assets | <u><u>\$ 1,979,576</u></u> |

See accompanying notes to basic financial statements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN
STATEMENT OF ACTIVITIES- PROPRIETARY FUND
FOR THE FISCAL YEAR ENDED JUNE 30, 2012

| | Business- type Activities |
|--|--|
| REVENUES | |
| Rent | \$ 622,224 |
| Other | 1,550 |
| Total revenues | 623,774 |
| EXPENSES | |
| Administrative | 160,688 |
| Utilities | 19,564 |
| Operating and maintenance | 145,081 |
| Taxes and insurance | 45,151 |
| Depreciation | 135,295 |
| Total expenses | 505,779 |
| Operating income | 117,995 |
| NON OPERATING REVENUES (EXPENSES) | |
| Interest received | 3,275 |
| Interest on mortgage | (60,075) |
| Total non operating revenues (expenses) | (56,800) |
| Net Change in Net Assets | 61,195 |
| Net Assets, Beginning of Year, as restated | 1,011,770 |
| NET ASSETS, END OF YEAR | \$ 1,072,965 |

See accompanying notes to basic financial statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN
STATEMENT OF CASH FLOWS- PROPRIETARY FUND
FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

| | <u>Business- type Activities</u> |
|--|--|
| CASH FLOWS FROM OPERATING ACTIVITIES | |
| Cash received from tenants and HUD | \$ 621,805 |
| Other cash received | <u>1,550</u> |
| | 623,355 |
| Administrative | (50,506) |
| Management fees | (48,960) |
| Salaries and wages | (111,379) |
| Utilities | (19,564) |
| Operating and maintenance | (89,173) |
| Miscellaneous taxes and insurance | <u>(45,853)</u> |
| | (365,435) |
| Net cash provided by operating activities | <u>257,920</u> |
| CASH FLOW FROM CAPITAL AND RELATED FINANCING ACTIVITIES | |
| Interest paid in capital debt | (60,731) |
| Mortgage principal payment | (98,403) |
| Purchase of capital assets | <u>(15,379)</u> |
| Net cash used in capital and related financing activities | <u>(174,513)</u> |
| CASH FLOWS FROM INVESTING ACTIVITIES | |
| Deposits to reserve for replacement and interest retained in account | (29,230) |
| Withdrawal from reserve for insurance escrow | (16,714) |
| Interest on investment | 3,275 |
| Deposits to and interest earned and retained for insurance escrow | <u>(2)</u> |
| Net cash provided by investing activities | <u>(42,671)</u> |
| Net increase (decrease) in cash | 40,736 |
| Cash at beginning of year | <u>111,135</u> |
| Cash at end of year | <u><u>\$ 151,871</u></u> |

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN
STATEMENT OF CASH FLOWS- PROPRIETARY FUND (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2012

**RECONCILIATION OF OPERATING INCOME TO
CASH FLOWS FROM OPERATING ACTIVITIES**

| | |
|---|--------------------------|
| Operating income | <u>\$ 117,995</u> |
| Adjustment to reconcile change in net assets to net cash provided by operating activities: | |
| Depreciation | 135,296 |
| (Increase) decrease in: | |
| Receivables | (419) |
| Miscellaneous prepaid expenses | (13) |
| Tenant security deposits | (1,139) |
| Increase (decrease) in: | |
| Accounts payable- 30 days | 6,806 |
| Payroll | (898) |
| Tenant security deposits | <u>292</u> |
| | <u>139,925</u> |
| Net cash provided by operating activities | <u><u>\$ 257,920</u></u> |

See accompanying notes to basic financial statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN**

NOTES TO THE BASIC FINANCIAL STATEMENTS

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Municipality of San Sebastián, Puerto Rico (Municipality) is a local governmental with full legislative, fiscal and administrative power to operate as a governmental under Law No. 81 of August 30, 1991, as amended, known as the *Autonomous Municipality Act of the Commonwealth of Puerto Rico (Law No. 81)*.

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

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

The accounting policies of the Municipality conform to accounting principles generally accepted in the United States of America as applicable to governmental units. The following is a summary of the more significant policies.

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

In June 1999, GASB issued Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments* (GASB No. 34). This statement established new financial reporting requirements for state and local governments. On July 1, 2003, the Municipality adopted the provisions of GASB No. 34 as well as other statements referred to below.

The accompanying basic financial statements present the financial position and the results of operations of the Municipality and its various funds and fund types. The basic financial statements are presented as of June 30, 2012, and for the fiscal year then ended. The more significant of these accounting policies are described below and, where appropriate, subsequent pronouncements will be referenced.

According to the financial reporting model established by GASB No. 34, the minimum required financial statement presentation applicable to the Municipality is composed of the following elements: (1) government-wide financial statements (GWFS), (2) governmental fund financial statements (GFFS), (3) notes to basic financial statements, and (4) required supplementary information (RSI).

The required supplementary information, which consists of a management discussion and analysis (MD&A), is information presented along with, but separate from, the Municipality's basic financial statements. The MD&A is a narrative report that introduces the accompanying basic financial statements and provides an analytical overview of the Municipality's financial activities for the year ended June 30, 2012, based on the Municipality's knowledge of the transactions, events and conditions reflected in the basic financial statements. The MD&A also highlights certain key fiscal policies that control the Municipality's operations.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN**

NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

As previously mentioned, on July 1, 2003, other statements and interpretations were also adopted in conjunction and simultaneously with GASB No. 34. Those statements and interpretations are: (1) GASB Statement No. 33 – *Accounting and Financial Reporting for Nonexchange Transactions*, (2) GASB Statement No. 37 – *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments: Omnibus*, (3) GASB Statement No. 38 – *Certain Financial Statement Note Disclosures* and (4) GASB Interpretation No. 6 – *Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements*.

GASB No. 34 also required that the accounting for all governmental activities reported in the GWFS be based on applicable pronouncements issued by the Financial Accounting Standards Board (FASB) and its predecessor bodies, such as the Accounting Principles Board (APB), issued on or before November 30, 1989, provided those pronouncements do not conflict with or contradict GASB pronouncements. Accordingly, in conjunction and simultaneously with the adoption of GASB No. 34, the Municipality also adopted the following pronouncements: (1) APB Opinion No. 20 – *Accounting Changes*, (2) APB Opinion No. 21 – *Interest on Receivables and Payables*, (3) FASB Statement No. 5 – *Accounting for Contingencies* and (4) FASB Statement No. 16 – *Prior Period Adjustments*. The Municipality has elected to not apply all statements and interpretations issued by FASB after November 30, 1989.

A. FINANCIAL REPORTING ENTITY

The accompanying basic financial statements include all departments and organizations units whose funds are under the custody and control of the Municipality. In evaluating the Municipality as a reporting entity, management has addressed all the potential component units. The decision to include any potential component unit in the reporting entity was made by applying the provisions of GASBS No. 14, *The Financial Reporting Entity*, as amended by GASB 39, *Determining Whether Certain Organizations are Component Units – an Amendment of GASB 14*.

The basic criteria for including a potential component unit within the reporting entity is if potential component units are financially accountable and other legally separate organizations for which the Municipality is not financially accountable but the nature and significance of their relationship with the Municipality may be such that exclusion of the financial statements from those of the Municipality would cause the accompanying basic financial statements to be misleading or incomplete. Accordingly, a legally separate organization would be reported as a component unit of the Municipality if all of the following criteria are met:

- The Mayor appoints a voting majority of an organization's governing body and, either (1) the Municipality has the ability to impose its will on that organization or (2) the organization has the potential to provide specific financial benefits to, or impose specific financial burdens on the Municipality.
- The economics resources, for which the Municipality is entitled, either received or held by the separate organization, are entirely or almost entirely for the direct benefit of the Municipality or its constituents.

The Municipality's management has concluded that based on the aforementioned criteria, there are no legally separate entities or organizations that should be reported as component units of the Municipality for the fiscal year ended June 30, 2012. Accordingly, these basic financial statements present only the Municipality as the reporting entity.

These financial statements present the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information of the Municipality, as of June 30, 2012, and the respective changes in financial position, where applicable, thereof for the fiscal year then ended.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN**

NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

B. MEASUREMENT FOCUS AND BASIS OF ACCOUNTING

GOVERNMENT-WIDE FINANCIAL STATEMENTS

The government-wide financial statements (the Statement of Net Assets and the Statement of Activities) are reported using the economic resources measurement focus and the accrual basis of accounting. Revenue is recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grant and similar items are recognized as revenue as soon as all eligibility requirements have been met.

GOVERNMENTAL FUND FINANCIAL STATEMENTS

The governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recorded when susceptible to accrual; as soon as it is both measurable and available. "Available" means collectible within the current period or soon enough thereafter, normally within sixty (60) days, to be used to pay liabilities of the current period. Expenditures are generally recognized when the related liability is incurred.

The exception to this general rule is the principal and interest on general obligation long-term debt and compensated absences, if any, are recognized when due.

In applying the "susceptible to accrual" concept to intergovernmental revenues (federal grants) pursuant to GASBS No. 33, *Accounting and Financial Reporting for Nonexchange Transactions* (the Municipality may act as either provider or recipient), the provider should recognize liabilities and expenses and the recipient should recognize receivables and revenue when the applicable eligibility requirements including time requirements, are met. Resources transmitted before the eligibility requirements are met should, under most circumstances, be reported as advances by the provider and deferred revenue by the recipient.

There are essentially two types of revenue. For some grants, funds must be expended by the Municipality on the specific purpose or project before any amounts will be reimbursed. Revenue is, therefore, recognized as expenditures are incurred to the extent available. For the other revenue, moneys are virtually unrestricted and are generally revocable only for failure to comply with prescribed compliance requirements. These resources are reflected as revenue at the time of receipt or earlier if the susceptible to accrual criteria is met.

Expenditures are generally recorded when a liability is incurred, as under accrual accounting. Modifications to the accrual basis of accounting include the following:

- ❖ Employee's vested annual vacation and sick leave is recorded as expenditure when utilized. The amount of accumulated annual vacation and sick leave unpaid at June 30, 2012, has been reported only in the government-wide financial statements.

C. FINANCIAL STATEMENT PRESENTATION

The basic financial statements include both government-wide (based on the Municipality as a whole) and fund financial statements. While the previous financial reporting model emphasized fund types (the total of all funds of a particular type), in the new financial model the focus is on either the Municipality as a whole, or major individual funds (within the basic financial statements). Both the government-wide and fund financial statements (within the basic financial statements) categorize primary activities as either governmental or business type.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN

NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

C. FINANCIAL STATEMENT PRESENTATION (CONTINUED)

GOVERNMENT-WIDE FINANCIAL STATEMENTS

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

The focus of the Statement of Net Assets is designed to be similar to bottom line results for the Municipality and its governmental activities. This statement, for the first time, combines and consolidates governmental fund's current financial resources (short-term expendable resources) with capital assets and long-term obligations.

The Statement of Net Assets presents the reporting entities' assets and liabilities, with the difference reported as net assets. Net assets are reported in three categories:

- ❖ **Invested in Capital Assets, Net of Related Debt** – These consists of capital assets, net of accumulated depreciation and amortization, and reduced by outstanding balances for bonds, notes, and other debt that are attributed to the acquisition, construction, or improvement of those assets.
- ❖ **Restricted Net Assets** – These results when constraints are placed on net assets use, which can be either externally imposed by creditors, grantors, contributors, and the like, or imposed by law through constitutional provisions or enabling legislation.
- ❖ **Unrestricted Net Assets** – These consists of net assets which do not meet the definition of the two preceding categories. Unrestricted net assets often are designated, to indicate that management does not consider them to be available for general operations. Unrestricted net assets often have constraints on resources that are imposed by management, but can be removed or modified.

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

The Statement of Activities is focused on both the gross and net costs per functional category. The statement reduces gross expenses (including depreciation) by related program revenues, operating and capital grants. This is intended to summarize and simplify the user's analysis of cost of various governmental services.

GOVERNMENTAL FUND FINANCIAL STATEMENTS

The fund financial statements (the Balance Sheet and the Statement of Revenues, Expenditures, and Changes in Fund Balances) are, in substance, very similar to the financial statements presented in the previous financial reporting model. Emphasis here is on the major funds in the governmental category. Non-major funds are summarized into a single column.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN

NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

C. FINANCIAL STATEMENT PRESENTATION (CONTINUED)

Traditional users of governmental financial statements will find the Fund Financial Statements presentation more familiar. The focus is on Major Funds, rather than the previous financial model's fund types. The Governmental Major Fund Statements are presented on current financial resources and modified accrual basis of accounting.

This is the manner in which these funds are normally budgeted. This presentation deemed most appropriate to (a) demonstrate legal and covenant compliance, (b) demonstrate the source and use of liquid resources, and (c) demonstrate how the Municipality's actual experience conforms to the budgeted fiscal plan.

Since the governmental fund statements are presented in a different measurement focus and basis of accounting than the government-wide statements, reconciliation is presented and a separate explanation for each differences.

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

The new model as defined in GASBS No. 34 established criteria (percentage of the assets, liabilities, revenues, or expenditures/expenses of either fund category in the governmental fund) for the determination of major funds. The non-major funds are combined in a single column in the fund financial statements. The Municipality reports the following major funds:

General Fund – This is the general operating fund of the Municipality. It is used to account for all financial resources, except those required to be accounted for in another fund.

State Assignment- Public Works and Transportation Fund – This is the fund used to account for the transactions of the State Assignments, which primarily objective, is the development of projects related to improvements and construction of streets and roads on the communities of the Municipality.

State Assignment- Recreational Facilities Fund – This is the fund used to account for the transactions of the State Assignments, which primarily objective, is the development of construction projects related to the recreational facilities of the Municipality.

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

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

Loans Fund – This is the fund used to account for all financial resources and transactions related to the loans for construction purposes and capital outlays of the Municipality, which is financed by loans from the Government Development Bank of Puerto Rico.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN

NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

D. FINANCIAL REPORTING PRESENTATION

The accounts of the Municipality are organized on the basis of funds, each of which is considered a separate accounting entity. The operations of each fund are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues, and expenditures. Fund types are as follows:

General Fund– Is the general operating fund of the Municipality. It is used to account for all governmental activity, except those required to be accounted for in another fund.

Special Revenue Fund–This is the fund used to account for revenues derived from local funds, state grants or other restricted revenue sources. The uses and limitations of each special revenue fund are specified by Municipality ordinances or state statutes.

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

Capital Projects Fund – This is the fund used to account for financial resources used for the acquisition or construction of major capital facilities. The uses and limitations of each capital projects fund are specified by Municipality ordinances or state statutes.

E. FUND BALANCES

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

Pursuant to the provisions of GASB 54, the fund balances amounts are reported as nonspendable, restricted, committed, assigned and unassigned, based on the relative strength of the constraints that control how specific amounts can be spent, as described as follows:

- ❖ **Nonspendable** – Represent resources that cannot be spent readily with cash or are legally or contractually required not to be spent, including but not limited to inventories, prepaid items, long-term balances of loans and notes receivable.
- ❖ **Restricted** – Represent resources that can be spent only for the specific purposes stipulated by constitutional provisions, external resource providers (externally imposed by creditors or grantors), or through enabling legislation (that is, legislation that creates a new revenue source and restricts its use). Effectively, restrictions may be changed or lifted only with the consent of resource providers.
- ❖ **Committed** – Represent resources used for specific purposes, imposed by formal action of the entity's highest level of decision making authority (Municipal Legislature through resolutions and ordinances) and can only be changed by similar law, ordinance or resolution, no later than the end of the fiscal year.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN

NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

E. FUND BALANCES (CONTINUED)

- ❖ **Assigned** – Represent resources intended to be used by the Municipality for specific purposes but do not meet the criteria to be classified as restricted or committed (generally executive orders approved by the Mayor). Intent can be expressed by the Municipal Legislature, the Mayor or by an official or body to which the Municipal Legislature delegates authority in conformity with Autonomous Municipalities Act of Puerto Rico, as amended. In governmental funds other than the general fund, assigned fund balance represents the remaining amount that is not restricted or committed.
- ❖ **Unassigned** – Represent the residual classification for the Municipality's general fund and includes all spendable amounts not contained in the other classifications. In other funds, the unassigned classification is used only to report a deficit balance resulting from overspending for specific purposes for which amounts had been restricted, committed, or assigned.

At June 30, 2012, the accompanying fund financial statements reported fund balances as restricted, assigned and unassigned.

F. BUDGETARY DATA

The Municipality annually adopts the Budget Resolution for all operating funds of the Municipality except for certain restricted accounts of Proprietary Funds and Special Revenue Funds. Budgetary control is legally maintained at the fund level. The budget is prepared using the modified accrual basis of accounting with encumbrance included as budgetary basis expenditures. The Municipality's Budget Resolution provides transfer authority (1) to the Mayor and the Management and Budget Director, within and between departments and funds, as long as the total budget of the Municipality (net of interfund transfers) is not increased; (2) to the Management and Budget Director to implement grant budgets as the grant applications are accepted by the Municipality; and (3) to the Management and Budget Director to amend (re-appropriate) each new year's budget, to the extent of outstanding encumbrances, and/or unexpended project/grant appropriations at year end. Municipality's Legislature action is required for (1) use of the budgeted Legislature contingency, and (2) the approval of supplemental appropriations. During the year, several supplemental appropriations were necessary.

The budget columns (original and final budgets) of the Budgetary Comparison – General Fund reflect the original budget and the amended budget (which have been adjusted for legally authorized revisions of the annual budgets during the year). Appropriations, except remaining project appropriations, encumbrances, and unexpended grant appropriations, lapse at the end of each fiscal year.

Amendments to the budget, including transfers, require the approval of the Municipal Legislature. Unencumbered appropriations lapse at the end of the next fiscal year. The Municipality follows these procedures, in accordance with law, in order to establish the budgetary data reflected in the basic financial statements:

1. Prior of May 31 of each fiscal year, the Mayor submits to the Municipal Legislature a proposed budget for the fiscal year commencing the following July 1 in addition of a budget message;

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN**

NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

F. BUDGETARY DATA (CONTINUED)

2. The budget document is available for public inspection prior to its approval by the Municipal Legislature;
3. The Commissioner of Municipal Affairs examines the budget to verify if it complied with the law's standards and sends it to the Mayor for any comments or recommendation before the limited date establishes by the Law;
4. Prior to June 13, the annual budget is legally enacted through passage of the annual appropriation ordinance;
5. If a budget is not adopted prior to the end of the end of the fiscal year, the annual budget for the preceding fiscal year, as approved by the Municipal Legislature and the Mayor, is automatically renewed for the ensuing fiscal year until a new budget is approved. This permits the Municipality to continue making payments for its operating and other expenses until the new budget is approved;
6. Subsequent to the enactment of the annual appropriation ordinance, the Municipal Legislature has the authority to make necessary amendments made during the fiscal year and are reflected in the budget information included in the Budgetary Comparison Schedule – General Fund;
7. Budgetary data for the Special Revenue Fund has not been presented in the accompanying basic financial statements as such funds are budgeted over the life of the respective grant or project and not on an annual basis.

Since the budgetary basis differs from accounting principles generally accepted in the United States of America (GAAP), actual amounts for the General Fund in the accompanying Budgetary Comparison Schedule, is presented on the budgetary basis to enhance comparability.

The principal differences between the budgetary and GAAP bases are the following:

1. Encumbrances are recorded as expenditures under the budgetary basis and as a reserve of fund balances under GAAP.
2. The non-exonerated portion of the property tax advances are presented as revenue in the budgetary basis and as other financing sources under GAAP.
3. Interfund transactions of the General and Special Revenue Funds are not included in the budgetary basis.
4. Certain accrued liabilities and other debts are not included in the budgetary basis.
5. Certain revenues susceptible to accrual, i.e., both measurable and available, are not included in the budgetary data.

All encumbrance appropriations in the operating budget lapse at the end of the fiscal year. Property taxes collected during the current year by the Municipal Revenue Collection Center (Fiscal Agent) are presented as revenues in the accounting basis but are not considered in the budgetary schedule.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN**

NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

F. BUDGETARY DATA (CONTINUED)

The special funds of the Special Revenue Fund have not been included in the budgetary comparison because balances are not budgeted. Also, the budget prepared for the Federal Finance Awards Programs included in the Major and Non Major Funds is based on a program period which is not necessarily a year. Accordingly, it's not practical to present an annual comparison of budget for such programs.

G. CASH, CASH EQUIVALENT AND INVESTMENT

The Finance Director of the Municipality is responsible for investing the available resources in certificates of deposit and other short-term investments. Investments are made from the available combined funds of the Municipality and, accordingly, it is not practical to disclose certificates of deposit and other short-term investments individually by fund in the combined financial statements. Interest earned on certificates of deposit and other short-term investments are recognized as revenue in the General Fund. Cash in the Special Revenue, Debt Service and Capital Project Funds are restricted; accordingly, resources available were not used for pool investments.

Under the laws and regulations of the Commonwealth, public funds deposited by the Municipality in commercial banks must be fully collateralized for the amounts deposited in excess of the federal depository insurance generally provided by the Federal Deposit Insurance Corporation (FDIC). All securities pledged as collateral are held by agents designated by the Commonwealth's Secretary of the Treasury, but not in the Municipality's name.

Cash with fiscal agent represents property tax collections retained by the Municipal Revenues Collection Center and undisbursed proceeds of certain bonds, loans or grants which are maintained in a cash custodian account by the Government Development Bank of the Commonwealth of Puerto Rico.

Cash balance recognized in the Debt Service Fund is restricted for the payment of the Municipality's obligations, and others are restricted for specific projects, such as the acquisition or construction of permanent improvements. The sinking fund is maintained by the Governmental Development Bank of Puerto Rico, agency which acts as the insurer and payer of the Municipality's bonds and notes issued in accordance with law.

H. RECEIVABLES

Receivable are stated net of estimated allowances for uncollectible accounts, which are determined upon past collection experience and current economic conditions. Receivable from Federal Government represents amounts owed to the Municipality for reimbursement of expenditures incurred pursuant to federally funded programs.

I. INVENTORIES

The General, Special Revenue and Capital Project Funds, purchases office and printing supplies, gasoline, oil and other expendable supplies held for consumption. The cost of purchases is recorded as expenditure in the appropriate fund and the inventory is not recorded in the basic financial statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN**

NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

J. CAPITAL ASSETS

Property, plant and equipment purchased or acquired is carried at historical cost or estimated historical cost. Contributed assets are recorded at fair market value as of the date received. Other costs incurred for repairs and maintenance is expensed as incurred.

Depreciation on all assets is provided on the straight-line basis over the following estimated useful lives:

| Capital Assets | Years |
|-------------------------------------|--------------|
| Buildings and building improvements | 20-50 |
| Infrastructure | 25-50 |
| Vehicles and equipment | 5-20 |
| Furniture and fixtures | 5-10 |

K. LONG-TERM OBLIGATIONS

The liabilities reported in the government-wide financial statements included general and special obligation bonds and notes, and other long-term liabilities, such as vacation, sick leave, litigation, long-term liabilities to other governmental entities.

In the fund financial statements, governmental fund types recognize bond issuances cost, during the current period. The face amount of debt issued is reported as other financing sources, while bond issuance costs, whether or not withheld from the actual debt proceeds received, are reported as expenditures.

L. COMPENSATED ABSENCES

The Municipality accrues accumulated unpaid vacation and sick leave and associated employee-related costs when earned (or estimated to be earned) by the employee. The Municipality's employees are granted 30 days of vacations and 18 days of sick leave annually. Vacations may be accumulated up to a maximum of sixty (60) days and sick leave up to a maximum of ninety (90) days. In the event of employee resignation, the employee is paid for accumulated vacation days up to the maximum allowed. Separation from employment prior to use of all or part of the sick leave terminates all rights for compensation, except for employees with ten years of service who are entitled to sick leave pay up to the maximum allowed. The Municipality accrued a liability for compensated absences, which meet the following criteria:

1. The Municipality's obligation relating to employee's rights to receive compensation for future absences is attributable to employee's services already rendered.
2. The obligation relates to rights that vest or accumulate.
3. Payment of the compensation is probable.
4. The amount can be reasonably estimated.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN**

NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

L. COMPENSATED ABSENCES (CONTINUED)

In accordance with the above criteria and requirements as established by GASBS No. 16; the Municipality has accrued a liability for compensated absences, which has been earned but not taken by Municipality's employees. For the government-wide statements, the current portion is the amount estimated to be used in the following year. For the governmental funds statements, all of the compensated absences are considered long-term and therefore, are not a fund liability and represents a reconciling item between the fund level and government-wide presentations.

The following is a summary of changes in the balance of Compensated Absences for the fiscal year ended June 30, 2012.

| <u>BALANCE JUNE 30, 2011</u> | <u>NEW ISSUES</u> | <u>RETIREMENTS AND CURRENT MATURATES</u> | <u>BALANCE JUNE 30, 2012</u> | <u>CURRENT PORTION</u> | <u>LONG-TERM PORTION</u> |
|----------------------------------|-------------------|--|----------------------------------|----------------------------|------------------------------|
| \$ 2,630,652 | \$ 97,261 | \$ - | \$ 2,727,913 | \$ 204,696 | \$ 2,523,217 |

M. INSURANCE

The Municipality has insurance coverage for its public facilities, primarily to provide protection from catastrophic losses. Also, principal officials of the Municipality are covered under various surety bonds. The Secretary of the Treasury Department of the Commonwealth of Puerto Rico is the agent commissioned to place all of the Municipality's insurance coverage. Corresponding premiums payable are withheld by the MunicipalRevenueCollectionCenter from quarterly advances of annual property tax and subsidy send to the Municipality.

N. INTERFUND TRANSACTIONS

Interfund transactions are reflected as loans, reimbursements or transfers. Loans are reported as receivables and payables as appropriate and are subject to elimination upon consolidation. Reimbursements occur when one fund incurs a cost, charges the appropriate benefiting fund and reduces its related cost as a reimbursement. All other interfund transactions are treated as transfers. Transfers between governmental or proprietary funds are netted as part of the reconciliation to the government-wide columnar presentation. The Municipality has the following types of reciprocal and nonreciprocal interfund activities:

- ❖ **Interfund loans** – Represent amounts provided with a requirement for repayment, which are recorded as “due from” in the lender governmental fund and “due to” in the borrower governmental fund. Interfund receivables, which are not considered currently available financial resources, are reported as advances. For amounts not expected to be collected within a reasonable period, interfund receivables/payables are reduced to the estimated realizable value and the amount that is not expected to be repaid is reported as a transfer from the governmental fund that made the loan.
- ❖ **Interfund transfers** – Represent flows of assets (permanent reallocation of financial resources among governmental funds) without equivalent flows of assets in return and without a requirement for repayment. Transfers are reported as other financing uses in the governmental fund making transfers and as other financing sources in the governmental fund receiving transfers.
- ❖ **Interfund reimbursements** – Represent repayments from the governmental fund responsible for particular expenditures or expenses to the governmental fund that initially paid for them.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN**

NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

O. CLAIMS AND JUDGMENTS

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

P. USE OF ESTIMATES

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

Q. ACCOUNTING FOR PENSION COSTS

For the purpose of applying the requirements of GASB Statement No. 27, *Accounting for Pensions by State and Local Government Employers* (GASB No. 27), amended by GASB Statement No. 50, *Pension Disclosures*. The Municipality accounts for pension costs from the standpoint of a participant in a multiple-employer cost-sharing plan. Accordingly pension costs recognized in the accompanying basic financial statements are equal to the statutorily required contributions, with a liability recorded for any unpaid required contributions. The state government of the Commonwealth of Puerto Rico is considered to be the sponsor of the Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS) and System 2000, a multi-employer cost-sharing defined benefit pension plan and a hybrid defined contribution plan, respectively, in which the employees of the Municipality participate. The Municipality is considered a participant and not a sponsor, of these retirement systems since the majority of the participants in the aforementioned pension trust funds are employees of the Commonwealth of Puerto Rico and the basic financial statements of such retirement systems are part of the financial reporting entity of the Commonwealth of Puerto Rico. Accordingly, no portion of the net pension obligation (NPO) related to ERS has been allocated to the Municipality in the accompanying basic financial statements. The basic financial statements of the Commonwealth of Puerto Rico report the total amount of the net pension obligation of ERS, including any amount that may correspond to the Municipality.

The Municipality accounts for pension costs from the standpoint of a participant in a multiple-employer cost-sharing plan. Accordingly, pension costs recognized in the accompanying basic financial statements are equal to the statutorily required contributions, with a liability recorded for any unpaid required contributions.

R. RISK FINANCING

The Municipality carries commercial insurance to cover casualty, theft, tort claims and other losses. Insurance policies are negotiated by the Puerto Rico Treasury Department and costs are allocated among all the Municipalities of Puerto Rico.

Cost of insurance allocated to the Municipality and deducted from the gross property tax collections by the Municipal Revenue Collection Center ("CRIM") for the year ended June 30, 2012 amounted to \$383,905. The current insurance policies have not been cancelled or terminated. The CRIM also deducted \$322,902 for workers compensation insurance covering all municipal employees.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN**

NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

S. FUTURE ADOPTION OF ACCOUNTING PRONOUNCEMENTS

The GASB has issued the following accounting standards that have effective dates after June 30, 2011:

- ❖ GASB Statement No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*. This Statement is effective for periods beginning after June 30, 2012;
- ❖ GASB Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*. This statement is effective for periods beginning after December 31, 2012;
- ❖ GASB Statement No. 61, *The Financial Reporting Entity: Omnibus- an amendment of GASB Statements No. 14 and No. 34*. This statement is effective for periods beginning after June 30, 2013;
- ❖ GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre- November 30, 1989 FASB and AICPA Pronouncements*. This statement is effective for periods beginning after December 31, 2012;
- ❖ GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources and Net Position*. This statement is effective for periods beginning after December 31, 2012;
- ❖ GASB Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions (an amendment of GASB Statement No. 53)*. This statement is effective for periods beginning after June 30, 2013;

The Authority's management has concluded that the future adoption of these GASB Statements will not have a significant impact on the Authority's basic financial statements.

NOTE 2– CASH AND CASH EQUIVALENTS

The Municipality maintains its deposits in various commercial banks located in Puerto Rico and Government Development Bank for Puerto Rico (GDB). Proceeds from bonds and funds related to certain grant awards are required by law to be held with GDB.

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN

NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)

NOTE 2 – CASH AND CASH EQUIVALENTS (CONTINUED)

Credit risk – This is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. In compliance with the laws and regulations of the Commonwealth, the Municipality has adopted, as its custodial and credit risk policy, the *Statement of Investment Guidelines for the Government of the Commonwealth of Puerto Rico*. Accordingly the Municipality invests 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 GDB. According to the aforementioned investment guidelines, the Municipality does not invest in marketable securities or any types of investments for which credit risk exposure may be significant. Therefore, the Municipality's management has concluded that the risk related to any possible loss related to defaults by commercial banks on the Municipality's deposits is considered low at June 30, 2012.

Interest rate risk – This is the risk that changes in interest rates of debt investments will adversely affect the fair value of an investment. The Municipality manages its exposure to declines in fair values by: (1) not including debt investments in its investment portfolio at June 30, 2011, (2) limiting the weighted average maturity of its investments to three months or less, and (3) keeping most of its bank deposits in interests bearing accounts generating interests at prevailing market rates. At June 30, 2012, the Municipality's investments in certificates of deposits are recorded at cost, which approximates their fair value. Therefore, the Municipality's management has concluded that at June 30, 2012, the interest rate risk associated with the Municipality's cash and cash equivalents is considered low.

Custodial credit risk – In the case of deposits, this is the risk that in the event of a bank failure, the Municipality's deposits may not be recovered. Pursuant to the *Statement of Investment Guidelines for the Government of the Commonwealth of Puerto Rico* the balances deposited in commercial banks by the Municipality are insured by the Federal Deposit Insurance Corporation (FDIC) generally up to a maximum of \$250,000 per depositor. In addition, public funds deposited in commercial banks by the Municipality are fully securities pledged as collateral are held, in the Municipality's name, by the agents of the Commonwealth's Secretary of Treasury. Deposits with GDB are uninsured and uncollateralized. However, no losses related to defaults by GDB on deposit transactions have been incurred by the Municipality through June 30, 2012. Therefore, the Municipality's management has concluded that at June 30, 2012 the custodial credit risk associated with the Municipality's cash and cash equivalents is considered low.

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

The Municipality's bank balances in commercial banks of \$5,263,581 in the General Fund, \$248,316 in the State Assignment- Public Works and Transportation Fund, \$2,672,510 in the State Assignment- Recreational Facilities Fund, \$2,616 in the Head Start Fund and \$3,731,369 in other governmental funds, were fully collateralized at June 30, 2012. The deposits at GDB of \$3,923,623 in the Debt Service Fund and \$3,679,773 in the Loans Fund are unsecured and uncollateralized, as no collateral is required to be carried by governmental banks.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN**

NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)

NOTE 3 – RECEIVABLES

A. SALES AND USE TAXES RECEIVABLES

As described below in Note 15, the Municipal Legislature approved the imposition of the municipal sales and use tax during fiscal year 2006-2007. Individuals, organizations and entities subject to collect the municipal sales and use tax must file a tax return to the Municipality. Tax is due each 20th day of each month based on tax collected in the preceding month. Therefore, sales tax receivable of \$67,221 and \$173,720 in the Debt Service Fund and in the governmental funds, respectively, represents the amounts due by the taxpayers at June 30, 2012.

B. PROPERTY TAXES RECEIVABLES

Property taxes receivable amounting to \$308,142 in the General Fund represents the final liquidation of the property taxes of the fiscal year 2011-2012, not collected by the Municipality at June 30, 2012. Property taxes receivable in the amount of \$22,692 in the Debt Service Fund represents advances from fiscal year 2011-2012, not collected by the Municipality at June 30, 2012.

C. INTERGOVERNMENTAL RECEIVABLES

State government receivable in the other governmental funds represents expenditures incurred, not yet reimbursed by the state agencies. Following is a detail of the state government receivable:

| <u>Description</u> | <u>Amount</u> |
|--|--------------------------|
| Puerto Rico Electric Power Authority | \$667,364 |
| State Department Work and Transportation | 182,558 |
| State Department of Labor- Law 52 | <u>93,805</u> |
| Total | <u>\$ 943,727</u> |

D. FEDERAL GRANTS RECEIVABLE

Federal grants receivable in the governmental funds represent expenditures incurred, not yet reimbursed by the federal agencies or the pass-through grantors. Following is a detail of the federal grants receivable:

| <u>Program Description</u> | <u>Amount</u> |
|---|--------------------------|
| Head Start | \$ 20,449 |
| Public & Indian Housing | 10,350 |
| Community Development Block Grant | 137,516 |
| Child Care & Development Block Grant | 18,121 |
| Homelessness Prevention and Rapid Re-housing (HPRP) | 1,764 |
| Others | <u>12,585</u> |
| Total | <u>\$ 200,785</u> |

E. OTHERS ACCOUNTS RECEIVABLE

At June 30, 2012, the Municipality maintained in the General Fund other miscellaneous receivables amounting to \$2,167. In addition, the Head Start Fund and the other governmental funds maintained miscellaneous receivables amounting to \$808 and \$4,863, respectively.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN**

NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)

NOTE 4 – DUE FROM / TO OTHER FUNDS

Interfund receivables and payables at June 30, 2012 are summarized as follows:

| Receivable Fund | Payable Fund | Purpose | Amount |
|--------------------------|--------------------------|--|--------------------------|
| General Fund | Head Start Fund | Payroll and related accruals paid and not reimbursed | \$528 |
| General Fund | Loans Fund | Payroll and related accruals paid and not reimbursed | 30,101 |
| General Fund | Other Governmental Funds | Payroll and related accruals paid and not reimbursed | 537,125 |
| Other Governmental Funds | General Fund | Cash pool in the same bank account | <u>246,392</u> |
| Total | | | <u>\$ 814,146</u> |

NOTE 5 – CAPITAL ASSETS

A summary of capital assets and changes occurring in 2012 for the Municipality was as follows:

| Governmental Activities | Balance July 1, 2011 (as restated) | Additions | Retirements / Reclassifications | Balance June 30, 2012 |
|--|--|----------------------------|------------------------------------|-----------------------------|
| Capital asset, not being depreciated: | | | | |
| Land | \$ 5,737,776 | \$ - | \$ - | \$ 5,737,776 |
| Construction in progress | <u>3,700,666</u> | <u>3,932,040</u> | <u>(2,336,924)</u> | <u>5,295,782</u> |
| Total capital assets not being depreciated | <u>9,438,442</u> | <u>3,932,040</u> | <u>(2,336,924)</u> | <u>11,033,558</u> |
| Capital assets, being depreciated: | | | | |
| Buildings and building improvements | 36,431,283 | 9,000 | 2,336,924 | 38,777,207 |
| Furniture and fixtures | 2,760,948 | 216,594 | (97,105) | 2,880,437 |
| Vehicles and equipment | 6,469,669 | 137,025 | - | 6,606,694 |
| Infrastructure | <u>13,059,588</u> | <u>836,850</u> | - | <u>13,896,438</u> |
| Total capital assets being depreciated | <u>58,721,488</u> | <u>1,199,469</u> | <u>2,239,819</u> | <u>62,160,776</u> |
| Less accumulated depreciation for: | | | | |
| Buildings and building improvements | (8,506,670) | (954,532) | - | (9,461,202) |
| Furniture and fixtures | (2,174,036) | (256,959) | 87,168 | (2,343,827) |
| Vehicles and equipment | (5,318,653) | (394,680) | - | (5,713,333) |
| Infrastructure | <u>(1,329,721)</u> | <u>(277,929)</u> | - | <u>(1,607,650)</u> |
| Total accumulated depreciation | <u>(17,329,080)</u> | <u>(1,884,100)</u> | <u>87,168</u> | <u>(19,126,012)</u> |
| Total capital assets being depreciated, net | <u>41,392,408</u> | <u>(684,631)</u> | <u>2,326,987</u> | <u>43,034,764</u> |
| Governmental activities capital assets, net | <u>\$ 50,830,850</u> | <u>\$ 3,247,409</u> | <u>\$ (9,937)</u> | <u>\$ 54,068,322</u> |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN**

NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)

NOTE 5 – CAPITAL ASSETS (CONTINUED)

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

| <u>Governmental activities</u> | <u>Amount</u> |
|------------------------------------|----------------------------|
| General Government | \$ 117,003 |
| Public Safety | 59,669 |
| Public Works | 659,417 |
| Culture | 265,773 |
| Recreation | 569,052 |
| Health and Welfare | 213,186 |
| Total depreciation expenses | <u>\$ 1,884,100</u> |

A summary of capital assets and changes occurring in 2012 for Villa Soigal Project was as follows:

| <u>Business-type Activities</u> | <u>Balance July 1, 2011</u> | <u>Additions</u> | <u>Retirements / Reclassifications</u> | <u>Balance June 30, 2012</u> |
|--|---------------------------------|----------------------------|--|----------------------------------|
| Capital asset, not being depreciated: | | | | |
| Land | \$ 58,350 | \$ - | \$ - | \$ 58,350 |
| Total capital assets not being depreciated | <u>58,350</u> | <u>-</u> | <u>-</u> | <u>58,350</u> |
| Capital assets, being depreciated: | | | | |
| Land improvements | 739,624 | - | - | 739,624 |
| Building and building improvements | 3,655,370 | - | - | 3,655,372 |
| Building equipment | 496,870 | 15,378 | - | 512,248 |
| Furniture and fixtures | 33,584 | - | - | 33,584 |
| Equipment | 12,703 | - | - | 12,703 |
| Total capital assets being depreciated | <u>4,938,151</u> | <u>15,378</u> | <u>-</u> | <u>4,953,529</u> |
| Less accumulated depreciation for: | | | | |
| Land improvements | (542,391) | (18,491) | - | (560,882) |
| Building and building improvements | (2,824,467) | (81,572) | - | (2,906,039) |
| Building equipment | (197,748) | (34,378) | - | (232,126) |
| Furniture and fixtures | (32,689) | (294) | - | (32,983) |
| Equipment | (11,414) | (561) | - | (11,975) |
| Total accumulated depreciation | <u>(3,608,709)</u> | <u>(135,296)</u> | <u>-</u> | <u>(3,744,055)</u> |
| Total capital assets being depreciated, net | <u>1,329,442</u> | <u>(119,918)</u> | <u>-</u> | <u>1,209,524</u> |
| Governmental activities capital assets, net | <u>\$ 1,387,792</u> | <u>\$ (119,918)</u> | <u>\$ -</u> | <u>\$ 1,267,874</u> |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN**

NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)

NOTE 6 – ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities in governmental fund financial statements represent expenditures incurred during fiscal year 2011-2012, and not paid by the Municipality at June 30, 2012. Following is a detail of these accounts payable and accrued liabilities by major fund:

| Major Governmental Funds | Accounts Payable | Accrued Liabilities | Total |
|-------------------------------------|----------------------------|----------------------------|----------------------------|
| General Fund | \$ 333,774 | \$90,442 | \$ 424,216 |
| State Assignment- Public Works Fund | 430,874 | - | 430,874 |
| Head Start Fund | 23,345 | - | 23,345 |
| Loans Fund | 251,718 | - | 251,718 |
| Other Governmental Funds | <u>758,804</u> | - | <u>758,804</u> |
| Total | <u>\$ 1,798,515</u> | <u>\$90,442</u> | <u>\$ 1,888,957</u> |

NOTE 7 – BONDS AND NOTES PAYABLE

As described below in Note 10, the Municipality issues general and special obligation bonds and notes, principally, to provide funds for the acquisition and construction of major capital facilities, to pay debt incurred in prior years, and to cover the expenditures of a special event. At June 30, 2012, the government-wide and fund financial statements presented the following accounts payable, regarding to the outstanding balance of these bonds and notes:

| Description | Amount |
|--------------------|----------------------------|
| Principal | \$ 1,025,000 |
| Accrued interests | <u>413,425</u> |
| Total | <u>\$ 1,438,425</u> |

NOTE8 – DUE TO OTHER GOVERNMENTAL UNITS

As of June 30, 2012, balance due to other governmental units consists of the following:

| Governmental Agency | Amount |
|---|----------------------------|
| Puerto Rico Electric Power Authority | \$ 667,364 |
| General Service Administration | 2,514 |
| Puerto Rico Water and Sewer Authority | 89,927 |
| Municipal Revenue Collection Center | 58,576 |
| Retirement System Administration | 71,387 |
| Retirement System Administration- Special Laws | 1,417,431 |
| Puerto Rico Department of Treasury | 3,565 |
| Puerto Rico Department of Labor | 5,060 |
| Internal Revenue Service | <u>47,310</u> |
| Total | <u>\$ 2,363,134</u> |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN**

NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)

NOTE 9 – DEFERRED REVENUES

- A. Municipal license taxes** – The deferred revenues of \$1,374,679 in the General Fund relates to volume of business tax collected in fiscal year 2010-2011 that will be earned in fiscal year 2012-2013.
- B. Federal Grants** – The deferred revenues presented in the other governmental funds represents the portion of federal grants received for which qualifying expenditures have not been incurred. Deferred revenues from the federal government are as follows:

| <u>Program Description</u> | <u>Amount</u> |
|---------------------------------|--------------------------|
| Child & Adult Care Food Program | \$13,471 |
| Public Assistance Grants | 152,796 |
| Others | <u>3,778</u> |
| Total | <u>\$ 170,045</u> |

- C. Others** – The deferred revenues of property taxes amounting to \$308,142 in the General Fund represents the final liquidation of the property taxes of the fiscal year 2011-2012, not collected by the Municipality at June 30, 2012.

NOTE 10 – GENERAL LONG-TERM DEBTS

Long-term liability activity for the year ended on June 30, 2012, was as follows:

Governmental Activities

| <u>Description</u> | <u>Beginning Balance (as restated)</u> | <u>Borrowings or Additions</u> | <u>Payments or Deductions</u> | <u>Ending Balance</u> | <u>Due Within One Year</u> |
|--|--|------------------------------------|-----------------------------------|-----------------------------|--------------------------------|
| Bonds and Notes Payable | \$ 19,272,000 | \$ - | \$ (2,115,000) | \$ 17,157,000 | \$ 1,210,000 |
| Property Tax Debt – Law 42 | 959,098 | - | (22,264) | 936,834 | 23,663 |
| Property Tax Debt – Law 146 | 158,921 | - | (7,567) | 151,354 | 7,568 |
| LIMS Repayment Plan | 32,272 | - | (32,272) | - | - |
| Estimated landfill closure and post-closure care cost | 246,590 | - | (15,492) | 231,098 | 16,267 |
| Compensated absences | 2,630,652 | 97,261 | - | 2,727,913 | 204,696 |
| Claims and Judgments | 1,800,000 | - | - | 1,800,000 | - |
| Health Insurance Administration | <u>256,266</u> | - | - | <u>256,266</u> | - |
| Total | <u>\$ 25,355,799</u> | <u>\$ 97,261</u> | <u>\$ (2,192,595)</u> | <u>\$ 23,260,465</u> | <u>\$ 1,462,194</u> |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN**

NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)

NOTE 10 – GENERAL LONG-TERM DEBTS (CONTINUED)

Business-type Activities

| Description | Beginning Balance | Borrowings or Additions | Payments or Deductions | Ending Balance | Due Within One Year |
|--|-------------------|-------------------------|------------------------|-------------------|---------------------|
| <u>Business-type Activities</u> | | | | | |
| Villa Soigal Project Mortgage | \$ 956,112 | \$ - | \$ (98,403) | \$ 857,709 | \$ 99,196 |
| Total | \$ 956,112 | \$ - | \$ (98,403) | \$ 857,709 | \$ 99,196 |

A. GENERAL OBLIGATIONS BONDS AND NOTES PAYABLE

The Municipality issues general and special obligation bonds and notes, principally, to provide funds for the acquisition and construction of major capital facilities, to pay debt incurred in prior years, and to cover the expenditures of a special event. Bonds and notes payables as of June 30, 2012, are comprised of the following individual issues:

| DESCRIPTION | AMOUNT |
|--|--------------|
| \$3,420,000, Series 1996, for construction purposes, payable in annual installments ranging from \$70,000 to \$315,000, excluding variable interest from 4.70% to 6.58%, through January 1, 2016 | \$ 1,130,000 |
| \$1,010,000, Series 1996, for construction purposes, payable in annual installments ranging from \$20,000 to \$95,000, excluding variable interest from 4.70 to 6.58%, through January 1, 2015 | 265,000 |
| \$1,800,000, Series 1997, for construction purposes, payable in installments ranging from \$20,000 to \$165,000, excluding variable interest from 4.87% to 6.56%, through July 1, 2021 | 1,110,000 |
| \$1,510,000, Series 2001, for construction purposes, payable in annual installments ranging from \$20,000 to \$135,000, excluding variable interest from 2.70% to 5.60%, through July 1, 2026 | 1,165,000 |
| \$1,110,000, Series 2005, for construction purposes, payable in annual installments ranging from \$50,000 to \$105,000, excluding variable interest from 3.28% to 4.80%, through January 1, 2019 | 620,000 |
| \$1,150,000, Series 2007, for construction purposes, payable in annual installments ranging from \$20,000 to \$95,000, excluding variable interest from 1.53% to 7.00%, through July 1, 2031 | 1,020,000 |
| \$485,000, Series 2007, for construction purposes, payable in annual installments ranging from \$30,000 to \$65,000, excluding variable interest from 1.53% to 7.00%, through July 1, 2016 | 235,000 |
| \$670,000, Series 2007, for construction purposes, payable in annual installments ranging from \$75,000 to \$120,000, excluding variable interest from 1.53% to 6.00%, through July 1, 2013 | 120,000 |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN**

NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)

A. GENERAL OBLIGATIONS BONDS AND NOTES PAYABLE (CONTINUED)

| DESCRIPTION | AMOUNT |
|---|-----------------------------|
| \$967,000, Series 2008, for construction purposes, payable in annual installments ranging from \$80,000 to \$ 142,000, excluding variable interest from 1.43% to 6.00%, through July 1, 2017 | 612,000 |
| \$3,445,000, Series 2008, for construction purposes, payable in annual installments ranging from \$50,000 to \$295,000, excluding variable interest from 1.53% to 7.50%, through July 1, 2032 | 3,215,000 |
| \$660,000, Series 2010, for construction purposes, payable in annual installments ranging from \$75,000 to \$120,000, excluding variable interest from 6.00% to 7.00%, through July 1, 2016 | 420,000 |
| \$990,000, Series 2010, for construction purposes, payable in annual installments ranging from \$10,000 to \$80,000, excluding variable interest from 6.00 to 7.00%, through July 1, 2034 | 945,000 |
| \$1,510,000, Series 2010, for construction purposes, payable in annual installments ranging from \$20,000 to \$130,000, excluding variable interest from 6.00% to 7.50%, through July 1, 2034 | 1,440,000 |
| \$605,000, Series 2010, for construction purposes, payable in annual installments ranging from \$5,000 to \$50,000, excluding variable interest from 6.00% to 7.50%, through July 1, 2034 | 580,000 |
| \$1,510,000, Series 2010, for construction purposes, payable in annual installments ranging from \$25,000 to \$120,000, excluding variable interest from 4.75% to 6.75%, through July 1, 2034 | 1,430,000 |
| \$2,770,000, Series 2011, for construction purposes, payable in annual installments ranging from \$60,000 to \$255,000, excluding variable interest from 6.00% to 7.50%, through July 1, 2030 | 2,640,000 |
| \$275,000, Series 2011, for operational purposes, payable in annual installments ranging from \$30,000 to \$50,000, excluding variable interest from 6.00 to 7.50%, through July 1, 2017 | <u>210,000</u> |
| Total General Obligations | <u>\$ 17,157,000</u> |

These bonds and notes are payable with the following Municipality's resources:

- ❖ Special ad valorem property tax, which is restricted for debt service and retained by the Government Development Bank for Puerto Rico for such purposes;
- ❖ Municipal sales taxes resources restricted for debt service, and;
- ❖ Operational resources.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN**

NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)

NOTE 10 – GENERAL LONG-TERM DEBTS (CONTINUED)

A. GENERAL OBLIGATIONS BONDS AND NOTES PAYABLE (CONTINUED)

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

| Year Ending June 30, | Principal payment | Interest payment | Total |
|-------------------------|-----------------------------|-----------------------------|-----------------------------|
| 2013 | \$ 1,210,000 | \$ 854,114 | \$ 2,064,114 |
| 2014 | 1,165,000 | 978,369 | 2,143,369 |
| 2015 | 1,260,000 | 935,485 | 2,195,485 |
| 2016 | 1,270,000 | 857,478 | 2,127,478 |
| 2017 | 827,000 | 807,889 | 1,634,889 |
| 2018-2022 | 3,365,000 | 3,442,981 | 6,807,981 |
| 2023-2027 | 3,560,000 | 2,376,976 | 5,936,976 |
| 2028-2032 | 3,775,000 | 1,035,864 | 4,810,864 |
| 2033-2037 | <u>725,000</u> | <u>79,075</u> | <u>804,075</u> |
| Total | <u>\$ 17,157,000</u> | <u>\$ 11,368,231</u> | <u>\$ 28,525,231</u> |

The mortgage payable by the Business-type Activities is owed by Villa Soigal Project and consists of a 8% mortgage note, payable in monthly installments of \$13,203, including interest, until 2019, collateralized with land and building.

Annual requirements to maturity of the mortgage are as follows:

| Year Ending June 30, | Principal payment | Interest payment | Total |
|-------------------------|-------------------------|--------------------------|----------------------------|
| 2013 | \$ 105,822 | \$ 52,602 | \$ 158,424 |
| 2014 | 112,909 | 45,515 | 158,424 |
| 2015 | 120,471 | 37,953 | 158,424 |
| 2016 | 128,539 | 29,885 | 158,424 |
| 2017 | 137,148 | 21,276 | 158,424 |
| 2018-2021 | <u>252,820</u> | <u>14,764</u> | <u>267,584</u> |
| Total | <u>\$857,709</u> | <u>\$ 201,995</u> | <u>\$ 1,059,704</u> |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN**

NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)

NOTE 10 – GENERAL LONG-TERM DEBTS (CONTINUED)

B. PROPERTY TAX DEBTS – LAW 42

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

In addition, on February 12, 2003, the Municipality entered into a repayment agreement with the Government Development Bank for Puerto Rico (GDB) and the CRIM, to pay off the excess of property tax advances through fiscal year 2000 and 2001. The CRIM retains the payment from the property tax advances of the Municipality. The amounts retained by the CRIM are remitted to GDB on July 1 of each year through July 1, 2032. The outstanding balance of the note payable to the CRIM at June 30, 2012 amounted to \$936,834.

C. PROPERTY TAX DEBT – LAW 146

On September 24, 2002, the CRIM, on behalf of the municipalities of Puerto Rico, entered into a financing agreement with GDB pursuant to the provisions of Law No. 146 of October 11, 2001. The purpose of this financing agreement was to extinguish in advance certain bonds payable issued by the Public Finance Corporation, a subsidiary of the GDB, which were originally issued to pay certain property tax receivables owned by the municipalities of Puerto Rico through 1996. The outstanding balance of the note payable to the CRIM at June 30, 2012 amounted to \$151,354.

D. PROPERTY TAX DEBTS

The annual requirements to amortize the property tax debts (Law 42 and Law 146) outstanding as of June 30, 2012 are as follows:

| Year Ending June 30, | Principal payment | Interest payment | Total |
|-------------------------|----------------------------|--------------------------|---------------------------|
| 2013 | \$ 31,230 | \$ 67,020 | \$ 98,250 |
| 2014 | 32,717 | 65,063 | 97,780 |
| 2015 | 34,297 | 63,012 | 97,309 |
| 2016 | 35,977 | 60,862 | 96,839 |
| 2017 | 37,762 | 58,606 | 96,368 |
| 2018-2022 | 219,766 | 255,013 | 474,779 |
| 2023-2027 | 284,569 | 178,443 | 463,012 |
| 2028-2032 | 372,455 | 78,790 | 451,245 |
| 2033-2035 | <u>39,415</u> | <u>1,219</u> | <u>40,634</u> |
| Total | <u>\$ 1,088,188</u> | <u>\$ 828,028</u> | <u>\$1,916,216</u> |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN**

NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)

NOTE 10 – GENERAL LONG-TERM DEBTS (CONTINUED)

E. COMPENSATED ABSENCES

The government-wide statement of net assets includes \$2,727,913 of accrued sick leave benefits, and accrued vacation benefits, representing the Municipality's commitment to fund such costs from future operations.

F. CLAIMS AND JUDGMENTS

Liabilities of \$3,600,000 reported in the statement of net assets represent the balance owed for claims and judgments at June 30, 2012, as described in Note 19.

G. STATE INSURANCE HEALTH ADMINISTRATION

Liabilities of \$256,266 reported in the statement of net assets represent the balance owed for services provided by the State Insurance Health Administration to the Municipality and not paid at June 30, 2012.

NOTE 11 – LANDFILL CLOSURE AND POSTCLOSURE CARE COST OBLIGATION

The Municipality owns a municipal solid waste landfill and adopted the required provisions of Statement No. 18, "Accounting for Municipal Solid Waste Landfill Closure and Post Closure Care Costs", issued by the Governmental Accounting Standards Board (GASB No. 18) and the regulations set forth by the U.S. Environmental Protection Agency (EPA) in its "Solid Waste Disposal Facility Criteria", issued on October 9, 1991. State and federal laws and regulations require the Municipality to place a final cover on its landfill site when closed and perform certain maintenance and monitoring functions at the landfill site for 30 years after closure. Although closure and post closure care costs will be paid only near or after the date that the landfill stops accepting waste, the Municipality reports a portion of these closure and post closure care costs as an operating expense in each period based on landfill capacity used as of each statement of net assets date. The Municipality discontinued its landfill operations and ceased to accept solid waste in January 1993. Post closure care procedures were assumed by the Municipality and the closure process was completed in January 17, 1997.

The total estimated liability for post closure care costs has been determined in \$231,098 as of June 30, 2012.

NOTE 12 – DEBT RETIREMENT

Revenues of the Debt Service Fund consist of the ad-valorem property taxes which are recognized as revenue when collected from taxpayers and reported by the MunicipalRevenueCollectionCenter of the Commonwealth of Puerto Rico to the Municipality.

These property taxes are accumulated by the MunicipalRevenueCollectionCenter in costs of the general obligations bonds issued by the Municipality. Payments are made to the Government Development Bank of the Commonwealth of Puerto Rico from such accumulated funds by the Municipal Revenue Collection Center of Puerto Rico.

NOTE 13 – PROPERTY TAXES

The MunicipalRevenueCollectionCenter of the Commonwealth of Puerto Rico is responsible for the assessment of all real and personal property located within the Municipality and for the levy, administration and collection of the corresponding tax contribution.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN**

NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)

NOTE 13 – PROPERTY TAXES (CONTINUED)

The property tax contribution is levied each year over the appraised value of the property at the beginning of the calendar year. The real property assessment is based on the current value existing in the year 1957 and the personal property at the current value at the date of the assessment.

The tax rate per annum is 9.08% for real property and 5.83% for personal property of which 1.03% of both belong to the Commonwealth of Puerto Rico and 8.05% and 4.80%, respectively, belongs to the Municipality. From the portion belonging to the Municipality, 6.00% and 3.00%, respectively, represents the Municipality's basic tax rate that is appropriated for general purposes and therefore accounted for through the General Fund.

The remaining portions 2.25% for real property and 2.00% for personal property represents the ad-valorem property taxes withheld by the Municipal Revenue Collection Center of the Commonwealth of Puerto Rico and restricted for debt service, which is accounted for through the Debt Service Fund (See Note 8). The Municipality has not reached the maximum statutory tax rate limit for the basic tax while there is no limitation for the ad-valorem tax rate.

The Commonwealth of Puerto Rico grants complete real property tax exoneration on the first \$15,000 assessed valuation on residential units occupied by their owners. However, the Municipality receives the full amount levied, except for residential units assessed at less than \$3,500 on which a complete exemption is granted. The Municipal Revenue Collection Center, instead of the property taxpayer, becomes the source of payment in these cases.

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

The Municipality records as revenue in the general fund the property tax contribution when received from monthly advances from Municipal Revenue Collection Center.

Due to the fact that collections of property tax are applied to the advances of property tax paid by the Municipal Revenue Collection Center, the amortization of the advance at end of year was not available due to that is in process of verification by external auditors.

NOTE 14 – MUNICIPAL LICENSE TAXES

The municipal license tax is levied each year based on the prior year's gross revenues for all commercial and industrial organizations doing business in the Municipality and which are not totally or partially exempt from this tax under the Industrial Incentives Laws of the Commonwealth of Puerto Rico. All taxpayers are required to file their declarations by April 23 of each year. The tax rates are as follows:

- ❖ 1.50% for financial institutions.
- ❖ 1.00% for savings and loan associations.
- ❖ 0.50% for other organizations over \$500,000.
- ❖ 0.40% for other organizations up to \$500,000.

Taxes are payable in two equal semi-annual installments on July 1 and January 1 following the date of levy. If they are paid with declaration, the taxpayer is granted a 5% of discount. Collections of taxes during current fiscal year, applicable to the next fiscal year, are recorded as deferred revenues in the General Fund.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN**

NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)

NOTE 15 – SALES AND USE TAXES

On July 4, 2006, the Legislature of the Commonwealth of Puerto Rico approved Act No. 117 (“Act 117”) which amends the Puerto Rico Internal Revenue Code of 1994 to provide for a sales and use tax of 5.5% to be imposed by the Commonwealth Government. Act 117 also authorizes each municipality government to impose a municipal sales 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.

Section 6189 of the Puerto Rico Internal Revenue Code of 1994, as amended, authorizes the Municipalities in Puerto Rico to impose a sales and use tax to consumers. This tax must be imposed in conformity with the base, exemptions and limitations contained Subtitle BB of the Code. The Municipal Sales Tax is specifically imposed overall sales transactions of taxable items and combined transactions (as defined by the municipal internal regulation) taken place within municipal limits. The Municipal Tax is also specifically imposed over the purchase price for the use, storage or consumption of taxable transactions (as defined by the municipal internal regulation) taken place within municipal limits.

The Municipal Legislature approved the imposition of the municipal sales and use tax during fiscal year 2006-2007. Individuals, organizations and entities subject to collect the municipal sales and use tax must file a tax return to the Municipality. Tax is due each 20th day of each month based on tax collected in the preceding month. Resources are recorded in the General Fund.

Also, on July 29, 2007, the Governor of Puerto Rico signed into Law an amendment of Act No. 117, H.B. 2193 known as Act No. 80. The most significant amendments were: first, to uniform the tax rate at 7% of which the municipalities will collect 1% and the Puerto Rico Treasury Department the other 6%, 05% of the 6% belongs to the municipality and it is distributed through three separate funds: Municipal Development Fund, Municipal Redemption Fund and Municipal Improvements Fund; secondly the establishment of a Local Commercial Rule and the elimination of source and nexus rules to impose the sale and use tax. These funds are administered by the Government Development Bank for Puerto Rico. Finally, the Law restricts the use of the funds by the municipalities to certain specific activities.

NOTE 16– INTERGOVERNMENTAL REVENUES

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

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN**

NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)

NOTE 17 – INTERFUND TRANSFERS

Interfund transfers during the fiscal year ended at June 30, 2012, are summarized as follows:

| Transfer Out | Transfer In | Purpose | Amount |
|---------------------|--------------------|-----------------|----------------------------|
| General Fund | Debt Service Fund | Debt retirement | <u>\$ 1,164,197</u> |
| Total | | | <u>\$ 1,164,197</u> |

NOTE 18– EMPLOYEE'S RETIREMENT PLAN

The Employee's Retirement System of the Government of Puerto Rico and its instrumentality (ERS) is the administrator of a cost-sharing multiple-employer retirement system established by the Commonwealth of Puerto Rico. The ERS was created under the Act 447, approved on May 15, 1951, as amended, and became effective on January 1, 1952. ERS covers all regular employees of the Commonwealth of Puerto Rico and its instrumentality and of certain municipalities and components units not covered by their own retirement systems.

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

The Municipality adopted the requirements of GASBS No. 25 for all the career employees that are covered under the Commonwealth of Puerto Rico Employee's Retirement System, a multiple-employer public employee retirement system, established by State Laws.

Under the plan, the employees and employer portions are contributed, for which, the employee amount is withheld from salaries. Covered employees are required by Commonwealth statute to contribute 5.775% for the first \$550 of monthly salary plus 8.275% for the excess of this amount, or on the alternative, 8.275% of all salary. The Municipality contributes to the system 9.275% of the participating employee's salaries.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN**

NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)

NOTE 18 – EMPLOYEE'S RETIREMENT PLAN (CONTINUED)

Law Number 305 of September 24, 1999, amends the Act Number 447 that establish a savings program. All employees active in the system as of December 31, 1999 may elect to transfer from defined contribution programs to the new savings program (a defined contribution plan). Employees in the savings program may now contribute from a minimum of 8.275% up to a maximum of 10% of their monthly salary, and will be invested in an account which will either: (a) earn a fixed rate based on the two-year Constant Maturity Treasury Note or, (b) earn a rate equal to 75% of the return of the System's investment portfolio (net of management fees), or (c) earn a combination of both alternatives. If at time of retirement accumulated benefits amount to \$10,000 or less may elect to receive a lump sum distribution up to the accumulated benefits. Under the new program the retirement age is reduced from 65 to 60 for those employees who joined the current plan on or after April 1, 1990.

The pension benefit for participants who retire with less than 30 years of service is computed at the rate of 1½% of their average compensation for each year of credit service for the remaining years. The System also provides for death and disability benefits and the assets of the System pertaining to the participant employees.

A variety of significant actuarial assumptions are used to determine the standard measure of the pension benefit obligation and these assumptions are summarized below:

- ❖ The present value of the future pension payments was computed by using a discount of 9%.
- ❖ Future pension payments reflect an assumption of a 6% salary increase.

All employees that do not elect to transfer for the new program and who at the time of employment are 55 years old or less are eligible to participate in the System. Pension benefits for participants with 30 years of service are as follows:

| <u>YEARS OF SERVICE</u> | <u>PARTICIPANT'S AGE</u> | <u>PENSION BENEFITS</u> |
|-------------------------|--------------------------|---|
| 30 or more | 55 or less | 65% of the average of the three years of highest salary during the employee's service period. |
| 30 or more | 58 or more | 75% of the average of the three years of highest salary during the employee's service period. |
| 30 or more | 65 or more | 75% of the average of the three years of highest salary during the employee's service period (employees started working after April 1, 1990). |

The amount of the total pension benefit obligation is based on a standardized measurement established by GASBS No. 27, *Financial Reporting for Defined Benefit Pension Plans and Notes Disclosure for Defined Contributions Plans*. The standardized measurement is the actuarial present value of estimated defined pension benefits, adjusted for the effects of projected salary increases and step-rate benefits, estimated to be payable in the future as a result of employee services performed to date.

The measure is intended to help users assess the System's funding status on a going-concern basis, assess progress made in accumulating sufficient assets to pay benefits when due, and make comparisons among other public retirement systems. The measure is independent of the actuarial funding method used to determine contributions to the plan.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN**

NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)

NOTE 18 – EMPLOYEE'S RETIREMENT PLAN (CONTINUED)

The membership of retirees and beneficiaries currently receiving benefits and terminated employees entitled to benefits, but not yet receiving benefits, and active employees and the distribution of active employees between vested and non-vested is not readily available.

Contributions in 2006 and prior years were made based on percentages established by the law. Such percentage has not been based on actuarial studies, as required by accounting principles generally accepted in the United States of America. An actuarial compilation of the annual contribution applicable to the Municipality has not been prepared. Accordingly, the accounts by which the actual contributions differ from the required actuarial contributions are not known.

The total pension expenditures recorded in the category of administration for the Fiscal Year Ended June 30, 2012 was approximately \$386,186. All employees who at the time of employment are 55 years old or less are eligible to participate in the System. No benefit is payable if the participant receives a refund of his accumulated contributions.

The historical trend information regarding the accumulation of assets and pension benefit obligation in the ERS is not available. For the ten-year trend information, refer to the separately issued financial statements of the ERS as of and for the fiscal year ended June 30, 2012. The P.R. Retirement Plan Administration provides additional information of the ERS. They issue a public available financial report that includes financial statements and required supplementary information for ERS, as a component unit of the Commonwealth of Puerto Rico. That report may be obtained by writing to the Administration at PO Box 42003, Minillas Station, San Juan, P.R. 00940.

NOTE 19– CONTINGENCIES

A. CLAIMS AND JUDGMENTS

The Municipality is, at present, a defendant in a number of legal matters that arise from alleged improper application of policies and negligence in the ordinary course of the Municipality's activities. With respect to pending litigation, the Municipality has reported liabilities of \$1,800,000 in the government wide statement of net assets.

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

In addition, the Municipality is a defendant or co-defendant in several legal proceedings, which are in discovery stage. Certain of these claims are covered by insurance. Legal counsels with the information currently available cannot determine the final outcome of these proceeding. However, it has been the Municipality's experience that such actions are settled for amounts substantially less than the claim amounts.

B. FEDERAL GRANTS

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN**

NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)

NOTE 20 – FUND BALANCE (DEFICIT)

As of June 30, 2012, the fund balance (deficit) is comprised of the following:

| Fund Balance (Deficit) | General Fund | State Assignment- Public Works & Transportation | State Assignment- Recreation Facilities | Debt Service Fund | Loans Fund | Other Governmental Fund | Total |
|-------------------------------------|----------------------------|---|---|----------------------------|---------------------------|-------------------------------|-----------------------------|
| Restricted for: | | | | | | | |
| General Government | \$ - | \$ - | \$ - | \$ - | \$ - | \$ 49,604 | \$ 49,604 |
| Public Safety | - | - | - | - | - | - | - |
| Public Works | - | - | - | - | - | 680,313 | 680,313 |
| Culture | - | - | - | - | - | - | - |
| Recreation | - | - | 2,672,510 | - | - | - | 2,672,510 |
| Health and Welfare | - | - | - | - | - | 80,082 | 80,082 |
| Capital Outlays | - | - | - | - | 3,397,954 | 1,979,163 | 5,377,117 |
| Debt Service | - | - | - | 2,575,111 | - | - | 2,575,111 |
| Assigned for: | | | | | | | |
| General Government | 263,166 | - | - | - | - | - | 263,166 |
| Public Safety | 1,941 | - | - | - | - | - | 1,941 |
| Public Works | 102,887 | - | - | - | - | - | 102,887 |
| Culture | 3,373 | - | - | - | - | - | 3,373 |
| Recreation | 1,180 | - | - | - | - | - | 1,180 |
| Health and Welfare | - | - | - | - | - | 131,100 | 131,100 |
| Debt Service | - | - | - | - | - | - | - |
| Unassigned | <u>1,923,977</u> | <u>-</u> | <u>-</u> | <u>-</u> | <u>-</u> | <u>-</u> | <u>1,923,977</u> |
| Total Fund Balance (Deficit) | <u>\$ 2,296,524</u> | <u>\$ -</u> | <u>\$ 2,672,510</u> | <u>\$ 2,575,111</u> | <u>\$3,397,954</u> | <u>\$ 2,920,262</u> | <u>\$ 13,862,361</u> |

NOTE 21 – ACCOUNTING CHANGES AND RESTATEMENTS

A. GOVERNMENTAL FUND FINANCIAL STATEMENTS

The following restatements have been made in the governmental fund financial statements, which are reported as an adjustment to the beginning fund balances:

| Description | General Fund |
|--|----------------------------|
| Fund balance, beginning | \$ 1,662,995 |
| To adjust the Retirement System Administration - Special Laws debt | <u>280,891</u> |
| Fund balance, beginning as restated | <u>\$ 1,943,886</u> |

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN

NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)

NOTE 21 – ACCOUNTING CHANGES AND RESTATEMENTS (CONTINUED)

B. GOVERNMENTAL WIDE FINANCIAL STATEMENTS

The following restatements have been made in the governmental wide financial statements, which are reported as an adjustment to the beginning net assets:

| Description | Total |
|---|----------------------------|
| Net assets, beginning | \$38,115,535 |
| To record adjustment to account balance of: | |
| a. Retirement System – Special Laws debt | 280,891 |
| b. Claims and judgment | <u>1,800,000</u> |
| Net assets, beginning as restated | <u>\$40,196,426</u> |

NOTE 22 – SUBSEQUENT EVENTS

On July 19, 2012 the Municipality's Executive Branch approved Resolution Number 1, authorizing to issue a general obligation bond in the amount of \$1,275,000; and,

On August 21, 2012 the Municipality's Executive Branch approved Ordinance Number 8, authorizing to issue a general obligation bond in the amount of \$2,075,000.

These bonds are payable with resources collected through the Municipal Redemption Fund.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN
BUDGETARY COMPARISON SCHEDULE- GENERAL FUND
FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

| | <u>Budgeted Amounts</u> | | <u>Actual Amounts</u> | <u>Variance with</u> |
|---|-------------------------|-------------------|---|---|
| | <u>Original</u> | <u>Final</u> | <u>(Budgetary Basis)</u> <u>(See Note A)</u> | <u>Final Budget</u> <u>Positive</u> <u>(Negative)</u> |
| REVENUES: | | | | |
| Property taxes | \$ 3,946,730 | \$ 3,946,730 | \$ 4,366,440 | \$ 419,710 |
| Municipal license taxes | 1,800,000 | 1,800,000 | 1,840,202 | 40,202 |
| Charges for services | 699,000 | 699,000 | 743,231 | 44,231 |
| State contributions | 6,417,027 | 6,417,027 | 6,319,843 | (97,184) |
| Licenses and permits | 552,669 | 552,669 | 688,132 | 135,463 |
| Interest, fines and penalties | 237,000 | 237,000 | 481,933 | 244,933 |
| Other revenues | 338,000 | 338,000 | 211,027 | (126,973) |
| Prior year allocation | - | 1,053,460 | - | (1,053,460) |
| Total revenues | <u>13,990,426</u> | <u>15,043,886</u> | <u>14,650,808</u> | <u>(393,078)</u> |
| EXPENDITURES, ENCUMBRANCES AND OTHER FINANCING USES: | | | | |
| Current: | | | | |
| General government | 8,622,940 | 8,806,652 | 8,645,265 | 161,387 |
| Public safety | 1,068,053 | 844,207 | 810,421 | 33,786 |
| Public works | 2,394,444 | 2,709,565 | 2,654,426 | 55,139 |
| Culture | 309,260 | 182,819 | 181,753 | 1,066 |
| Recreation | 330,240 | 342,807 | 337,126 | 5,681 |
| Health and welfare | 750,844 | 750,844 | 708,133 | 42,711 |
| Transfers to other funds | 514,645 | 1,406,992 | 1,164,197 | 242,795 |
| Total expenditures, encumbrances and other financing uses | <u>13,990,426</u> | <u>15,043,886</u> | <u>14,501,321</u> | <u>542,565</u> |
| EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES, ENCUMBRANCES AND OTHER FINANCING SOURCES (USES) | <u>\$ -</u> | <u>\$ -</u> | <u>\$ 149,487</u> | <u>\$ 149,487</u> |

NOTE A – EXPLANATION OF DIFFERENCE BETWEEN BUDGETARY INFLOWS AND OUTFLOWS AND GAAP REVENUES AND EXPENSES

Explanation of Differences:

Sources/inflows of resources:

| | |
|---|----------------------|
| Actual amounts (budgetary basis) "available for appropriation" from the budgetary comparison schedule | \$ 14,650,808 |
| Differences-budget to GAAP | - |
| Total revenues and other financing sources as reported on the statement of revenues, expenditures, and changes in fund balances | <u>\$ 14,650,808</u> |

Uses/outflows of resources:

| | |
|--|----------------------|
| Actual amounts (budgetary basis) "total charges to appropriations" from the budgetary comparison schedule | \$ 14,501,321 |
| Differences-budget to GAAP: | |
| Accrual adjustments to expenditures | 6,791 |
| Prior year expenditure are not outflows of budgetary resources, but are expenditure for financial purposes | 73,859 |
| Encumbrances for supplies and equipment ordered, but not received, are reported in the year the order is placed for budgetary reporting purposes | (283,801) |
| Transfer to other funds are outflows of budgetary resources but are not expenditure for financial reporting purposes | <u>(1,164,197)</u> |
| Total expenditures and other financing uses as reported on the statement of revenues, expenditures, and changes in fund balances | <u>\$ 13,133,973</u> |

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN

NOTE TO BUDGETARY COMPARISON SCHEDULE – GENERAL FUND

FOR THE FISCAL YEAR ENDED JUNE 30, 2012

NOTE B – STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY

A. BUDGETARY CONTROL

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

The Municipality prepares its annual budget including the operations of the general fund.

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

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

The annual budget as presented in the Budgetary Comparison Schedule-General Fund is the budget ordinance at June 30, 2011 representing the original budget. There were no supplemental appropriations for the year ended June 30, 2012.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN**

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

FOR THE FISCAL YEAR ENDED JUNE 30, 2012

| <u>FEDERAL GRANTOR/PASS-THROUGH OR CLUSTER TITLE</u> | <u>FEDERAL CFDA NUMBER</u> | <u>PASS-THROUGH IDENTIFICATION NUMBER</u> | <u>FEDERAL EXPENDITURES</u> |
|---|------------------------------------|---|---------------------------------|
| <u>U.S. Department of Agriculture</u> | | | |
| Direct Programs: | | | |
| Rural Rental Housing Loan (Section 515 Direct Loan) | 10.415 | | \$ 857,709 |
| Pass-through Puerto Rico Education Department Child and Adult Care Food Program | 10.558 | CCC-013 | <u>399,972</u> |
| Subtotal Department of Agriculture | | | <u>1,257,681</u> |
| <u>U.S. Department of Housing and Urban Development</u> | | | |
| Direct Programs: | | | |
| Community Development Block Grant Program, Entitlement Grants | 14.218 | | <u>1,368,485</u> |
| Section 8 Housing Assistance Payments | 14.195 | | 565,854 |
| ARRA-Homelessness Prevention and Rapid Re-Housing Program | 14.257 | | 351,841 |
| Public and Indian Housing | 14.850 | | 45,953 |
| Section 8 Housing Choice Voucher Program | 14.871 | | <u>791,573</u> |
| Subtotal U.S. Dept. of Housing and Urban Development | | | <u>1,755,221</u> |
| <u>U.S. Department of Justice</u> | | | |
| Pass-through Program from: | | | |
| P.R. Department of Justice: Edward Byrnes Memorial Grant Program | 16.579 | | <u>71,864</u> |
| <u>U.S. Department of Transportation</u> | | | |
| Pass-through Puerto Rico Department of Transportation (Traffic Safety Commission): | | | |
| State and Community Highway Safety (ARRA) | 20.600 | N/AV | <u>62,950</u> |
| <u>U.S. Department of Energy</u> | | | |
| Energy Efficiency and Conservation Block Grant (ARRA) | 81.128 | | <u>36,020</u> |
| <u>U.S. Department of Health and Human Services</u> | | | |
| Pass-through Puerto Rico Governor's Office of Child Services and Community Development | | | |
| Head Start Program | 93.600 | 02CH994-06 | 2,953,840 |
| Pass-through Puerto Rico Governor's Office of Child Services and Community: | | | |
| Child Care and Development Block Grant Cluster | 93.575 | 241-2010-46 | <u>395,134</u> |
| Subtotal Dept. of Health and Human Services | | | <u>3,348,974</u> |
| TOTAL EXPENDITURES OF FEDERAL AWARDS | | | <u>\$7,901,195</u> |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN**

NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

JUNE 30, 2012

NOTE A - BASIS OF PRESENTATION

The accompanying schedule of expenditures of federal awards includes the federal grant activity of the Municipality and is presented on the modified accrual basis of accounting. Expenditures are recognized when the related liability is incurred. 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.

NOTE B - FEDERAL CFDA NUMBER

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

NOTE C - PASS-THROUGH ENTITY IDENTIFYING NUMBER

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 sub recipient. Numbers identified as N/A are not applicable and numbers identified as N/AV are not available.

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

| Description | Head Start Fund | Other Governmental Funds | Business-Type Activities |
|---|--------------------|--------------------------------|-----------------------------|
| 10.415 | \$ - | \$ 857,709 | \$ - |
| 10.558 | - | 399,972 | - |
| 14.195 | - | - | 565,854 |
| 14.218 | - | 1,368,485 | - |
| 14.257 | - | 351,841 | - |
| 14.850 | - | 45,953 | - |
| 14.871 | - | 791,573 | - |
| 16.579 | - | 71,864 | - |
| 20.600 | - | 62,950 | - |
| 81.128 | - | 36,020 | - |
| 93.575 | - | 395,134 | - |
| 93.600 | <u>2,953,840</u> | <u>-</u> | <u>-</u> |
| Total federal awards expenditures | 2,953,840 | 4,381,501 | 565,854 |
| Expenditures and changes in basis of accounting | <u>-</u> | <u>4,154,354</u> | <u>-</u> |
| Total expenditures, fund statements | <u>\$2,953,840</u> | <u>\$8,535,855</u> | <u>\$565,854</u> |

The federal expenditure of Rural Rental Housing Loan (Section 515 Direct Loan, CFDA 10.415) is a loan guarantee and do not represent a cash award or expenditure for the fiscal year.

**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 Member of the
Municipal Assembly
Municipality of San Sebastián, Puerto Rico

We have audited the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of Municipality of San Sebastián, Puerto Rico as of and for the year ended June 30, 2012, which collectively comprise Municipality of San Sebastián, Puerto Rico's basic financial statements and have issued our report thereon dated January 28, 2013. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

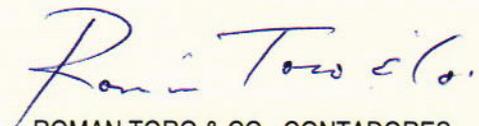
A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination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

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

Compliance and Other Matters

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

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



ROMAN TORO & CO., CONTADORES
PUBLICOS AUTORIZADOS, CSP
LICENSE #35 - IN FORCE

Yauco, Puerto Rico
January 28, 2013

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the original of this report



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

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

Compliance

We have audited Municipality of San Sebastián, 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 Sebastián, Puerto Rico's major federal programs for the year ended June 30, 2012. Municipality of San Sebastián, 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. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of Municipality of San Sebastián's management. Our responsibility is to express an opinion on Municipality of San Sebastián's compliance based on our audit.

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

In our opinion, Municipality of San Sebastián, Puerto Rico, complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2012.

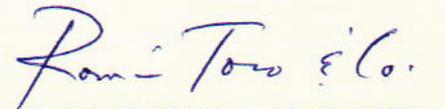
Internal Control Over Compliance

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

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

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


ROMAN TORO & CO., CONTADORES
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Yauco, Puerto Rico
January 28, 2013

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**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2012**

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 |
|----------------|---|
| 10.415 | Rural Rental Housing Loan |
| 14.195 | Section 8 Housing Assistance Payments |
| 14.218 | Community Development Block Grant – Entitlement Grants |
| 14.257 | ARRA – Homelessness Prevention and Rapid Re-Housing Program |
| 14.871 | Section 8 Housing Choice Vouchers Program |
| 93.575; 93.713 | Child Care and Development Block Grant Cluster |
| 93.600; 93.708 | Head Start Programs Cluster |

Dollar threshold used to distinguish between Type A and Type B Programs:

\$300,000

Auditee qualified as low-risk auditee?

Yes No

SECTION II – FINANCIAL STATEMENTS FINDINGS

No findings are reported.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)
FOR THE YEAR ENDED JUNE 30, 2012**

SECTION III - FEDERAL AWARD FINDINGS

No findings are reported.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
FOR THE YEAR ENDED JUNE 30, 2012

| Year | Finding Number | Finding | CFDA Number | Questioned Cost(s) | Comments |
|---|----------------|--|-------------|--------------------|--|
| (1) Prior Audit Findings, fully corrected or not noted during our audit: | | | | | |
| 2011 | 2011-III-I | The municipality did not comply with expending the required 60% of the program assigned funds within the first two years since it funds were available for obligation. | 14.257 | None | Total funds of the program was used in their entirety within the program award term limit. |
| (2) Prior Audit Findings, not corrected or partially corrected: | | | | | |
| | | None. | | | |
| (3) Corrective action taken is significantly different from corrective action previously reported: | | | | | |
| | | None. | | | |
| (4) Prior Audit Findings, are no longer valid: | | | | | |
| | | None. | | | |

END OF SCHEDULE