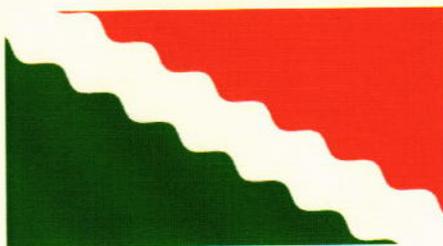


**OFICINA DEL COMISIONADO DE ASUNTOS MUNICIPALES
ÁREA DE ASESORAMIENTO, REGLAMENTACIÓN E INTERVENCIÓN FISCAL
ÁREA DE ARCHIVO DIGITAL**

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

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

FISCAL YEAR ENDED JUNE 30, 2013



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

**HON. JAVIER JIMENEZ PEREZ
MAYOR**

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN

BASIC FINANCIAL STATEMENTS ACCOMPANIED BY
REQUIRED SUPPLEMENTARY INFORMATION

FISCAL YEAR ENDED JUNE 30, 2013

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INDEPENDENT AUDITOR'S REPORT

Honorable Mayor and Member of the
Municipal Legislature
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, 2013, and the related notes to the financial statements, which collectively comprise the Municipality's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, 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, 2013, and the respective changes in financial position and, where applicable, cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis-of-Matter

Newly Adopted Standards

As discussed in Note 22 to the financial statements, the **Municipality** adopted new accounting guidance, Governmental Accounting Standards Board (GASB) Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities* effective July 1, 2012, and Statement No. 66, *Technical Corrections—2012—an amendment of GASB Statements No. 10 and No. 62*. Our opinion is not modified with respect to this matter.

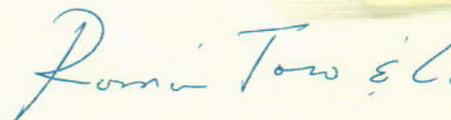
Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and budgetary information on pages 3 through 13 and 58 through 59 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated December 20, 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* in considering Municipality of San Sebastián, Puerto Rico's internal control over financial reporting and compliance.



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

Yauco, Puerto Rico
December 20, 2013

Stamp #E93362 was affixed to
the original report

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

MANAGEMENT'S DISCUSSION AND ANALYSIS

FOR THE FISCAL YEAR ENDED JUNE 30, 2013

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, 2013. 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.

This MD&A is prepared in order to comply with the reporting model required by Governmental Accounting Standards Board Statement No. 34 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, 2013 by \$53,226,312, and at June 30, 2012 by \$49,319,542, as restated;
- The Municipality's total net position increase by \$3,906,770 during fiscal year 2012-2013;
- As of June 30, 2013, the Municipality's governmental funds reported combined ending fund balance of \$12,499,890, a decrease of \$1,362,471 from the prior year;
- At June 30, 2013, the Statement of Net Position presented an unrestricted deficit of \$1,053,792;
- The Municipality's capital assets inventory increase as a result of this year's operations. Capital assets as of June 30, 2013 were \$64,668,777 (net of accumulated depreciation);
- The investment in capital assets for this year was \$48,852,038 (net of related debt);
- Loans principal payments were \$1,545,000 and \$2,115,000 in 2013 and 2012, respectively.

BUSINESS-TYPE ACTIVITIES –FINANCIAL HIGHLIGHTS

- The total net position of the proprietary fund amounted to \$1,095,790, of which \$627,792 are invested in capital assets, net of related debt, \$385,005 are restricted for the operations of federally funded programs and \$82,993 are unrestricted;
- The total net position of the proprietary fund increased by \$22,825 during the fiscal year ended on June 30, 2013.

OVERVIEW OF THE BASIC FINANCIAL STATEMENTS

This discussion and analysis is 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, 2013

GOVERNMENT-WIDE FINANCIAL STATEMENTS

The government-wide financial statements are composed of: (1) the statement of net position 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 POSITION

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

STATEMENT OF ACTIVITIES

The statement of activities presents information showing how the Municipality's net position changed during the fiscal year ended June 30, 2013, 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 position, 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, 2013

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 position – proprietary fund, (4) the statement of revenues, expenses and net change – 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 Sebastián.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

FOR THE FISCAL YEAR ENDED JUNE 30, 2013

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 Villa 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 Villa Soigal is to provide adequate housing to low-income residents of the Municipality.

The activities of Villa 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)

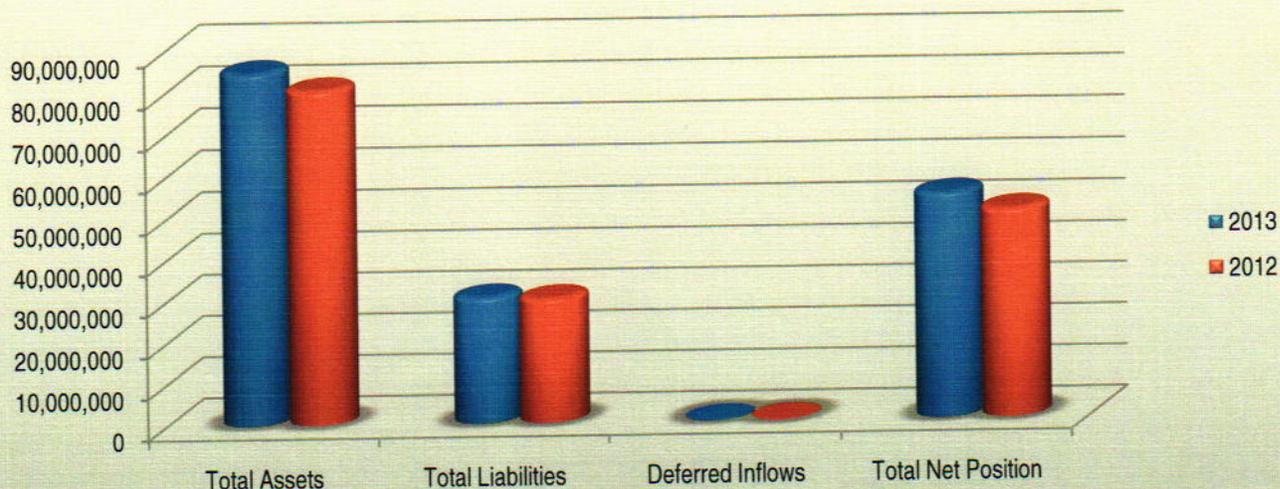
FOR THE FISCAL YEAR ENDED JUNE 30, 2013

GOVERNMENT-WIDE FINANCIAL ANALYSIS

GOVERNMENTAL NET POSITION

As noted earlier, net position 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 \$53,226,312 as of June 30, 2013, versus \$49,319,542 as of June 30, 2012, as restated. Business-type activities assets exceeded liabilities by \$1,095,790 as of June 30, 2013, versus \$1,072,965 as of June 30, 2012. Our analysis below focuses on the net position (**Table 1**) and changes in net position of the Municipality's governmental activities and business-type activities.

Table 1 Statement of Net Position	Governmental Activities		Business-type Activities		Total	
	2013	2012 (as restated)	2013	2012	2013	2012 (as restated)
Current and non-current assets	\$ 18,355,859	\$ 20,949,346	\$ 539,805	\$ 711,702	\$ 18,895,664	\$ 21,661,048
Capital assets	64,668,777	57,648,537	1,378,932	1,267,874	66,047,709	58,916,411
Total Assets	83,024,636	78,597,883	1,918,737	1,979,576	84,943,373	80,577,459
Current liabilities	5,114,276	6,397,831	184,716	134,581	5,298,992	6,532,412
Long-term liabilities	24,531,245	22,710,465	638,231	772,030	25,169,476	23,482,495
Total Liabilities	29,645,521	29,108,296	822,947	906,611	30,468,468	30,014,907
Deferred Inflows of resources	152,803	170,045	-	-	152,803	170,045
Net position:						
Investment in capital assets, net of related debt	48,852,038	40,701,537	627,792	368,486	49,479,830	41,070,023
Restricted	5,428,066	11,565,837	385,005	538,376	5,813,071	12,104,213
Unrestricted (Deficit)	(1,053,792)	(2,947,832)	82,993	166,103	(970,799)	(2,781,729)
Total Net Position	\$ 53,226,312	\$ 49,319,542	\$ 1,095,790	\$ 1,072,965	\$ 54,322,102	\$ 50,392,507



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

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

FOR THE FISCAL YEAR ENDED JUNE 30, 2013

GOVERNMENT-WIDE FINANCIAL ANALYSIS (CONTINUED)

The largest portion of the Municipality's net position 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 position represents resources that are subject to external restrictions on how they may be used.

GOVERNMENTAL ACTIVITIES

Governmental activities increased the Municipality's net position. Key elements of this increase are as follows: the Municipality's governmental activities had net expenses of \$14,084,811. 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 \$3,906,770. In addition, business-type activities increased the Municipality's net position by \$22,825.

The cost of all governmental activities and business-type activities this year was \$25,076,834 and \$610,348, respectively. **Table 2** presents the cost of each of the Municipality's largest programs.

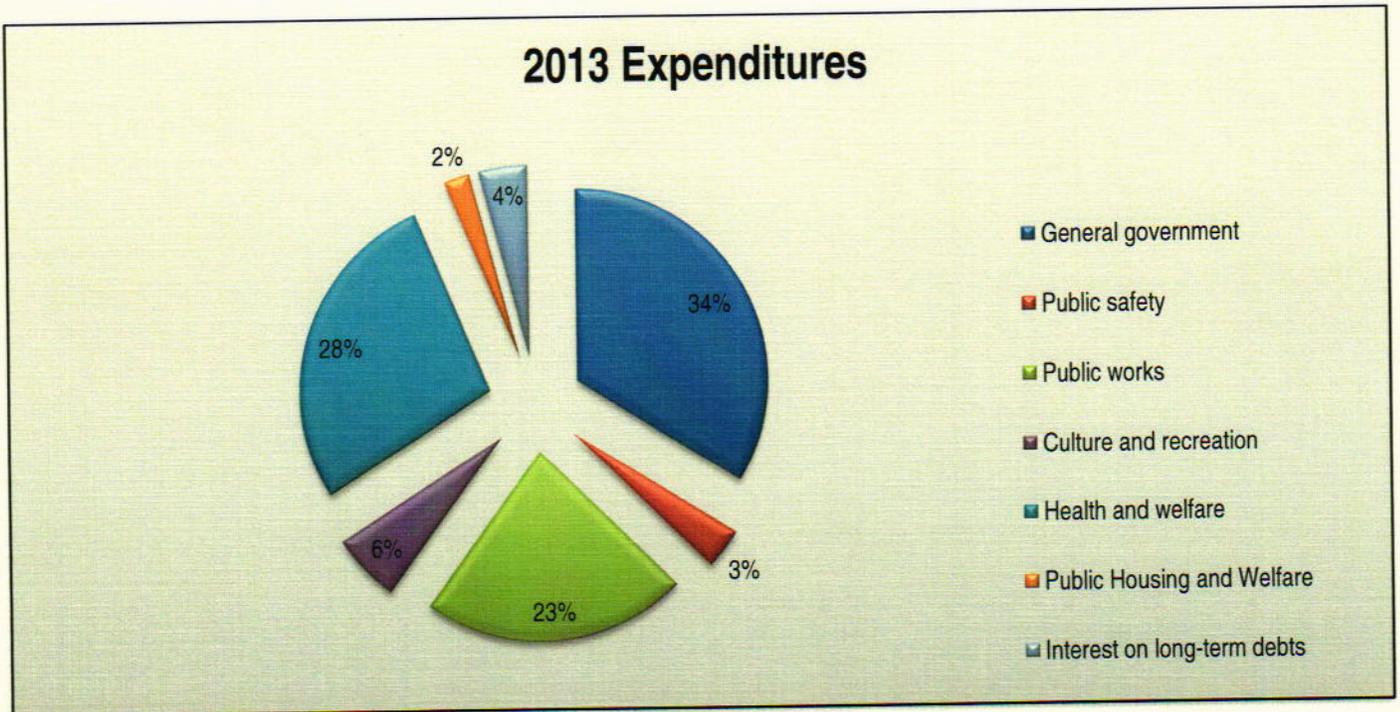
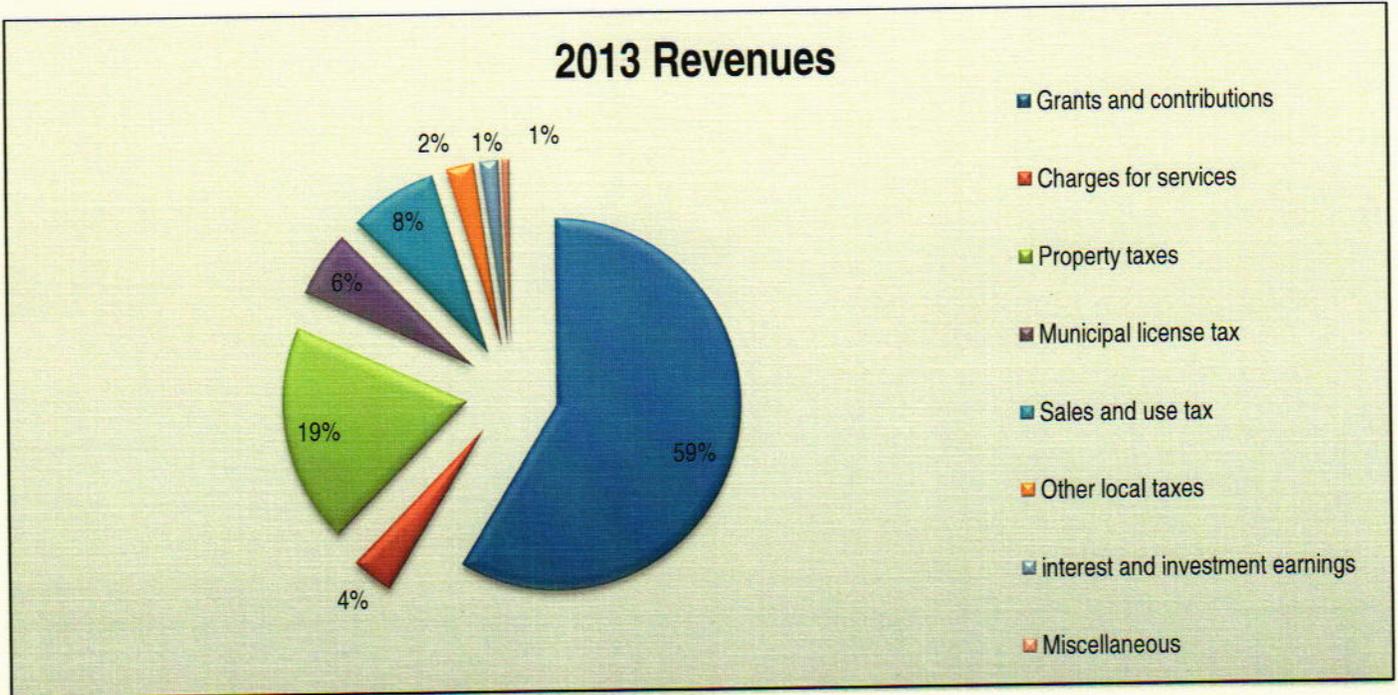
Table 2 Statement of Activities	Governmental Activities		Business-type Activities		Total	
	2013	2012	2013	2012	2013	2012
Revenues						
Program revenues:						
Grants and contributions	\$ 16,777,488	\$ 20,066,076	\$ 628,685	\$ 622,224	\$ 17,406,173	\$ 20,688,300
Charge for services	1,104,459	743,231			1,104,459	743,231
General revenues:						
Property taxes	5,677,677	6,207,154			5,677,677	6,207,154
Municipal license tax	1,716,969	1,840,202			1,716,969	1,840,202
Sales and use tax	2,310,677	2,195,810			2,310,677	2,195,810
Other local taxes	723,293	688,132			723,293	688,132
Interest and investment earnings	476,897	687,703	2,883	3,275	479,780	690,978
Miscellaneous	196,144	433,523	1,605	1,550	197,749	435,073
Total revenues	28,983,604	32,861,831	633,173	627,049	29,616,777	33,488,880
Expenses						
General government	8,706,508	8,613,046			8,706,508	8,613,046
Public safety	901,427	940,695			901,427	940,695
Public works	5,822,608	8,575,857			5,822,608	8,575,857
Culture and recreation	1,509,573	1,471,368			1,509,573	1,471,368
Health and welfare	7,125,408	7,372,087			7,125,408	7,372,087
Public Housing and Welfare			558,319	505,779	558,319	505,779
Interest on long-term debts	1,011,310	895,877	52,029	60,075	1,063,339	955,952
Total expenses	25,076,834	27,868,930	610,348	565,854	25,687,182	28,434,784
Net change	3,906,770	4,992,901	22,825	61,195	3,929,595	5,054,096
Net position – beginning, as restated	49,319,542	44,326,641	1,072,965	1,011,770	50,392,507	45,338,411
Net position – ending	\$ 53,226,312	\$ 49,319,542	\$ 1,095,790	\$ 1,072,965	\$ 54,322,102	\$ 50,392,507

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

FOR THE FISCAL YEAR ENDED JUNE 30, 2013

GOVERNMENT-WIDE FINANCIAL ANALYSIS (CONTINUED)



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

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

FOR THE FISCAL YEAR ENDED JUNE 30, 2013

GOVERNMENT-WIDE FINANCIAL ANALYSIS (CONTINUED)

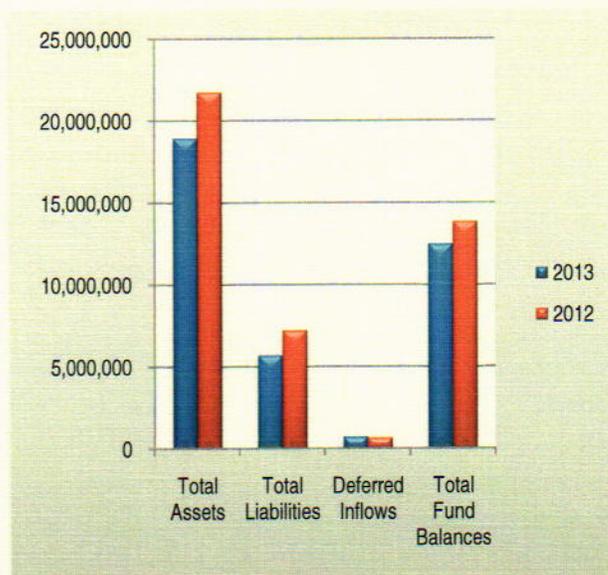
Approximately thirty-five percent (35%) of the Municipality's governmental activities and business-type activities total revenue came from taxes, while fifty-nine percent (59%) resulted from grants and contributions. Federal grants represent thirty-three percent (33%) of the governmental activities grants 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-four percent (34%) of total expenses resulted from general government, twenty-three percent (23%) from public works, six percent (6%) from culture and recreation and twenty-eight percent (28%) 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	2012	
Balance Sheet	2013	(as restated)
Assets:		
Total Major Funds	\$ 14,900,588	\$ 17,377,256
Total Other Funds	<u>4,037,409</u>	<u>4,386,236</u>
Total assets	\$ 18,937,997	\$ 21,763,492
Liabilities:		
Total Major Funds	\$ 4,478,800	\$ 5,916,048
Total Other Funds	<u>1,217,614</u>	<u>1,295,929</u>
Total Liabilities	<u>5,696,414</u>	<u>7,211,977</u>
Deferred Inflows Resources:		
Total Mayor Funds	588,890	519,109
Total Other Funds	<u>152,803</u>	<u>170,045</u>
	<u>741,693</u>	<u>689,154</u>
Fund Balances:		
Restricted	8,425,153	11,434,737
Assigned	478,024	503,647
Unassigned	<u>3,596,713</u>	<u>1,923,977</u>
Combined total fund balances	<u>12,499,890</u>	<u>13,862,361</u>
Total liabilities, deferred inflows and fund balances	\$ 18,937,997	\$ 21,763,492



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, 2013 the Municipality's governmental funds reported combined ending fund balances of \$12,499,890, a decrease of \$1,362,471 from the prior year.

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

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

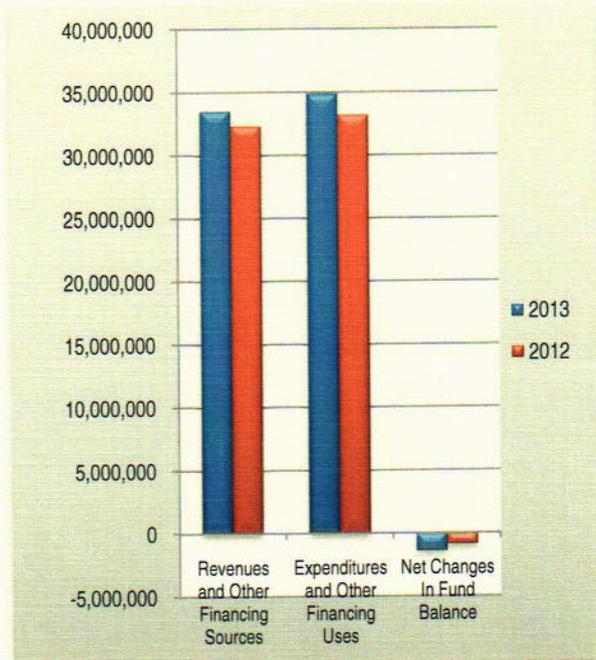
FOR THE FISCAL YEAR ENDED JUNE 30, 2013

GOVERNMENT FUND FINANCIAL ANALYSIS (CONTINUED)

The Municipality has an unassigned fund balance of \$3,596,713 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 (\$359,850) and others (\$118,174), (b) to pay debt service (\$2,719,049) and (c) for other restricted purposes (\$5,706,104).

**Table 4
Changes in Fund Balances**

	<u>2013</u>	<u>2012</u>
Revenues:		
Total revenues – Major Funds	\$ 20,231,724	\$ 26,219,509
Total revenues – Other Funds	8,682,099	6,123,213
Combined total revenues	<u>28,913,823</u>	<u>32,342,722</u>
Expenditures:		
Total expenditures – Major Funds	23,525,228	24,665,881
Total expenditures – Other Funds	11,361,066	8,535,855
Combined total expenditures	<u>34,886,294</u>	<u>33,201,736</u>
Other financing sources (uses):		
Other financing sources – Major Funds	4,610,422	-
Other financing sources – Other Funds	(422)	-
Combined other financing sources (uses), net	<u>4,610,000</u>	<u>-</u>
Net changes in fund balance	<u>(1,362,471)</u>	<u>(859,014)</u>
Fund Balance – beginning	13,862,361	14,721,375
Fund Balance – ending	<u>\$ 12,499,890</u>	<u>\$ 13,862,361</u>



PROPRIETARY FUND FINANCIAL ANALYSIS

At June 30, 2013, the total assets of proprietary fund amounted to \$1,918,737, which consisted principally of: (1) cash and investments of \$513,088, and (2) capital assets of \$1,378,932, net of accumulated depreciation.

At June 30, 2013, the total liabilities of the proprietary fund amounted to \$822,947, which consisted of: (1) mortgage notes payable of \$751,140, and (2) accounts payable and accrued liabilities of \$71,807.

The total net position of proprietary fund amounted to \$1,095,790 at June 30, 2013, of which \$627,792 are invested in capital assets, and \$385,005 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, 2013

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	\$ 14,467,443	\$14,911,952	\$ 444,509
Total expenditures, encumbrances and other financing uses	<u>14,467,443</u>	<u>13,588,557</u>	<u>878,886</u>
Excess or deficiency	\$ -	\$ 1,323,395	\$1,323,395

The original and the final budget of the General Fund for the fiscal year ended June 30, 2013 amounted to \$14,275,193 and \$14,467,443, 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, 2013 were \$14,911,952, which is approximately three percent (3%), or \$444,509 more 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, 2013 were \$13,588,557, which is approximately six percent (6%), or \$878,886 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, 2013 amounted to \$64,668,777 (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 \$7,791,722. **Table 6** present the major classes of capital assets.

Table 6 Capital Assets	Amount
Construction in progress	\$ 3,127,430
Land	6,071,776
Buildings and building improvements	40,770,354
Furniture and fixtures	579,655
Vehicles and equipment	934,610
Infrastructure	<u>13,184,952</u>
Total Assets	\$ 64,668,777

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

FOR THE FISCAL YEAR ENDED JUNE 30, 2013

LONG-TERM DEBT

At June 30, 2013, the Municipality had total of \$24,531,245 in general obligations and others outstanding debts, as shown in **Table 7**. Of this amount, \$20,222,000 comprises debt backed by the full faith and credit of the government and \$4,309,245 is other obligations.

Table 7	
Long Term Debts	Amount
General obligations bonds and notes	\$20,222,000
Others	<u>4,309,245</u>
Total Long Term Debts	<u>\$24,531,245</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 2013 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 POSITION
JUNE 30, 2013**

	<u>Governmental Activities</u>	<u>Business-type Activities</u>	<u>Total</u>
ASSETS:			
Cash and investments	\$ 9,049,467	\$ 513,088	\$ 9,562,555
Cash with fiscal agent	7,978,472	-	7,978,472
Receivables:			
Municipal license taxes	18,534	-	18,534
Sales and use taxes	218,363	-	218,363
Property taxes	202,684	-	202,684
Rent, licenses and permits	194,381	-	194,381
Intergovernmental	297,214	-	297,214
Interest, fines and penalties	223,431	-	223,431
Federal grants	163,972	-	163,972
Others	9,341	4,525	13,866
Other current assets	-	5,554	5,554
	<u>18,355,859</u>	<u>523,167</u>	<u>18,879,026</u>
Capital assets:			
Land, improvements, and construction in progress	9,199,206	58,350	9,257,556
Other capital assets, net of depreciation	55,469,571	1,320,582	56,790,153
Total capital assets	<u>64,668,777</u>	<u>1,378,932</u>	<u>66,047,709</u>
Other non-current assets	-	16,638	16,638
TOTAL ASSETS	<u>83,024,636</u>	<u>1,918,737</u>	<u>84,943,373</u>
LIABILITIES:			
Accounts payable and accrued liabilities	1,390,744	71,807	1,462,551
Bonds and notes payable	1,295,000	-	1,295,000
Accrued interests	493,663	-	493,663
Due to governmental units	207,165	-	207,165
Unearned revenues:			
Municipal license taxes	1,727,704	-	1,727,704
Long-term liabilities:			
Due within one year	1,786,976	112,909	1,899,885
Due in more than one year	22,744,269	638,231	23,382,500
TOTAL LIABILITIES	<u>29,645,521</u>	<u>822,947</u>	<u>30,468,468</u>
Deferred Inflows of Resources	<u>152,803</u>	<u>-</u>	<u>152,803</u>
NET POSITION			
Invested in capital assets, net of related debt	48,852,038	627,792	49,479,830
Restricted for:			
Debt service	2,719,049	-	2,719,049
Other purposes	2,709,017	385,005	3,094,022
Unrestricted (deficit)	<u>(1,053,792)</u>	<u>82,993</u>	<u>(970,799)</u>
TOTAL NET POSITION	<u>\$ 53,226,312</u>	<u>\$ 1,095,790</u>	<u>\$ 54,322,102</u>

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

**Commonwealth of Puerto Rico
Municipality of San Sebastián
Statement of Activities
For the Year Ended June 30, 2013**

Functions/Programs	Expenses	Charges for Services	Program Revenues		Net (Expense) Revenue and Change in Net Position		Total
			Operating Grants and Contributions	Capital Grants and Contributions	Governmental Activities	Business-type Activities	
Governmental Activities:							
General government	\$ 8,706,508	\$ 44,812	\$ -	\$ -	\$ (8,661,696)	\$ -	\$ (8,661,696)
Public safety	901,427	-	-	-	(901,427)	-	(901,427)
Public works	5,822,608	-	1,645,773	2,143,496	(2,033,339)	-	(2,033,339)
Culture and recreation	1,509,573	-	-	-	(1,509,573)	-	(1,509,573)
Health and welfare	7,125,408	1,059,647	6,098,295	-	32,534	-	32,534
Interest on long-term debt	1,011,310	-	-	-	(1,011,310)	-	(1,011,310)
Total governmental activities	\$ 25,076,834	\$ 1,104,459	\$ 7,744,068	\$ 2,143,496	(14,084,811)	-	(14,084,811)
Business-type Activities:							
Public housing and welfare, including interests on long-term obligation of \$52,029	\$ 610,348	\$ -	\$ 628,685	\$ -	-	18,337	18,337
Total business-type activities	\$ 610,348	\$ -	\$ 628,685	\$ -	-	18,337	18,337
General revenues:							
Property taxes					5,677,677	-	5,677,677
Municipal license tax					1,716,969	-	1,716,969
Sales and use tax					2,310,677	-	2,310,677
Other local taxes					723,293	-	723,293
Grant and contributions not restricted to specific programs					6,889,924	-	6,889,924
Interest and investment earnings					476,897	2,883	479,780
Miscellaneous					196,144	1,605	197,749
Total general revenues					17,991,581	4,488	17,996,069
Net change					3,906,770	22,825	3,929,595
Net position - beginning-as restated					49,319,542	1,072,965	50,392,507
Net position - ending					\$ 53,226,312	\$ 1,095,790	\$ 54,322,102

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, 2013

	General Fund	Head Start Fund	Debt Service Fund	Loans Fund	Other Governmental Funds	Total Governmental Funds
ASSETS						
Cash and investments	\$ 5,614,081	\$ 1,118	\$ -	\$ -	\$ 3,434,268	\$ 9,049,467
Cash with fiscal agent	-	-	4,415,315	3,563,157	-	7,978,472
Receivables:						
Municipal license taxes	18,534	-	-	-	-	18,534
Sales and use taxes	-	-	68,893	-	149,470	218,363
Property taxes	179,180	-	23,504	-	-	202,684
Rent, licenses and permits	194,381	-	-	-	-	194,381
Intergovernmental	-	-	-	-	297,214	297,214
Interest, fines and penalties	223,431	-	-	-	-	223,431
Federal grants	-	13,631	-	-	150,341	163,972
Others	2,417	808	-	-	6,116	9,341
Due from other funds	582,139	-	-	-	-	582,139
Total Assets	\$ 6,814,163	\$ 15,557	\$ 4,507,712	\$ 3,563,157	\$ 4,037,409	\$ 18,937,998
LIABILITIES, DEFERRED INFLOWS OF RESOURCES, AND FUND BALANCES						
LIABILITIES						
Accounts payable and accrued liabilities	\$ 333,841	\$ 15,557	\$ -	\$ 405,871	\$ 635,475	\$ 1,390,744
Bonds and notes payable	-	-	1,295,000	-	-	1,295,000
Accrued interests	-	-	493,663	-	-	493,663
Due to governmental units	207,165	-	-	-	-	207,165
Due to other funds	-	-	-	-	582,139	582,139
Unearned revenues:						
Municipal license taxes	1,727,704	-	-	-	-	1,727,704
Total Liabilities	2,268,710	15,557	1,788,663	405,871	1,217,614	5,696,415
DEFERRED INFLOWS OF RESOURCES						
Unavailable revenue:						
Property taxes	179,180	-	-	-	-	179,180
Rent, licenses and permits	189,911	-	-	-	-	189,911
Interest, fines and penalties	219,799	-	-	-	-	219,799
Federal grants	-	-	-	-	152,803	152,803
Total Deferred Inflows of Resources	588,890	-	-	-	152,803	741,693
Fund balances:						
Restricted	-	-	2,719,049	3,157,286	2,548,818	8,425,153
Assigned	359,850	-	-	-	118,174	478,024
Unassigned	3,596,713	-	-	-	-	3,596,713
Total fund balances	3,956,563	-	2,719,049	3,157,286	2,666,992	12,499,890
Total liabilities, Deferred Inflows of Resources, and Fund Balances	\$ 6,814,163	\$ 15,557	\$ 4,507,712	\$ 3,563,157	\$ 4,037,409	\$ 18,937,998

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

Commonwealth of Puerto Rico
Municipality of San Sebastián
Statement of Revenues, Expenditures and Changes in Fund Balances
Governmental Funds
For the Year Ended June 30, 2013

	General Fund	Head Start Fund	Debt Service Fund	Loans Fund	Other Governmental Funds	Total Governmental Funds
Revenues						
Property taxes	\$ 4,239,238	\$ -	\$ 1,567,401	\$ -	\$ -	\$ 5,806,639
Municipal license taxes	1,716,969	-	-	-	-	1,716,969
Sales and use taxes	-	-	816,952	-	1,493,725	2,310,677
Charges for services	901,911	-	-	-	-	901,911
Federal grants and contributions	-	2,932,081	-	-	2,661,699	5,593,780
State contributions	6,889,924	-	-	-	4,293,784	11,183,708
Licenses and permits	546,893	-	-	-	-	546,893
Interest, fines and penalties	420,873	-	3,338	-	30,343	454,554
Other revenues	196,144	-	-	-	202,548	398,692
Total revenues	14,911,952	2,932,081	2,387,691	-	8,682,099	28,913,823
Expenditures						
Current						
General government	8,711,238	-	-	1,266,107	-	9,977,345
Public safety	830,937	-	-	-	-	830,937
Public works	2,395,623	-	-	17,252	2,527,857	4,940,732
Culture	182,457	-	-	-	-	182,457
Recreation	357,781	-	-	-	11,195	368,976
Health and welfare	708,133	2,932,081	-	-	3,394,665	7,034,879
Capital outlay	-	-	-	3,567,309	5,427,349	8,994,658
Debt service:						
Principal	-	-	1,545,000	-	-	1,545,000
Interest and other charges	-	-	1,011,310	-	-	1,011,310
Total expenditures	13,186,169	2,932,081	2,556,310	4,850,668	11,361,066	34,886,294
Excess (deficiency) of revenues over (under) expenditures	1,725,783	-	(168,619)	(4,850,668)	(2,678,967)	(5,972,471)
Other financing sources (uses)						
Long term debt issuance	-	-	-	4,610,000	-	4,610,000
Transfers in	2,428	-	314,563	-	-	316,991
Transfers out	(314,563)	-	(2,006)	-	(422)	(316,991)
Total other financing sources (uses)	(312,135)	-	312,557	4,610,000	(422)	4,610,000
Net change in fund balances	1,413,648	-	143,938	(240,668)	(2,679,389)	(1,362,471)
Fund balance (deficit), beginning-as restated	2,542,915	-	2,575,111	3,397,954	5,346,381	13,862,361
Fund balance (deficit), ending	\$ 3,956,563	\$ -	\$ 2,719,049	\$ 3,157,286	\$ 2,666,992	\$ 12,499,890

A.P. [Signature]

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 POSITION
FOR THE FISCAL YEAR ENDED JUNE 30, 2013**

TOTAL FUND BALANCES – GOVERNMENTAL FUNDS **\$ 12,499,890**

Amounts reported for Governmental Activities in the Statement of Net Position 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	\$9,199,206	
Depreciable Capital Assets	76,826,755	
Accumulated Depreciation	<u>(21,357,184)</u>	
 Total Capital Assets		 64,668,777

Some of the Municipality's receivables will be collected after year end, but are not available soon enough to pay for the current period's expenditure and therefore, are deferred in the funds	588,890
---	---------

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	(20,222,000)	
Compensated Absences	(2,781,191)	
Property Tax Debt – Law 42	(913,171)	
Property Tax Debt – Law 146	(143,786)	
State Health Insurance Administration	(256,266)	
Landfill Closure and Post-Closures Costs	<u>(214,831)</u>	
 Total Long-Term Liabilities		 <u>(24,531,245)</u>

TOTAL NET POSITION OF GOVERNMENTAL ACTIVITIES **\$ 53,226,312**

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, 2013

NET CHANGE IN FUND BALANCES – TOTAL GOVERNMENTAL FUNDS \$ (1,362,471)

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.....	9,251,412	
Depreciation Expense	<u>(2,231,172)</u>	
Excess of Capital Assets Additions over Depreciation Expense		7,020,240

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 the funds. The following amount represented these revenues from prior year	(519,109)
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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 the funds. The following amount represented these revenues from current year	588,890
---	---------

Debt proceeds provide current financial resources to governmental funds, but issuing debt increases long- term liabilities in the Statement of Net Position. In the current period these amounts are	(4,610,000)
--	-------------

Repayment of debt proceeds principal is expenditure in the governmental funds, but the repayment reduces Long-Term Liabilities in the Statement of Net Position. In the current year the repayments were.....	1,545,000
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Repayment of long-term principal is expenditure in the governmental funds, but the repayment reduces Long-Term Liabilities in the Statement of Net Position. In the current year, the repayments were:

Property Tax Debt – Law 42.....	23,663	
Property Tax Debt – Law 146.....	7,568	
Estimated Landfill Closure and Post-closure Care Cost.....	16,267	
Compensated absences.....	(53,278)	
Claims and Judgments.....	<u>1,250,000</u>	
Total Additional Expenditures.....		<u>1,244,220</u>

CHANGE IN NET POSITION OF GOVERNMENTAL ACTIVITIES \$3,906,770

See accompanying Notes to Basic Financial Statements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN
STATEMENT OF NET POSITION- PROPRIETARY FUND
June 30, 2013

	<u>Business-type Activities</u>
ASSETS:	
Current Assets:	
Cash	\$ 128,083
Accounts receivables	4,525
Miscellaneous prepaid expenses	<u>5,554</u>
Total current assets	<u>138,162</u>
Restricted Assets:	
Restricted cash	<u>385,005</u>
Capital Assets:	
Land	58,350
Building and other depreciable assets, net of accumulated depreciation	<u>1,320,582</u>
Total capital assets	<u>1,378,932</u>
Other assets	<u>16,638</u>
Total Assets	<u><u>\$ 1,918,737</u></u>
LIABILITIES:	
Current Liabilities:	
Mortgage payable	\$ 112,909
Accounts payable	45,306
Accrued liabilities	12,368
Tenant security deposits	<u>14,133</u>
Total current liabilities	184,716
Non-current liabilities:	
Mortgage payable	<u>638,231</u>
Total liabilities	<u>822,947</u>
NET POSITION	
Invested in Capital Assets, Net of Related Debt	627,792
Restricted deposits	385,005
Unrestricted	<u>82,993</u>
Total net position	<u>1,095,790</u>
Total Liabilities and Net Position	<u><u>\$ 1,918,737</u></u>

See accompanying notes to basic financial statements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN
FUND NET POSITION - PROPRIETARY FUND
FOR THE FISCAL YEAR ENDED JUNE 30, 2013

	<u>Business-type Activities</u>
REVENUES	
Rent	\$ 628,685
Other	<u>1,605</u>
Total revenues	<u>630,290</u>
EXPENSES	
Administrative	166,447
Utilities	19,820
Operating and maintenance	192,681
Taxes and insurance	44,730
Depreciation	<u>134,641</u>
Total expenses	<u>558,319</u>
Operating income	<u>71,971</u>
NON OPERATING REVENUES (EXPENSES)	
Interest received	2,883
Interest on mortgage	<u>(52,029)</u>
Total non operating revenues (expenses)	<u>(49,146)</u>
Net Change	<u>22,825</u>
Fund Net Position, beginning	<u>1,072,965</u>
NET POSITION, END OF YEAR	<u><u>\$ 1,095,790</u></u>

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, 2013**

	Business-type Activities
CASH FLOWS FROM OPERATING ACTIVITIES	
Cash received from tenants and HUD	\$ 625,496
Other cash received	1,605
	627,101
Administrative	(38,400)
Management fees	(60,480)
Salaries and wages	(123,678)
Utilities	(19,820)
Operating and maintenance	(113,586)
Miscellaneous taxes and insurance	(45,784)
	(401,748)
Net cash provided by operating activities	225,353
CASH FLOW FROM CAPITAL AND RELATED	
FINANCING ACTIVITIES	
Interest paid in capital debt	(52,739)
Mortgage principal payment	(106,569)
Purchase of capital assets	(245,699)
	(405,007)
CASH FLOWS FROM INVESTING ACTIVITIES	
Deposits to reserve for replacement and interest retained in account	(30,877)
Withdrawal from reserve for replacement account	183,860
Deposits to reserve for insurance escrow	(16,714)
Withdrawal from reserve for insurance escrow	16,714
Interest on investment	2,883
	155,866
Net cash provided by investing activities	155,866
Net decrease in cash	(23,788)
Cash at beginning of year	151,871
Cash at end of year	\$ 128,083

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN
STATEMENT OF CASH FLOWS- PROPRIETARY FUND (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2013**

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

Operating income	<u>\$ 71,971</u>
Adjustment to reconcile change in net position to net cash provided by operating activities:	
Depreciation	134,641
(Increase) decrease in:	
Receivables	(3,189)
Miscellaneous prepaid expenses	(2,072)
Tenant security deposits	386
Increase (decrease) in:	
Accounts payable- 30 days	22,632
Payroll	367
Tenant security deposits	<u>617</u>
	<u>153,382</u>
Net cash provided by operating activities	<u><u>\$ 225,353</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, 2013, 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, 2013, 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*, (4) GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, and (5) GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*.

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 A, *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, 2013. 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, 2013, 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 Position 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, 2013, 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 Position 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 Position 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 Position presents the reporting entities' assets and liabilities, with the difference reported as net position. Net position is 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** – These results when constraints are placed the use of resources, which can be either externally imposed by creditors, grantors, contributors, and the like, or imposed by law through constitutional provisions or enabling legislation.
- ❖ **Unrestricted** – These consists of resources which do not meet the definition of the two preceding categories. Unrestricted resources often are designated, to indicate that management does not consider them to be available for general operations. Unrestricted resources often have constraints 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.

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

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, 2013, 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 30, 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 Revenue 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, 2013.

<u>BALANCE JUNE 30, 2012</u>	<u>NEW ISSUES</u>	<u>RETIREMENTS AND CURRENT MATURATES</u>	<u>BALANCE JUNE 30, 2013</u>	<u>CURRENT PORTION</u>	<u>LONG-TERM PORTION</u>
<u>\$ 2,727,913</u>	<u>\$53,278</u>	<u>\$ _____</u>	<u>\$ 2,781,191</u>	<u>\$ 212,178</u>	<u>\$ 2,781,191</u>

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 Municipal Revenue Collection Center 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 during the fiscal year 2012-2013 amounted to \$393,374. From this amount, \$5,773 was deducted from the gross property tax collections by the Municipal Revenue Collection Center ("CRIM"). The current insurance policies have not been cancelled or terminated. The CRIM also deducted \$326,078 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, 2013:

- ❖ GASB Statement No. 61, *The Financial Reporting Entity: Omnibus- an amendment of GASB Statements No. 14 and No. 34*. This statement is effective for reporting periods beginning after June 30, 2013;
- ❖ GASB Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions (an amendment of GASB Statement No. 53)*. This statement is effective for reporting periods beginning after June 30, 2013;
- ❖ GASB Statement No. 69, *Government Combinations and Disposal of Government Operations*. This statement is effective for reporting periods beginning after December 15, 2013;
- ❖ GASB Statement No. 68, *Accounting and Financial Reporting for Pensions – an Amendment of GASB Statement No. 27*. This statement is effective for fiscal years beginning after June 15, 2014. Earlier application is encourage.

The Municipality'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.

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 it's 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, 2013.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SAN SEBASTIAN

NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)

NOTE 2 – CASH AND CASH EQUIVALENTS (CONTINUED)

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, 2013, (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, 2013, 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, 2013. Therefore, the Municipality's management has concluded that at June 30, 2013 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, 2013.

The Municipality's bank balances in commercial banks of \$5,614,171 in the General Fund, \$1,118 in the Head Start Fund and \$3,434,268 in Other Governmental Funds, were fully collateralized at June 30, 2013. The deposits at GDB of \$4,415,315 in the Debt Service Fund and \$3,563,157 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 \$68,893 and \$149,470 in the Debt Service Fund and in Other Governmental Funds, respectively, represents the amounts due by the taxpayers at June 30, 2013.

B. PROPERTY TAXES RECEIVABLES

Property taxes receivable amounting to \$179,180 in the General Fund represents the final liquidation of the property taxes of the fiscal year 2012-2013, not collected by the Municipality at June 30, 2013. Property taxes receivable in the amount of \$23,504 in the Debt Service Fund represents advances from fiscal year 2012-2013, not collected by the Municipality at June 30, 2013.

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:

Description	Amount
State Department of Labor- Law 52	<u>\$297,214</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:

Program Description	Amount
Head Start	\$ 13,631
Public & Indian Housing	8,845
Community Development Block Grant	15,199
Child Care & Development Block Grant	44,417
Child & Adult Care Food Program	81,656
Others	<u>224</u>
Total	<u>\$163,972</u>

E. OTHERS ACCOUNTS RECEIVABLE

At June 30, 2013, the Municipality maintained in the General Fund other miscellaneous receivables amounting to \$2,327. In addition, the Head Start Fund and the Other Governmental Funds maintained miscellaneous receivables amounting to \$808 and \$6,116 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, 2013 are summarized as follows:

Receivable Fund	Payable Fund	Purpose	Amount
General Fund	Other Governmental Funds	Payroll and related accruals paid and not reimbursed	\$449,202
General Fund	Other Governmental Funds	Operating loans and operational costs paid and not reimbursed	<u>132,937</u>
Total			<u>\$582,139</u>

NOTE 5 – CAPITAL ASSETS

A summary of capital assets and changes occurring in 2013 for the Municipality was as follows:

Governmental Activities	Balance July 1, 2012 (as restated)	Additions	Retirements / Reclassifications	Balance June 30, 2013
Capital asset, not being depreciated:				
Land	\$ 5,737,776	\$ 334,000	\$ -	\$ 6,071,776
Construction in progress	<u>8,104,515</u>	<u>7,677,771</u>	<u>(12,654,856)</u>	<u>3,127,430</u>
Total capital assets not being depreciated	<u>13,842,291</u>	<u>8,011,771</u>	<u>(12,654,856)</u>	<u>9,199,206</u>
Capital assets, being depreciated:				
Buildings and building improvements	38,777,207	12,742,321	-	51,519,528
Furniture and fixtures	2,880,437	324,443	-	3,204,880
Vehicles and equipment	6,606,694	401,161	-	7,007,855
Infrastructure	<u>13,896,438</u>	<u>1,198,054</u>	-	<u>15,094,492</u>
Total capital assets being depreciated	<u>62,160,776</u>	<u>14,665,979</u>	-	<u>76,826,755</u>
Less accumulated depreciation for:				
Buildings and building improvements	(9,461,202)	(1,287,972)	-	(10,749,174)
Furniture and fixtures	(2,343,827)	(281,398)	-	(2,625,225)
Vehicles and equipment	(5,713,333)	(359,912)	-	(6,073,245)
Infrastructure	<u>(1,607,650)</u>	<u>(301,890)</u>	-	<u>(1,909,540)</u>
Total accumulated depreciation	<u>(19,126,012)</u>	<u>(2,231,172)</u>	-	<u>(21,357,184)</u>
Total capital assets being depreciated, net	<u>43,034,764</u>	<u>12,434,807</u>	-	<u>55,469,571</u>
Governmental activities capital assets, net	<u>\$ 56,877,055</u>	<u>\$ 20,446,578</u>	<u>\$(12,654,856)</u>	<u>\$ 64,668,777</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	\$ 111,493
Public Safety	70,490
Public Works	575,546
Culture	1,015,250
Recreation	2,678
Health and Welfare	<u>455,715</u>
Total depreciation expenses	<u>\$ 2,231,172</u>

A summary of capital assets and changes occurring in 2013 for Villa Soigal Project was as follows:

<u>Business-type Activities</u>	<u>Balance July 1, 2012</u>	<u>Additions</u>	<u>Retirements / Reclassifications</u>	<u>Balance June 30, 2013</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	26,722	-	3,682,092
Building equipment	512,248	218,976	-	731,224
Furniture and fixtures	33,584	-	-	33,584
Equipment	<u>12,703</u>	<u>-</u>	<u>-</u>	<u>12,703</u>
Total capital assets being depreciated	<u>4,953,529</u>	<u>245,698</u>	<u>-</u>	<u>5,199,227</u>
Less accumulated depreciation for:				
Land improvements	(560,882)	(18,491)	-	(579,373)
Building and building improvements	(2,906,039)	(96,270)	-	(3,002,309)
Building equipment	(232,126)	(19,062)	-	(251,188)
Furniture and fixtures	(32,983)	(256)	-	(33,239)
Equipment	<u>(11,975)</u>	<u>(561)</u>	<u>-</u>	<u>(12,536)</u>
Total accumulated depreciation	<u>(3,744,005)</u>	<u>(134,640)</u>	<u>-</u>	<u>(3,878,645)</u>
Total capital assets being depreciated, net	<u>1,209,524</u>	<u>111,058</u>	<u>-</u>	<u>1,320,582</u>
Governmental activities capital assets, net	<u>\$ 1,267,874</u>	<u>\$ 111,058</u>	<u>\$ -</u>	<u>\$ 1,378,932</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 2012-2013, and not paid by the Municipality at June 30, 2013. Following is a detail of these accounts payable and accrued liabilities by major fund:

Major Governmental Funds	Accounts Payable	Accrued Liabilities	Total
General Fund	\$ 260,017	\$73,824	\$ 333,841
Head Start Fund	15,557	-	15,557
Loans Fund	405,871	-	405,871
Other Governmental Funds	<u>635,475</u>	-	<u>635,475</u>
Total	<u>\$ 1,316,920</u>	<u>\$73,824</u>	<u>\$1,390,744</u>

NOTE 7 – BONDS AND NOTES PAYABLE

As described 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, 2013, 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	\$ 1,295,000
Accrued interests	<u>493,663</u>
Total	<u>\$ 1,788,663</u>

NOTE8 – DUE TO OTHER GOVERNMENTAL UNITS

As of June 30, 2013, balance due to other governmental units consists of the following:

Governmental Agency	Amount
General Service Administration	\$ 2,514
Puerto Rico Water and Sewer Authority	79,896
State Insurance Fund Corporation	2,718
Retirement System Administration	63,707
Puerto Rico Department of Treasury	5,844
Puerto Rico Department of Labor	2,379
Internal Revenue Service	<u>50,107</u>
Total	<u>\$ 207,165</u>

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

NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)

NOTE 9 – DEFERRED INFLOWS OF RESOURCES

- A. Property taxes** – Unavailable revenues related to property taxes amounting to \$179,180 in the General Fund represents the final liquidation of the property taxes of the fiscal year 2012-2013, not collected by the Municipality at June 30, 2013.
- B. Rent, licenses and permits**– Unavailable revenues amounting to \$189,911 in the General Fund represents the revenues related to the rent of Municipality’s property for the fiscal year 2012-2013, not collected at June 30, 2013.
- C. Interests, fines and penalties**– Unavailable revenues amounting to \$219,799 in the General Fund represents the penalties applied to the taxpayers that did not paid in a timely manner or did not paid the municipal license taxes. This amount has not been collected at June 30, 2013.
- D. Federal Grants** –Unavailable revenues presented in the Other Governmental Funds represents the portion of federal grants received for which qualifying expenditures have not been incurred. Deferred inflows of resources from the federal government are as follows:

<u>Program Description</u>	<u>Amount</u>
Public Assistance Grants	<u>\$ 152,803</u>
Total	<u>\$ 152,803</u>

NOTE 10 – GENERAL LONG-TERM DEBTS

Long-term liability activity for the year ended on June 30, 2013, 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	\$ 17,157,000	\$ 4,610,000	\$ (1,545,000)	\$ 20,222,000	\$ 1,525,000
Property Tax Debt – Law 42	936,834	-	(23,663)	913,171	25,150
Property Tax Debt – Law 146	151,354	-	(7,568)	143,786	7,568
Estimated landfill closure and post-closure care cost	231,098	-	(16,267)	214,831	17,080
Compensated absences	2,727,913	53,278	-	2,781,191	212,178
Claims and Judgments	1,250,000	-	(1,250,000)	-	-
Health Insurance Administration	256,266	-	-	256,266	-
Total	<u>\$ 22,710,465</u>	<u>\$ 4,663,278</u>	<u>\$ (2,842,498)</u>	<u>\$ 24,531,245</u>	<u>\$ 1,786,976</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	\$ 857,709	\$ -	\$ (106,569)	\$ 751,140	\$ 112,909
Total	\$ 857,709	\$ -	\$ (106,569)	\$ 751,140	\$ 112,909

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, 2013, 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	\$ 880,000
\$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	185,000
\$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	1,025,000
\$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	1,115,000
\$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	545,000
\$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	995,000
\$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	180,000
\$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	507,000

**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)

DESCRIPTION	AMOUNT
\$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	3,145,000
\$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	325,000
\$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	925,000
\$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	1,410,000
\$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	570,000
\$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	1,400,000
\$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	2,565,000
\$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 7.00%, through July 1, 2017	175,000
\$1,275,000, Series 2012, for construction purposes, payable in annual installments ranging from \$140,000 to \$225,000, excluding variable interest from 6.00% to 7.50%, through July 1, 2019	1,135,000
\$2,075,000, Series 2012, for construction purposes, payable in annual installments ranging from \$50,000 to \$190,000, excluding variable interest from 6.00% to 7.50%, through July 1, 2032	2,025,000
\$1,260,000, Series 2012, for operational purposes, payable in annual installments ranging from \$145,000 to \$220,000, excluding variable interest from 6.00% to 7.50%, through July 1, 2019	<u>1,115,000</u>
Total General Obligations	<u>\$ 20,222,000</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, 2013 are as follows:

Year Ending June 30,	Principal payment	Interest payment	Total
2014	\$ 1,525,000	\$ 1,140,383	\$ 2,665,383
2015	1,650,000	1,189,910	2,839,910
2016	1,690,000	1,093,303	2,783,303
2017	1,277,000	1,002,814	2,279,814
2018	1,155,000	957,681	2,112,681
2019-2023	4,210,000	3,782,746	7,992,746
2024-2028	4,305,000	2,453,931	6,758,931
2029-2033	4,030,000	883,614	4,913,614
2034-2038	380,000	27,200	407,200
Total	<u>\$20,222,000</u>	<u>\$ 12,531,582</u>	<u>\$ 32,753,582</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
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	146,333	12,091	158,424
2019	105,740	2,672	108,412
Total	<u>\$751,140</u>	<u>\$149,392</u>	<u>\$ 900,532</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, 2013 amounted to \$913,171.

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, 2013 amounted to \$143,786.

D. PROPERTY TAX DEBTS

The annual requirements to amortize the property tax debts (Law 42 and Law 146) outstanding as of June 30, 2013 are as follows:

Year Ending June 30,	Principal payment	Interest payment	Total
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	39,659	56,238	95,897
2019-2023	231,197	241,228	472,425
2024-2028	300,072	160,586	460,658
2029-2033	345,276	55,412	400,688
Total	<u>\$ 1,056,957</u>	<u>\$ 761,007</u>	<u>\$1,817,964</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 position includes \$2,781,191 of accrued sick leave benefits, and accrued vacation benefits, representing the Municipality's commitment to fund such costs from future operations.

F. STATE INSURANCE HEALTH ADMINISTRATION

Liabilities of \$256,266 reported in the statement of net position represent the balance owed for services provided by the State Insurance Health Administration to the Municipality and not paid at June 30, 2013.

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 position 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 \$214,831 as of June 30, 2013.

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 Municipal Revenue Collection Center of the Commonwealth of Puerto Rico to the Municipality.

These property taxes are accumulated by the Municipal Revenue Collection Center 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 Municipal Revenue Collection Center 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.

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

NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)

NOTE 14 – MUNICIPAL LICENSE TAXES (CONTINUED)

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 unearned revenues in the General Fund.

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%, 0.51% 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.

Puerto Rico Law 40 of 2013, as amended, will reduce the total municipal sales and use tax to 1% (from the previous total 1.5%) effective February 1, 2014, which would eliminate the 0.5% collected by the PR Treasury.

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, 2013, are summarized as follows:

Transfer Out	Transfer In	Purpose	Amount
General Fund	Debt Service Fund	Debt retirement	\$ 314,563
Debt Service Fund	General Fund	To cover operational expenditure	2,006
Other Governmental Fund	Debt Service Fund	To cover operational expenditure	<u>422</u>
Total			<u>\$ 316,991</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 Puerto Rico Law 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, its instrumentalities, and municipalities and components units not covered by their own retirement systems.

Participation is mandatory for governmental and municipal employees, 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. Temporary and transitory employees are excluded from participation in the System. 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, and their hiring date. 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.

Law Number 305 of September 24, 1999, amended Puerto Rico Law Number 447, establishing a savings program called "Retirement System 2000". All employees active in the system as of December 31, 1999 may have elected to transfer from defined contribution programs to the new savings program (a defined contribution plan). Employees in the savings program may have contribute from a minimum of 8.275% up to a maximum of 10% of their monthly salary, and will 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 have elected 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.

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

NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)

NOTE 18- EMPLOYEE'S RETIREMENT PLAN (CONTINUED)

Puerto Rico Law Number 3 of April 4, 2013 created a new hybrid system incorporating elements of defined benefit and defined contribution plans. As of July 1, 2013, every employee who is a participant of the ERS who had not retired as of June 30, 2013, and any new participant who joins after that date, shall become part of the Defined Contribution Hybrid Program. As per Puerto Rico Law Number 3 of 2013, new provisions shall apply to employees who participate in the System that (1) began to work before January 1, 2000, (2) as of June 30, 2013, are not participants of the Retirement Savings Account Program established in Chapter 3 of Law Number 3, and (3) as of June 30, 2013, do not meet the requirements of years of service and age to retire that are required in Chapter 2 of Law Number 3, or having met such requirements did not elect to retire before July 1, 2013. The savings accounts under the Retirement System 2000 of employees who joined the System for the first time on or after January 1, 2000, shall be rolled over to the Defined Contribution Hybrid Program. Additionally, those who could retire on or before June 30, 2013 because they are 60 years old, may retire on any later date, and they shall be entitled to receive the annuity that could be acquired with the balance of the contributions under the Retirement Savings Account Program which are transferred to the Defined Contribution Hybrid Program.

Under the plans, the employees and employer portions are contributed, for which, the employee amount is withheld from salaries. The authority under which the funding policy and the obligations to contribute to the ERS and System 2000 by the plans' members, employers and other contributing entities (state of municipal contributions), are established or may be amended by law:

- Up to June 30, 2013, covered employees were 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.
- After June 30, 2013, every participant of the Hybrid Program shall compulsorily have to contribute 10% of his/her salary while he/she is an employee. The participants of the Hybrid may voluntarily contribute to their account an amount in addition to the one established here. These contributions shall be credited to the contribution account of each participant of the Hybrid Program. Employees who contribute to the retirement system in a special plan with the ERS in coordination with their contributions to Social Security, as defined by the ERS administrator, will be required to contribute 7% of their monthly salaries up to \$550 for FY 2014, to be increased to 8.5% for FY 2015, and finally 10% for FY 2016 and all future periods.
- The Municipality contributed to the system 9.275% of the participating employee's salaries for the fiscal year ended in June 30, 2013 and prior years. Puerto Rico Law 116 of July 6, 2011 increased the employer contribution rate required from the Municipality. The contribution rate increased from 9.275% to 20.775%, to be implemented in incremental 1% to 1.25% annual increased between those years. The same law provided that for fiscal years 2012, 2013, and 2014, the Puerto Rico Office of Management and Budget would contribute these increases for all Municipalities. Starting in fiscal year 2014-2015, the Municipality is required to contribute 12.275% of the participating employee's salaries for that period, and the rate will increase to 13.275% in FY 2016, 14.525% in FY 2017, 15.775% in FY 2018, 17.025% in FY 2019, 18.275% in FY 2020, and finally to 19.525% in FY 2021 and all future periods.

Before July 1, 2013, all employees that did not elect to transfer for the System 2000 Savings program and who at the time of employment were 55 years old or less were eligible to participate in the defined contribution system, with pension benefits for participants as follows:

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

NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)

NOTE 18- EMPLOYEE'S RETIREMENT PLAN (CONTINUED)

<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 (employees hired before April 1, 1990).
30 or more	65 or more	75% of the average of the three years of highest salary during the employee's service period (employees hired after April 1, 1990).
Less than 30, more than 10	N/A	1.5% of their average compensation for each year of credit service for the remaining years.

After July 1, 2013, both the defined contribution and System 2000 Savings systems will be converted to the new Hybrid Defined Contribution System. The following the changes implemented by Puerto Rico Law 3 of 2013, all employees that elect to retire, regardless of the previous retirement system they participated in, will be entitled to retire and receive their benefits under the following conditions:

<u>PREVIOUS RETIREMENT PROGRAM</u>	<u>YEARS OF SERVICE</u>	<u>PARTICIPANT'S AGE, AS OF JUNE 30, 2013</u>	<u>ELIGIBLE AGE TO RETIRE</u>
Savings System ("System 2000")	N/A	60 years or more	May retire at any time in the future after June 30, 2013.
Savings System ("System 2000")	N/A	55 to 59 years	May retire once participant meets the predetermined age of 61 to 65 years of age, respectively.
Savings System ("System 2000")	N/A	55	May retire at any time in the future after June 30, 2013, but only for public officers in high-risk positions.
Defined Benefit Program (employed before April 1, 1990).	25 or 10 years or more, respectively	54 or 57 years or less, respectively	May retire once participant meets the predetermined age of 59 to 61 years of age and 10 years of service.
Defined Benefit Program (hired after April 1, 1990 but before January 1, 2000).	10 years	64 years or less	May retire once participant meets the predetermined age of 65 years of age.
All other employees not covered above.	10 years	65 years or more	May retire at any time in the future after June 30, 2013.

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

NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)

NOTE 18- EMPLOYEE'S RETIREMENT PLAN (CONTINUED)

Public Officers in High-Risk Positions may voluntarily opt to retire after reaching the age of 55 and 30 years of service. Retirement shall be mandatory on the date the participant reaches both 30 years of service and the age of 58. Retirement shall be optional for the members of the System in active service, on and after the date they have attained the age of 55 years and have completed at least 25 years of creditable service; and for members of the System who having reached the age of 58 years, and have completed at least 10 years of creditable service. The members of the Police shall also have the option of a retirement annuity on and after the date on which they have attained the age of 50 years and have completed at least 25 years of creditable service. Any participant whose separation from the service occurs prior to having attained the age of 58 years, who shall have completed at least 10 years of creditable service, and who shall have not applied for, nor received reimbursement of accumulated contributions shall be entitled to receive a deferred retirement annuity. Said participants shall receive a deferred retirement annuity which shall commence upon attaining the age of 58 years or after attaining the age of 50 years in the case of policemen or firemen, and 55 years in the case of the other participants, if they have completed at least 25 years of service in one case or the other.

For employees who were hired before April 1, 1990, the amount of the annuity shall be one and 1.50% of the average compensation multiplied by the number of years of creditable service up to 20 years, plus 2% of the average compensation multiplied by the number of years of creditable service in excess of 20 years up to June 30, 2013. For employees hired after April 1, 1990, the amount of the annuity shall be 1.5% of the average compensation multiplied by the years of accredited services up to June 30, 2013. From July 1, 2013 onwards, participants in the retirement system will not accumulate new years of service nor receive accreditation for previously unrecognized service years, transfer contributions, or return contributions for periods ending on or before June 30, 2013.

However, a minimum pension of \$500 per month, effective July 1, 2013, is hereby fixed for those participants who retired in from the retirement systems. Every pensioner who receives pension of less than \$500 per month shall receive, effective July 1, 2013, the increase require for his/her pension to be \$500.

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.

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.

Contributions in 2013 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.

**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.

In the event of the death of any participant who had contributions accrued in the new hybrid system, contributions would be reimbursed to heirs or other designated persons as determined by the participant, equal to the original contributions plus undistributed income up to the date of the participant's death. In the case of total and permanent disability or due to terminal illness, the participant will be entitled to his or hers contributions in a lump sum or an annuity at the option of the participant. The Puerto Rico Employee Retirement System also established a disability benefits program, which may provide temporary annuities by means of disability insurance in the event of total and permanent disabilities, and is funded by a maximum of 0.25% of participant's salary.

Additional benefits are annually awarded for participants of the defined contribution and hybrid retirement systems, but not the Retirement 2000 System, now replaced by the hybrid system. These benefits include a medicine bonus of \$100 provided by July 15th, a Christmas bonus of \$200 provided by December 20th, and contribution of \$100 by the Systems to employees' medical insurance plans. These additional benefits are funded by a special contribution by the Municipality to the systems beginning from fiscal year 2013-2014 onwards in the order of \$2,000 for every pensioner in the Systems who began to work before December 31, 1999.

The total pension expenditures recorded in the category of administration for the Fiscal Year Ended June 30, 2013 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, 2013. 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 not reported liabilities in the government wide statement of net position.

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.

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

NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)

NOTE 19- CONTINGENCIES (CONTINUED)

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.

NOTE 20 - FUND BALANCE

As of June 30, 2013, the fund balance is comprised of the following:

Fund Balance	General Fund	Debt Service Fund	Loans Fund	Other Governmental Fund	Total
Restricted for:					
Public Works	\$ -	\$ -	\$ -	\$ 706,419	\$ 706,419
Recreation	-	-	-	1,243,161	1,243,161
Health and Welfare	-	-	-	104,685	104,685
Capital Outlays	-	-	3,157,286	494,553	3,651,839
Debt Service	-	2,719,049	-	-	2,719,049
Assigned for:					
General Government	205,711	-	-	-	205,711
Public Safety	6,795	-	-	-	6,795
Public Works	133,877	-	-	-	133,877
Culture	10,396	-	-	-	10,396
Recreation	3,071	-	-	-	3,071
Health and Welfare	-	-	-	118,174	118,174
Unassigned	<u>3,596,713</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>3,596,713</u>
Total Fund Balance	<u>\$ 3,956,563</u>	<u>\$ 2,719,049</u>	<u>\$3,157,286</u>	<u>\$ 2,666,992</u>	<u>\$ 12,499,890</u>

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

NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)

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	Other Governmental Fund
Fund balance, beginning	\$ 2,296,524	\$ 5,592,772
To eliminate interfund balances that are no longer valid	<u>246,391</u>	<u>(246,391)</u>
Fund balance, beginning as restated	<u>\$ 2,542,915</u>	<u>\$ 5,346,381</u>

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 position:

Description	Total
Net position, beginning	\$ 45,189,327
To adjust the claims and judgments	550,000
To recognize state donation land	334,000
To recognize state donation construction in progress	<u>3,246,215</u>
Net position, beginning as restated	<u>\$ 49,319,542</u>

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

NOTES TO THE BASIC FINANCIAL STATEMENTS (CONTINUED)

NOTE 22 –NEW ACCOUNTING STANDARDS

The provisions of the following Governmental Accounting Standards Board (GASB) Statement have been implemented for the year ended June 30, 2013:

GASB Statement No. 62 *Codification of Accounting and Financial Reporting Guidance in Pre-November 30, 1989 FASB and AICPA Pronouncements*: The objective of this Statement is to incorporate into the GASB's authoritative literature certain accounting and financial reporting guidance that is included in the following pronouncements issued on or before November 30, 1989, which does not conflict with or contradict GASB pronouncements:

1. Financial Accounting Standards Board (FASB) Statements and Interpretations
2. Accounting Principles Board Opinions
3. Accounting Research Bulletins of the American Institute of Certified Public Accountants' (AICPA) Committee on Accounting Procedures

GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, This Statement provides financial reporting guidance for deferred outflows of resources and deferred inflows of resources.

GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*. This Statement established accounting and financial reporting that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously as revenues and expenses. The adoption of this statement require that debt issuance cost be recognized as an expenses in the period incurred.

GASB Statement No. 66, *Technical Correction – 2012- an amendment of GASB Statements No. 10 and No. 62*. The objective of this Statement is to improve accounting and financial reporting for a governmental financial reporting entity by resolving conflicting guidance that resulted from the issuance of two pronouncements, Statement No. 54 Fund Balance Reporting and Governmental Fund Type Definitions, No. 62 Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 199 FASB and AICPA Pronouncements.

NOTE 23 – SUBSEQUENT EVENTS

On August 15, 2013, the Municipality's Executive Branch approved Ordinance Number 16, authorizing to issue a general obligation bond in the amount of \$1,730,000.

Municipality has evaluated events through December 20, 2013, the date which the financial statements were available to be issued. Except for subsequent events mentioned above, no additional events were identified that should be disclosed or adjusted in the Financial Statements or its Notes.

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

BUDGETARY COMPARISON SCHEDULE- GENERAL FUND

FOR THE FISCAL YEAR ENDED JUNE 30, 2013

	<u>Budgeted Amounts</u>		<u>Actual Amounts (Budgetary Basis) (See Note A)</u>	<u>Variance with Final Budget Positive (Negative)</u>
	<u>Original</u>	<u>Final</u>		
REVENUES:				
Property taxes	\$ 3,904,948	\$ 3,904,948	\$ 4,239,238	\$ 334,290
Municipal license taxes	1,800,000	1,800,000	1,716,969	(83,031)
Charges for services	722,000	722,000	901,911	179,911
State contributions	6,724,830	6,724,830	6,889,924	165,094
Licenses and permits	590,415	590,415	546,893	(43,522)
Interest, fines and penalties	245,000	245,000	420,873	175,873
Other revenues	288,000	288,000	196,144	(91,856)
Prior year allocation	-	192,250	-	(192,250)
Total revenues	<u>14,275,193</u>	<u>14,467,443</u>	<u>14,911,952</u>	<u>444,509</u>
EXPENDITURES, ENCUMBRANCES AND OTHER FINANCING USES:				
Current:				
General government	9,590,672	9,172,459	8,813,012	359,447
Public safety	1,038,347	1,066,876	837,050	229,826
Public works	2,109,192	2,572,377	2,366,263	206,114
Culture	290,660	191,431	189,678	1,753
Recreation	353,758	379,486	359,858	19,628
Health and welfare	750,844	750,844	708,133	42,711
Transfers to other funds	141,720	333,970	314,563	19,407
Total expenditures, encumbrances and other financing uses	<u>14,275,193</u>	<u>14,467,443</u>	<u>13,588,557</u>	<u>878,886</u>
EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES, ENCUMBRANCES AND OTHER FINANCING SOURCES (USES)	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,323,395</u>	<u>\$ 1,323,395</u>

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

**NOTES TO BUDGETARY COMPARISON SCHEDULE- GENERAL FUND
FOR THE FISCAL YEAR ENDED JUNE 30, 2013**

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	\$ 14,911,952
Differences-budget to GAAP	-
Total revenues and other financing sources as reported on the statement of revenues, expenditures, and changes in fund balances	<u>\$ 14,911,952</u>

Uses/outflows of resources:

Actual amounts (budgetary basis) "total charges to appropriations" from the budgetary comparison schedule	\$ 13,588,557
Differences-budget to GAAP:	
Accrual adjustments to expenditures	9,609
Prior year expenditure are not outflows of budgetary resources, but are expenditure for financial purposes	112,902
Encumbrances for supplies and equipment ordered, but not received, are reported in the year the order is placed for budgetary reporting purposes	(210,336)
Transfer to other funds are outflows of budgetary resources but are not expenditure for financial reporting purposes	<u>(314,563)</u>
Total expenditures and other financing uses as reported on the statement of revenues, expenditures, and changes in fund balances	<u>\$ 13,186,169</u>

NOTE B – STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY

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, 2013 representing the original budget. There were no supplemental appropriations for the year ended June 30, 2013.