

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

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



**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF VILLALBA**

**SINGLE AUDIT REPORT**

For the Fiscal Year Ended June 30, 2011  
(With Independent Auditors' Report Thereon)

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF VILLALBA**

**Basic Financial Statements and  
Supplemental Schedule  
Single Audit Report  
June 30, 2011**

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**INDEPENDENT AUDITOR'S REPORT**

HONORABLE MAYOR AND MUNICIPAL COUNCIL  
MUNICIPALITY OF VILLALBA, PUERTO RICO

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

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

The Municipality did not have complete, updated and accurate accounting records of the capital assets in order to obtain sufficient and competent evidential matter related to the capital assets reported in the accompanying statement of net assets for \$34,707,827 net of accumulated depreciation of \$10,199,140 as of June 30, 2011, and the amount of depreciation expense stated at \$1,233,938 for the year then ended. Because of the inadequacy of the accounting records, we were unable to form an opinion regarding the capital assets reported in the accompanying statement of net assets.

The Municipality did not maintain complete and accurate records of all interfund transactions in the due from and to accounts balance for the fiscal year 2010-11. Therefore, we did not express an opinion on such amounts presented on the financial statements.

Because of the significance of the matter discussed in the third paragraph, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the financial position of the governmental activities of the Municipality of Villalba as of June 30, 2011, and the changes in financial position thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In addition, in our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to obtain sufficient evidence to satisfy ourselves on the amounts reported as the interfund transactions in the due from and due to accounts balance, the financial statements referred to in the first paragraph present fairly, in all material respects, the respective financial position of each major fund and the remaining fund information of the Municipality of Villalba as of June 30, 2011 and the respective changes in financial position, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

INDEPENDENT AUDITOR'S REPORT  
Municipality of Villalba

As described in Note 1 to the financial statements, the Municipality adopted the provisions of GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, in 2011.

In accordance with Government Auditing Standards, we have also issued a report dated December 4, 2012, on our consideration of the Municipality's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the result of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be read in conjunction with this report in considering the results of our audit.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and budgetary comparison information on pages 5 through 17 and 66 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Municipality of Villalba's basic financial statements. The accompanying Financial Data Schedule is presented for purpose of additional analysis and is not required part of the basic financial statements. The accompanying Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations, and is also not a required part of the basic financial statements of the Municipality. The Financial Data Schedule and the Schedule of Expenditures of Federal Awards are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements taken as a whole.

*Mendoza & Ramos CPAs*  
MENDOZA & RAMOS  
CONTADORES PÚBLICOS AUTORIZADOS, C.S.P.  
December 4, 2012  
Guayama, Puerto Rico

The stamp number 2573181  
was affixed to the original of this report.



MUNICIPALITY OF VILLALBA  
COMMONWEALTH OF PUERTO RICO

MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&A)  
FISCAL YEAR ENDED JUNE 30, 2011

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As management of the Municipality of Villalba (the Municipality), we offer readers the following discussion and analysis of the Municipality's financial activities reported in the accompanying basic financial statements as of and for the fiscal year ended June 30, 2011. We encourage readers to consider the information presented here in conjunction with additional information that is furnished in the accompanying financial statements, which follow this narrative.

Besides, this document includes comparative data with prior year as this information was available for the fiscal year ended on June 30, 2010. This MD & A is prepared in order to comply with the Governmental Accounting Standards Board (GASB) Statement No. 34, "Basic Financial Statements – and Management's Discussion and Analysis-for State and Local Governments." and, among other purposes, to provide the financial statements users with the following major information:

- a broader basis in focusing important issues;
- acknowledgement of an overview of the Municipality's financial activities;
- provides for an evaluation of its financial condition as of the end of fiscal year 2010-2011 compared with prior year results;
- identification of uses of funds in the financing of the Municipality's variety of activities and;
- asses management's ability to handle budgetary functions.

## **FINANCIAL HIGHLIGHTS**

### ***Government-Wide Highlights:***

- The Municipality's total assets amounted to \$29,003,108 at June 30, 2011, of which \$24,508,687 (85%) consist of capital assets (net of accumulated depreciation and amortization of \$10,199,140), \$783,645 (3%) consist of cash and cash equivalents, \$1,955,600 (7%) consist of cash with fiscal agent (which are restricted principally for capital projects and debt service) and \$1,755,176 (6%) consist of accounts receivable.
- The Municipality's total liabilities amounted to \$18,687,633 at June 30, 2011, of which \$8,432,000 (45%) consist of bonds and notes payable, \$1,864,829 (10%) consist of accounts payable and accrued liabilities, \$1,562,374 (8%) consist of accrued compensated absences, \$ 2,034,761 (11%) consist of unearned revenues, and \$4,793,669 (26%) consist of other long-term debts.
- The Municipality's total assets exceeded its liabilities (net assets) by \$10,315,475, at June 30, 2011.
- The Municipality's total revenues amounted to \$15,268,812 for the fiscal year ended June 30, 2011, of which \$4,327,984 (28%) arose from taxes, \$10,574,772 (69%) arose from intergovernmental grants and contributions, and \$366,056 (3%) arose from miscellaneous revenues and interest on deposits.

MUNICIPALITY OF VILLALBA  
COMMONWEALTH OF PUERTO RICO

MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&A) (CONTINUED)  
FISCAL YEAR ENDED JUNE 30, 2011

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- The Municipality's total expenses amounted to \$14,373,040, for the fiscal year ended June 30, 2011, of which \$8,278,369 (58%) were incurred in providing direct services and benefits to citizens in relation to public works, economic development, health and welfare, public safety, culture and recreation. In addition, the Municipality incurred in \$214,952 (1%) of its total expenses, in interests related to its long-term obligations, and \$5,860,719 (41%) in general government activities to support the Municipality's functions and programs. The Municipality's total expenses include depreciation and amortization of capital assets in the amount of \$ 1,233,938, for the fiscal year ended June 30, 2011.
- The Municipality's total net assets increased by \$895,772, during the fiscal year ended June 30, 2011.

***Governmental Funds' Highlights:***

- The total fund balances of governmental funds amounted to \$379,720, at June 30, 2011, of which \$3,627,549 are restricted, committed and assigned, while (\$3,247,829) are presented as unassigned fund.
- The fund balances of governmental funds decreased by \$674,748, during the fiscal year ended June 30, 2011.

**OVERVIEW OF THE BASIC FINANCIAL STATEMENTS**

The purpose of financial reporting is to provide external users of basic financial statements with information that will help them to make decisions or draw conclusions about the Municipality. There are many external parties that use the basic financial statements of the Municipality; however, these parties do not always have the same specific objectives. In order to address the needs of as many parties as reasonably possible, the Municipality, in accordance with required financial reporting standards, presents this Management's Discussion and Analysis (MD&A) as an introduction to the accompanying basic financial statements. This narrative represents an overview and analysis of the financial activities of the Municipality for the fiscal year ended June 30, 2011. Because this MD&A is designed to focus on the current year activities, resulting changes and currently known facts, we encourage readers to consider the information presented in this MD&A in conjunction with the additional information furnished in the accompanying basic financial statements.

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

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

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MUNICIPALITY OF VILLALBA  
COMMONWEALTH OF PUERTO RICO

MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&A) (CONTINUED)  
FISCAL YEAR ENDED JUNE 30, 2011

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**a) Government-Wide Financial Statements**

The GWFS are composed of: (1) the statements of net assets (SNA) and (2) the statement of activities (SA). These financial statements can be found immediately following this MD&A. GWFS are designed to provide readers with a broad overview of the Municipality's operations as a whole in a manner similar to private-sector businesses. These statements provide short-term and long-term information about the Municipality's financial position, which assist the Municipality's management to determine the economic condition at June 30, 2011. The GWFS are prepared using methods that are similar to those used by most private businesses.

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

**1. Statement of Net Assets**

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

**2. Statement of Activities**

The SA presents information showing how the Municipality's net assets changed during the fiscal year ended June 30, 2011, by presenting all of the Municipality's revenues and expenses. As previously discussed, the items reported in SA are measured in a manner similar to the approach used by a commercial enterprise in that revenues are recognized when earned or established criteria are satisfied, and expenses are recorded when incurred by the Municipality. Consequently, revenues are reported even when they may not be collected for several months after the end of the fiscal year and expenses are recorded even though they may not have used cash during the current year.

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

MUNICIPALITY OF VILLALBA  
COMMONWEALTH OF PUERTO RICO

MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&A) (CONTINUED)  
FISCAL YEAR ENDED JUNE 30, 2011

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

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

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

**b) Fund Financial Statements**

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

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The Municipality, like most other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. Each fund is considered an independent fiscal entity accounted for within a set of self-balancing accounts that comprise its assets, 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. All of the funds of the Municipality can be divided into two categories: governmental funds and proprietary funds.

**1. Governmental funds**

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

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

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COMMONWEALTH OF PUERTO RICO

MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&A) (CONTINUED)  
FISCAL YEAR ENDED JUNE 30, 2011

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

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

The Municipality has four major governmental funds. Each major fund is presented in a separate column in the balance sheet – governmental funds and the statement of revenues, expenditures and changes in fund balances – governmental funds. The four major governmental funds are: (1) general fund, (2) HUD Fund, (3) State Assignment Fund, and (4) Other governmental fund.

**c) Notes to Basic Financial Statements**

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

**d) Other Supplementary Information**

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

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COMMONWEALTH OF PUERTO RICO

MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&A) (CONTINUED)  
FISCAL YEAR ENDED JUNE 30, 2011

**FINANCIAL ANALYSIS OF GOVERNMENT-WIDE FINANCIAL STATEMENTS**

The Municipality's overall financial position and operations at June 30, 2011 and 2010 are summarized as follows, based on the information included in the accompanying statement of net assets:

	Governmental Activities		Change	
	2011	2010	\$	%
<b>Assets:</b>				
Current assets	\$ 4,494,421	\$ 4,926,829	\$ (451,408)	-9.16%
Non-current assets:				
Capital assets, net	24,508,687	23,169,361	1,339,326	5.78%
Total assets	<u>\$ 29,003,108</u>	<u>\$ 28,096,190</u>	<u>\$ 887,918</u>	<u>3.16%</u>
<b>Liabilities:</b>				
Current liabilities, excluding long-term obligations	\$ 3,899,590	\$ 3,634,104	\$ 265,486	7.31%
Long-term obligations:				
Due within one year	1,723,694	1,789,170	(65,476)	-3.66%
Due after one year	13,064,349	13,253,213	(188,864)	-1.43%
Total liabilities	<u>\$ 18,687,633</u>	<u>\$ 18,676,487</u>	<u>\$ 11,146</u>	<u>0.06%</u>
<b>Net assets (deficit):</b>				
Invested in capital assets, net of related debt	\$ 15,187,648	\$ 16,835,378	\$ (1,647,730)	-9.79%
Restricted	3,337,808	3,282,988	54,820	1.67%
Unrestricted	(8,209,981)	(10,698,663)	2,488,682	-23.08%
Total net assets	<u>\$ 10,315,475</u>	<u>\$ 9,419,703</u>	<u>\$ 895,772</u>	<u>9.31%</u>

At June 30, 2011, the Municipality's current assets, amounting to \$4,494,421, are mainly composed of restricted and unrestricted cash and cash equivalents (\$783,645), restricted cash with fiscal agent (\$1,955,600), and restricted and unrestricted intergovernmental grants and contributions receivable (\$1,755,176).

The Municipality's non-current assets, amounting to \$24,508,687, at June 30, 2011, are substantially composed of capital assets, with a cost basis of \$34,707,827, which are reported net of accumulated depreciation and amortization of \$10,199,140.

At June 30, 2011, the Municipality's current liabilities amounting to \$5,623,284, are mainly composed of unearned revenues (\$2,034,761), accounts payable and accrued liabilities (\$1,307,981), interest payable (\$53,414), intergovernmental payables (\$503,434). Unearned revenues principally consist of unearned

MUNICIPALITY OF VILLALBA  
COMMONWEALTH OF PUERTO RICO

MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&A) (CONTINUED)  
FISCAL YEAR ENDED JUNE 30, 2011

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revenues associated with municipal license taxes and intergovernmental grants and contributions related to state and federally funded grant programs.

The Municipality's non-current liabilities, amounting to \$ 14,788,043, at June 30, 2011, are mainly composed of portion due within one year of bonds and notes payable \$ 1,723,694, and the portion due after one year of bonds and notes payable \$ 13,064,349.

As noted earlier, net assets may serve over time as a useful indicator of the Municipality's financial position. The assets of the Municipality exceeded liabilities by \$ 10,315,475 at June 30, 2011. The most significant portion of net assets \$ 3,337,808, at June 30, 2011, represents resources that are restricted for debt service payments and to finance the operations of federal and state funded programs. The another significant portion net assets \$ 15,187,648, reflects the Municipality's investment in capital assets (e.g. land, buildings, machinery, equipment, furniture, fixtures, infrastructure, etc.), net of all related debt still outstanding that was issued to acquire, construct or improve those assets. The Municipality uses these capital assets to provide services to its citizens; consequently, these assets are not available for future spending. Although the Municipality's investment in capital assets is reported net of the outstanding related debt, the resources needed to repay that debt must be provided by other sources, since capital assets cannot be used to liquidate these liabilities.

The remaining component of total net assets consists of unrestricted net liabilities amounting to (\$8,209,981), at June 30, 2011. These unrestricted net liabilities are the consequence of previous budgets that did not provide sufficient funding for incurred long-term obligations, such as bonds and notes payable, compensated absences, etc. Historically, a significant portion of such obligations has been budgeted on a pay-as-you-go basis.

The total net assets of the Municipality increased by \$ 895,772, for the fiscal year ended June 30, 2011. Such increase is due to the excess of total revenues \$ 15,268,812, over total expenses \$ 14,373,040, including depreciation and amortization of capital assets of \$ 1,233,938, for the fiscal year ended June 30, 2011.

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COMMONWEALTH OF PUERTO RICO

MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&A) (CONTINUED)  
FISCAL YEAR ENDED JUNE 30, 2011

The following is a condensed presentation of the Municipality's results of operations as reported in the statement of activities for the fiscal years ended June 30, 2011 and 2010:

	Governmental Activities		Change	
	2011	2010	\$	%
<b>Program revenues:</b>				
Program-specific operating grants and contributions	\$ 2,978,400	\$ 5,048,541	\$ (2,070,141)	-41.00%
Charges for services	-	56,640	(56,640)	-100.00%
<b>Total program revenues</b>	<b>2,978,400</b>	<b>5,105,181</b>	<b>(2,126,781)</b>	<b>-41.66%</b>
<b>General revenues:</b>				
Property taxes	\$ 1,370,164	\$ 1,347,281	\$ 22,883	1.70%
Municipal license taxes	1,636,958	1,641,884	(4,926)	-0.30%
Sales and use taxes	975,638	930,077	45,561	4.90%
Unrestricted grants and contributions	7,596,372	6,640,779	936,593	14.10%
Other local taxes	345,224	374,786	(29,562)	-7.89%
Other general revenues (various sources)	366,056	191,830	174,226	90.82%
<b>Total general revenues</b>	<b>12,290,412</b>	<b>11,126,637</b>	<b>1,144,775</b>	<b>10.29%</b>
<b>Total revenues</b>	<b>\$ 15,268,812</b>	<b>\$ 16,231,818</b>	<b>\$ (982,006)</b>	<b>-6.05%</b>
<b>Program expenses:</b>				
General government	\$ 5,879,719	\$ 8,374,951	\$ (2,495,232)	-29.79%
Urban and economic development	286,620	1,929,150	(1,642,530)	-85.14%
Health and welfare	2,998,008	3,139,634	(141,626)	-4.51%
Public safety	901,251	499,516	401,735	80.42%
Culture and recreation	590,556	958,839	(368,283)	-38.41%
Public Works	3,501,934	4,234,757	(732,823)	-17.30%
Interest on long-term obligations	214,952	428,881	(213,929)	-49.88%
<b>Total expenses</b>	<b>\$ 14,373,040</b>	<b>\$ 19,565,728</b>	<b>\$ (5,192,688)</b>	<b>-26.54%</b>
<b>Net increase (decrease) in net assets</b>	<b>895,772</b>	<b>(3,333,910)</b>	<b>4,210,682</b>	<b>-126.30%</b>
<b>Net assets, at beginning of fiscal year</b>	<b>9,419,703</b>	<b>12,753,613</b>	<b>(3,333,910)</b>	<b>-26.14%</b>
<b>Net assets, at end of fiscal year</b>	<b>\$ 10,315,475</b>	<b>\$ 9,419,703</b>	<b>\$ 876,772</b>	<b>9.31%</b>

As previously mentioned, the Municipality's total net assets increased by \$895,772, during the current fiscal year. Approximately 29% (\$4,327,984), of the Municipality's total revenues for the current fiscal year came from property, municipal license, construction excise and sales and use taxes, while 69% (\$10,574,772), resulted from restricted and unrestricted operating grants and contributions.

MUNICIPALITY OF VILLALBA  
COMMONWEALTH OF PUERTO RICO

MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&A) (CONTINUED)  
FISCAL YEAR ENDED JUNE 30, 2011

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The Municipality's expenses cover a wide range of services. The largest expenses of the Municipality for the fiscal year ended June 30, 2011 were related to: (1) general administrative and operating costs (\$5,860,719), which were classified as "general government" and accounted for 41% of total expenses, (2) public safety (\$901,251), which accounted for 6% of total expenses, (3) public works (\$3,501,934), which accounted for 25% of total expense, (4) health and welfare (\$3,017,008), which accounted for 21% percent of total expenses (5) culture and recreation (\$590,556), which accounted for 4% of total expenses, (6) urban and development (\$286,620), which accounted for 2% of total expenses (7) interest on long-term \$214,952, which accounted for 1% of total expenses. These expenses include depreciation of capital assets and deferred charges in the amount of \$ 1,233,938, for the fiscal year ended June 30, 2011.

### **FINANCIAL ANALYSIS OF GOVERNMENTAL ACTIVITIES**

#### *Analysis of Financial Position of Governmental Funds*

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

At June 30, 2011, the total assets of governmental funds amounted to \$ 11,975,237, which consisted principally of: (1) cash and cash equivalents of \$783,645 (7%), (2) cash in fiscal agent of \$1,955,600 (16%), (3) municipal licenses, property and sales taxes, intergovernmental, accrued interests and other receivables of \$9,235,992 (77%). Such assets include cash, cash equivalents and receivables that are principally used for debt service, capital projects, encumbrances and other specific purposes.

At June 30, 2011, the total liabilities of governmental funds amounted to \$11,595,517, which consisted principally of: (1) deferred revenues of \$2,034,761 (18%), (2) accounts payable and accrued liabilities and another payables of \$8,834,908 (76%), (3) intergovernmental accounts payable of \$503,434 (4%) and matured bonds and interests due and payable of \$ 222,414 (2%).

The total fund balances of governmental funds amounted to \$379,720, at June 30, 2011, of which \$3,627,549, are reserved for restricted, committed and assigned, while \$ (3,247,829) represent unassigned fund balance. The fund balances of governmental funds decreased by \$674,748, during the fiscal year ended June 30, 2011.

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MUNICIPALITY OF VILLALBA  
COMMONWEALTH OF PUERTO RICO

MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&A) (CONTINUED)  
FISCAL YEAR ENDED JUNE 30, 2011

The following table presents the condensed financial position of governmental funds at June 30, 2011 and 2010:

	<b>2011</b>	<b>2010</b>
<b>Assets:</b>		
Total assets - major governmental funds	\$ 6,077,140	\$ 6,684,410
Total assets - other governmental funds	5,898,097	6,491,713
Combined total assets	11,975,237	13,176,123
<b>Liabilities:</b>		
Total liabilities - major governmental funds	6,921,082	7,507,195
Total liabilities - other governmental funds	4,674,435	4,614,460
Combined total liabilities	11,595,517	12,121,655
<b>Fund balances (deficits):</b>		
Restricted – major governmental funds	2,114,146	2,281,650
Restricted – other governmental funds	1,223,662	1,877,253
Committed – major governmental funds	289,741	192,709
Unassigned	(3,247,829)	(3,297,144)
Combined total fund balances	379,720	1,054,468
<b>Total liabilities and fund balances</b>	<b>\$ 11,975,237</b>	<b>\$ 13,176,123</b>

**Major Governmental Funds**

**General fund (GF)** – The GF is the principal operating fund of the Municipality. The GF's total assets amounted to \$4,441,948, at June 30, 2011. Such assets consist principally of: (1) Cash in commercial banks (\$69,302), (2) accounts receivables and due receivables from governmental entities (\$63,921), (3) short-term amounts due from other funds (\$3,952,664), and (4) restricted cash in fiscal agent (\$356,061).

The GF's total liabilities amounted to \$6,591,822, at June 30, 2011. Such liabilities are composed mainly of: (1) unearned revenues (\$1,725,896), (2) due to other funds (\$3,574,264) and (3) accounts payable and accrued liabilities, including amounts due to other governments \$1,291,662.

MUNICIPALITY OF VILLALBA  
COMMONWEALTH OF PUERTO RICO

MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&A) (CONTINUED)  
FISCAL YEAR ENDED JUNE 30, 2011

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At the end of the current fiscal year, fund balance for restricted and assigned reached \$ 1,097,955, unassigned fund balance of the GF amounted to \$ (3,247,829), while total fund balance reached (\$2,149,874).

**HUD Fund-** The HUD Fund total assets amounted to \$212,472, at June 30, 2011, which consist principally of: (1) restricted cash in commercial bank (\$78,825) and (2) due from governmental entities (\$127,754). The HUD Fund total liabilities amounted to \$133,342, at June 30, 2011, which are composed mainly of (1) accounts payable and accrued liabilities (\$77,032) and (2) due to other funds (\$56,310). At the end of the current fiscal year, the HUD Fund had total restricted fund balances amounted to \$ 79,400.

**State Assignment Fund (SAF)-** The SAF total assets amounted to \$1,422,450, at June 30, 2011, which consist mainly of: (1) restricted cash in commercial banks (\$46,235), (2) due from other funds (\$1,306,117) and (3) due from other governmental entities (\$70,098). The SAF total liabilities amounted to \$ 195,918, at June 30, 2011. At the end of the current fiscal year, SAF had total restricted fund balance reached \$1,226,532.

**Other governmental funds (OGF)-** The OGF's total assets amounted to \$ 5,898,097, at June 30, 2011, which consist mainly of: (1) restricted cash and cash equivalents (\$ 589,283), (2) restricted cash in fiscal agent (\$1,599,539), (3) due from other funds (\$2,268,146) and (4) receivables from intergovernmental grants and contributions (\$1,419,470). The OGF's total liabilities amounted to \$ 4,674,435, at June 30, 2011, which are mainly composed of deferred revenues (\$308,865), accounts payable and accrued liabilities (\$381,186) and short-term amounts due to other funds (\$ 3,761,970). At the end of the current fiscal year, OGF's total reserved fund balance reached \$ 1,223,662.

*Analysis of Operating Results of Governmental Funds*

**Major Governmental Funds**

**General fund** – The total fund balance of the GF increased by \$78,646, during current fiscal year. Total revenues, expenditures and other financing sources (net) amounted to \$10,671,733, \$10,279,305, and \$313,782, respectively, for the fiscal year ended June 30, 2011.

Approximately 35% (\$3,731,292), of the GF's total revenues for the current fiscal year came from property, municipal license, construction excise and sales and use taxes, while 62% \$6,574,385, resulted from intergovernmental grants and contributions. Interest revenues, charges for services and miscellaneous revenues, amounting to \$366,056, provided 3% of the total revenues for the current fiscal year.

The largest expenses of the GF for the fiscal year ended June 30, 2011 were related to: (1) general administrative and operating costs (\$6,583,793), which were classified as "general government" and accounted for 64% of total expenses, (2) public safety \$845,085, which accounted for 8% of total expenses, (3) public works \$1,187,836 which accounted for 12% percent of total expenses, (4) health and welfare \$1,142,678, which accounted for 11% of total expenses, (5) culture and recreation \$519,913, which accounted for 5% of total expenses.

**HUD Fund** – The total fund balance of the HUD Fund is \$ 79,400, during current fiscal year. Total revenues for the fiscal year ended June 30, 2011 are \$ 1,421,633.

MUNICIPALITY OF VILLALBA  
COMMONWEALTH OF PUERTO RICO

MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&A) (CONTINUED)  
FISCAL YEAR ENDED JUNE 30, 2011

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Total expenditures amounted to \$ 1,409,554, for the fiscal year ended June 30, 2011. HUD Fund total expenditures for the current fiscal year came from health and welfare and urban economic development to \$523,844 and \$885,670, respectively.

**State Assignment Fund (SAF)**- The total fund balance of the SAF decreased by \$111,882, during current fiscal year. Total revenue amounted to \$82,105, for the fiscal year ended June 30, 2011.

SAF's total expenditures for the current fiscal year came from Public Work \$193,487, and culture, recreative and education \$500.

**Other governmental funds (OGF)** – The total fund balance of the OGF decreased by \$ 653,591, during current fiscal year. Total revenues and expenditures amounted to \$3,047,230, and \$4,014,603, respectively, for the fiscal year ended June 30, 2011. Approximately 58% (\$1,765,624), of OGF's total revenues for the current fiscal year came from intergovernmental grants and \$731,025 (24%) from federal grants.

The largest expenses of the OGF for the fiscal year ended June 30, 2011 were related to: (1) health and welfare (\$1,243,402), which accounted for 31% percent of total expenses, (2) urban and economic development (\$208,578), which accounted for 5% of total expenses and (3) public works (\$ 1,932,414), which accounted for 48%.

## **BUDGETARY HIGHLIGHTS**

### **a) General Fund**

The final budget of the general fund for the fiscal year ended June 30, 2011 amounted to \$11,383,483. Over the course of the fiscal year, the Municipality revised the GF's budget in order to include increases and decreases in revenues that were identified during the course of the fiscal year based on current developments that positively affected the Municipality's finances. The laws and regulations of the Commonwealth mandate a balanced budget.

The total actual revenues (budgetary basis) of the general fund for the fiscal year ended June 30, 2011 were \$ 10,325,406, which is 9% (\$ 1,058,077), lower than the budgeted revenues. In addition, the total actual expenditures (budgetary basis) of the general fund for the fiscal year ended June 30, 2011 were \$ 9,177,074, which is 17% (\$ 1,836,672), lower than the budgeted expenditures.

The most significant fluctuations in actual revenues occurred in construction excise taxes which had actual revenues that were \$ 942,773, lower than budgeted. This fluctuation arise because a no construction projects were, initiated during the current year.

Also, the most significant fluctuations in actual expenditures and encumbrances occurred in general government, which had actual expenditures and encumbrances that were \$ 1,374,030, lower than budgeted.

MUNICIPALITY OF VILLALBA  
COMMONWEALTH OF PUERTO RICO

MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&A) (CONTINUED)  
FISCAL YEAR ENDED JUNE 30, 2011

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**CAPITAL ASSETS AND DEBT ADMINISTRATION**

**a) Capital Assets**

The Municipality has invested \$ 34,707,827 in capital assets used in governmental activities, which have an accumulated depreciation and amortization of \$ 10,199,140, at June 30, 2011. The net capital assets of governmental activities increased during the current fiscal year due to the current fiscal year's capital additions \$ 5,178,024, which were partially offset by the depreciation and amortization expense \$ 1,233,938 for the same period.

**b) Debt Administration**

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

At June 30, 2011, the Municipality's total bonded debt amounted to \$8,432,000, consisting of bonds payable. Such debt is backed by the full faith and credit of the Municipality.

The following is a summary of the debt activity for the fiscal year ended June 30, 2011:

- Bonds payable decreased by 9% (\$450,000) by the principal payments on bonds.
- The Municipality has also certain outstanding notes payable due to CRIM (\$1,771,806). Such notes payable decreased by \$55,560, during the current fiscal year mainly due to the principal payments made during the same period.

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

The Municipality relies primarily on property and municipal taxes as well as federal and state grants to carry out the governmental activities. Historically, property and municipal taxes have been very predictable with increases of approximately five percent. Federal and State grant revenues may vary if new grants are available but the revenue also is very predictable. Those factors were considered when preparing the Municipality's budget for the fiscal year 2011-2012.

**REQUEST FOR INFORMATION**

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

MUNICIPALITY OF VILLALBA  
COMMONWEALTH OF PUERTO RICO

STATEMENT OF NET ASSETS  
YEAR ENDED JUNE 30, 2011

<b>Assets</b>	
<b>Current assets:</b>	
Cash in commercial banks	\$ 783,645
Cash in fiscal agent	1,955,600
Accounts receivable, net of allowance for doubtful accounts:	
Property taxes	46,111
Intergovernmental	1,626,225
Sales tax	51,634
Miscellaneous	31,206
Total current assets	4,494,421
<b>Noncurrent assets:</b>	
Capital assets, net of accumulated depreciation and amortization of \$10,199,140	24,508,687
Total noncurrent assets	24,508,687
Total assets	\$ 29,003,108
<b>Current Liabilities (due within one year):</b>	
Accounts payable	\$ 1,307,981
Intergovernmental payables	503,434
Accrued interest payable on long-term debt	53,414
Unearned revenues	2,034,761
Current portion of long-term obligations:	
Bonds payable	285,000
Other debts	1,438,694
Total current liabilities	5,623,284
Noncurrent liabilities (due in more than one year):	13,064,349
Total liabilities	\$ 18,687,633
<b>Net assets (liabilities):</b>	
Invested in capital assets, net of related debt	\$ 15,187,648
Restricted for:	
Hud Fund	79,400
Debt service	788,428
State Assignment Fund	1,226,532
Special Revenue	1,243,448
Unrestricted net liabilities	(8,209,981)
Total net assets	\$ 10,315,475

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

MUNICIPALITY OF VILLALBA  
COMMONWEALTH OF PUERTO RICO

STATEMENT OF ACTIVITIES  
YEAR ENDED JUNE 30, 2011

Functions/programs	Expenses	Program Revenues			Net Expenses and Charges in Net Assets
		Charges for services	Operating grants and contributions	Capital grants and contributions	
Governmental activities :					
General government	\$ 5,860,719	\$ -	\$ -	\$ -	\$ (5,860,719)
Health and welfare	3,017,008	-	1,388,196	-	(1,628,812)
Public works	3,501,934	-	476,491	-	(3,025,443)
Public safety	901,251	-	19,465	-	(881,786)
Culture, recreation and education	590,556	-	-	-	(590,556)
Urban and economic development	286,620	-	1,094,248	-	807,628
Interest on long-term obligation	214,952	-	-	-	(214,952)
Total governmental activities	<u>\$ 14,373,040</u>	<u>\$ -</u>	<u>\$ 2,978,400</u>	<u>\$ -</u>	<u>\$ (11,394,640)</u>
General Revenues:					
Taxes:					
Property taxes					1,370,164
Municipal license taxes					1,636,958
Sales taxes					975,638
Construction excise taxes					345,224
Total taxes					<u>4,327,984</u>
Grants and contributions, not restricted to specific programs					7,596,372
Miscellaneous					366,056
Total general revenues					<u>12,290,412</u>
Net changes in net assets					895,772
Net assets at beginning of the year					<u>9,419,703</u>
Net assets at the end of the year					<u>\$ 10,315,475</u>

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

MUNICIPALITY OF VILLALBA  
COMMONWEALTH OF PUERTO RICO

BALANCE SHEET – GOVERNMENTAL FUNDS  
YEAR ENDED JUNE 30, 2011

	MAJOR FUNDS				Total Governmental Funds
	General Fund	HUD Fund	State Assignment Fund	Other Governmental Fund	
<b>ASSETS</b>					
Cash in commercial banks	\$ 69,302	\$ 78,825	\$ 46,235	\$ 589,283	\$ 783,645
Cash in fiscal agent	356,061	-	-	1,599,539	1,955,600
Account receivable, net of doubtful accounts:					
Other	55,018	6,163	-	21,659	82,840
Due from other funds	3,952,664	-	1,306,117	2,268,146	7,526,927
Due from governmental entities	8,903	127,754	70,098	1,419,470	1,626,225
Total assets	<u>\$ 4,441,948</u>	<u>\$ 212,742</u>	<u>\$ 1,422,450</u>	<u>\$ 5,898,097</u>	<u>\$ 11,975,237</u>
<b>LIABILITIES</b>					
Accounts payable	788,228	77,032	61,535	381,186	1,307,981
Intergovernmental	503,434	-	-	-	503,434
Due to other funds	3,574,264	56,310	134,383	3,761,970	7,526,927
Unearned revenue	1,725,896	-	-	308,865	2,034,761
Matured bonds due and payable	-	-	-	169,000	169,000
Matured interests due and payable	-	-	-	53,414	53,414
Total liabilities	<u>6,591,822</u>	<u>133,342</u>	<u>195,918</u>	<u>4,674,435</u>	<u>11,595,517</u>
<b>FUND BALANCE</b>					
Fund balance:					
Restricted	808,214	79,400	1,226,532	1,223,662	3,337,808
Committed	289,741	-	-	-	289,741
Unassigned	(3,247,829)	-	-	-	(3,247,829)
Total fund balances (deficit)	<u>(2,149,874)</u>	<u>79,400</u>	<u>1,226,532</u>	<u>1,223,662</u>	<u>379,720</u>
<b>TOTAL LIABILITIES AND FUND BALANCE (DEFICIT)</b>	<u>\$ 4,441,948</u>	<u>\$ 212,742</u>	<u>\$ 1,422,450</u>	<u>\$ 5,898,097</u>	<u>\$ 11,975,237</u>

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

MUNICIPALITY OF VILLALBA  
COMMONWEALTH OF PUERTO RICO

RECONCILIATION OF THE BALANCE SHEET – GOVERNMENTAL FUNDS TO THE  
STATEMENT OF NET ASSETS  
YEAR ENDED JUNE 30, 2011

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Aggregate fund balance reported in the balance sheet - governmental funds	\$ 379,720
Governmental activities' amounts reported in the statement of net assets and the balance sheet - governmental funds are different because:	
Some of the Municipality's revenues will be collected after year-end but are not available soon enough to pay the current period's expenditures.	
	46,111
Capital assets (net of accumulated depreciation) used in governmental activities are not financial resources, therefore, are not reported in the governmental funds	24,508,687
The following liabilities are not due (mature) in the current period, therefore, are not reported in the governmental funds:	
Bonds payable	(8,263,000)
Convertible Line of Credit	(1,550,000)
Notes payable to Municipal Revenue Collection Center (CRIM)	(1,771,806)
Compensated absences	(1,562,374)
Other Debts	<u>(1,471,863)</u>
Net assets as reported in the accompanying statement of net assets	<u>\$ 10,315,475</u>

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

MUNICIPALITY OF VILLALBA  
COMMONWEALTH OF PUERTO RICO

STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES –  
GOVERNMENTAL FUNDS  
YEAR ENDED JUNE 30, 2011

	MAJOR FUNDS				Total Governmental Funds
	General Fund	HUD Fund	State Assignment Fund	Other Governmental Fund	
<b>REVENUES</b>					
Taxes:					
Property taxes	\$ 1,057,377	\$ -	\$ -	\$ 266,676	\$ 1,324,053
Municipal license	1,636,958	-	-	-	1,636,958
Construction excise taxes	345,224	-	-	-	345,224
Sales tax	691,733	-	-	283,905	975,638
Charges of service	-	-	-	-	-
Intergovernmental grants and contributions:					
Federal government	-	1,421,633	-	731,025	2,152,658
State government	6,574,385	-	82,105	1,765,624	8,422,114
Investment earnings	-	-	-	-	-
Miscellaneous	366,056	-	-	-	366,056
<b>Total Revenues</b>	<b>\$ 10,671,733</b>	<b>\$ 1,421,633</b>	<b>\$ 82,105</b>	<b>\$ 3,047,230</b>	<b>\$ 15,222,701</b>
<b>EXPENDITURES</b>					
Current:					
General government	6,583,793	-	-	2,000	6,585,793
Health and welfare	1,142,678	523,884	-	1,243,402	2,909,964
Public works	1,187,836	-	193,487	1,932,414	3,313,737
Public safety	845,085	-	-	-	845,085
Culture, recreation and education	519,913	-	500	14,257	534,670
Community Development	-	-	-	-	-
Urban and economic development	-	885,670	-	208,578	1,094,248
Debt service:					
Principal	-	-	-	399,000	399,000
Interest	-	-	-	214,952	214,952
<b>Total Expenditures</b>	<b>10,279,305</b>	<b>1,409,554</b>	<b>193,987</b>	<b>4,014,603</b>	<b>15,897,449</b>
Excess (Deficiency) of Revenues over expenditures	392,428	12,079	(111,882)	(967,373)	(674,748)
<b>OTHER FINANCING SOURCES (USES)</b>					
Transfer in from other funds	-	-	-	313,782	313,782
Transfer out to other funds	(313,782)	-	-	-	(313,782)
Proceeds from debt issuance	-	-	-	-	-
<b>Total Other Financing Sources (uses)</b>	<b>(313,782)</b>	<b>-</b>	<b>-</b>	<b>313,782</b>	<b>-</b>
<b>NET CHANGE IN FUND BALANCES (DEFICITS)</b>	<b>78,646</b>	<b>12,079</b>	<b>(111,882)</b>	<b>(653,591)</b>	<b>(674,748)</b>
<b>FUND BALANCE (DEFICIT) AT BEGINNING OF YEAR</b>	<b>(2,228,520)</b>	<b>67,321</b>	<b>1,338,414</b>	<b>1,877,253</b>	<b>1,054,468</b>
<b>FUND BALANCE (DEFICIT) AT END OF YEAR</b>	<b>\$ (2,149,874)</b>	<b>\$ 79,400</b>	<b>\$ 1,226,532</b>	<b>\$ 1,223,662</b>	<b>\$ 379,720</b>

*(2,149,874)*

*Original  
2/2/2012*

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

MUNICIPALITY OF VILLALBA  
COMMONWEALTH OF PUERTO RICO

RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES,  
AND CHANGES IN FUND BALANCES OF  
GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES  
YEAR ENDED JUNE 30, 2011

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Net change in fund balances- total governmental funds		\$ (674,748)
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Governmental activities amounts reported in the statement of activities and the statement of Revenues, expenditures and changes in fund balances governmental funds are different because:

Revenues in the Statement of Activities that do not provide current financial resources are not reported as revenues in the funds		46,111
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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:

Governmental Activities:		
Capital Outlay	2,573,264	
Depreciation Expense	<u>(1,233,938)</u>	
Excess of Capital Outlay over Depreciation Expense		1,339,326

Some expenses reported in the Statements of Activities do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds. These activities consist of:

Decrease in Compensated Absences	248,241	
Increase in Other Debt	<u>(513,158)</u>	
Total Additional Expenditures		(264,917)

Repayment of principal of long-term obligations is an expenditures in the governmental funds, but the repayment reduces long-term liabilities in the statement of net assets		<u>450,000</u>
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Net changes in net assets reported in the accompanying statements of activities		<u>\$ 895,772</u>
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*The notes to the financial statements are an integral part of this statement.*

MUNICIPALITY OF VILLALBA  
COMMONWEALTH OF PUERTO RICO

NOTES TO BASIC FINANCIAL STATEMENTS  
YEAR ENDED JUNE 30, 2011

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**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The Municipality of Villalba, Puerto Rico (Municipality), is a local municipal government constituted in 1917 in the Commonwealth of Puerto Rico. The Municipality has full legislative, fiscal and all other governmental powers and responsibilities expressly assigned by Law No. 81 of August 30, 1991, as amended, known as *Autonomous Municipalities Act of the Commonwealth of Puerto Rico* (Act No. 81).

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

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

The accounting policies of the Municipality conform to Accounting Principles Generally Accepted in the United States of America (GAAP) as applicable to governmental units. The following is a summary of the more significant of such policies.

**a) *Financial Reporting Model***

The accompanying basic financial statements present the financial position of the governmental activities, each major governmental fund, and the aggregate remaining fund information of the Municipality at June 30, 2011, in conformity with Accounting Principles Generally Accepted in the United States of America (GAAP), as prescribed by the Governmental Accounting Standards Board (GASB). In addition, the accompanying basic financial statements present the changes in the financial position (results of operations) of the governmental activities, each major governmental fund, and the aggregate remaining fund information for the fiscal year ended June 30, 2011 in conformity with GAAP.

The minimum required financial statement presentation applicable to the Municipality is composed of the following elements: (1) government-wide financial statements (GWFS), (2) governmental fund financial statements (GFFS), (3) notes to basic financial statements, and (4) required supplementary information (RSI).

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

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 fiscal year ended June 30, 2011, based on the Municipality's knowledge of the transactions, events and conditions

MUNICIPALITY OF VILLALBA  
COMMONWEALTH OF PUERTO RICO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)  
YEAR ENDED JUNE 30, 2011

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reflected in the basic financial statements. The MD&A also highlights certain key fiscal policies that control the Municipality's operations.

The budgetary comparison schedule – general fund, is also included as other required supplementary information which have been subjected to the auditing procedures applied in the audit of the accompanying basic financial statements as of and for the fiscal year ended June 30, 2011.

**b) *Financial Reporting Entity***

The accompanying basic financial statements include all departments, agencies and municipal entities that: (1) are under the legal and administrative control of the Mayor and (2) whose funds are under the legal custody and control of the Municipality's Director of Finance and Budget, as prescribed by Law No. 81.

The Municipality's management has considered all potential component units for which it may be financially accountable and other legally separate organizations for which the nature and significance of their relationship with the Municipality may be such that exclusion of their basic financial statements from those of the Municipality would cause the Municipality's basic financial statements to be misleading or incomplete.

The Municipality's management has concluded that, based on the criteria set forth by GASB Statement No. 14 - *The Financial Reporting Entity* (GASB No. 14) and GASB Statement No. 39 - *Determining Whether Certain Organizations are Component Units* (GASB No. 39), there are no legally separate entities or organizations that should be reported as component units of the Municipality as of June 30, 2011 nor for the year then ended.

**c) *Government-wide Financial Statements***

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

The focus of the GWFS is not on compliance with budgets, regulatory requirements or on the use of available or currently expendable financial resources (referred to as fiscal accountability), but on operational accountability information about the Municipality as a single economic unit. Operational accountability is the Municipality's responsibility to report to the extent to which it has met its operating objectives efficiently and effectively, using all resources available for that purpose. It focuses on the Municipality's principal operating objective, which is to provide services to its citizens.

The accompanying statement of net assets provides short-term and long-term information about the Municipality's financial position and condition by presenting all of the Municipality's assets and liabilities, with the difference between these two items reported as "net assets" (equity).

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This statement assists management in assessing the level of services that can be provided by the Municipality in the future, and its ability to meet its obligations as they become due. In addition, this statement reports the extent to which the Municipality has invested in capital assets, including infrastructure, and discloses legal and contractual restrictions on resources.

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

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

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

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

- **Unrestricted net assets** – These consist of net assets that are neither externally or legally restricted, nor invested in capital assets. However, unrestricted net assets often are designated to indicate that management does not consider them to be available for general operations. Unrestricted net assets often have constraints that are imposed by management, but can be removed or modified.

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

The accompanying statement of activities presents the results of the Municipality's operations by showing how the Municipality's net assets changed during the year ended June 30, 2011, using a net (expense) revenue format. This statement presents the cost of each function/program as well

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as the extent to which each of the Municipality's functions, programs or other services either contributes to or draws from the Municipality's general revenues (such as property taxes, municipal license taxes, construction excise taxes, etc.).

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

**General Government:**

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

**Public Works:**

- Department of Public Works
- Department of Recycling Services

**Public Safety:**

- Department of Municipal Police
- Office of Emergency Management

**Health and Welfare:**

- Department of Elderly Affairs

**Culture and Recreation:**

- Department of Recreation and Sports

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

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

- **Charges for services** – These generally consist of exchange or exchange-like transactions involving charges to customers or applicants who purchase, use or directly benefit from the goods, services or privileges provided, or are otherwise directly affected by the services. These include fees charged for specific services, charges for licenses and permits, and fines and forfeitures, among others.
- **Program-specific capital and operating grants and contributions** – These consist of transactions that are either mandatory or voluntary non-exchange transactions with other governments, organizations, or individuals that restrict the resources for use in a particular program. Capital grants and contributions consist of capital assets or resources that are restricted for capital purposes – to purchase, construct or renovate capital assets associated with a specific program. Operating grants and contributions consist of resources that are required to be used to finance the costs of operating a specific program or can be used either for operating or capital purposes of a specific program. Restricted capital and operating grants and contributions are program revenues because they are specifically attributable to a program and reduce the net expense of that program to the Municipality. They are reported net of estimated uncollectible amounts.

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

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

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

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

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

**d) Governmental Fund Financial Statements**

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

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

- **General fund** – The general fund is the Municipality's main operating fund and a major governmental fund, as defined below, used to account for all financial resources and governmental activities not accounted for and reported in another fund. It is presumed that the Municipality's governmental activities have been reported in the general fund except for transactions for which one of the following compelling reasons has required the use of another fund: (1) legal requirements, (2) GAAP requirements or (3) the demands of sound financial administration requiring the use of a governmental fund other than the general fund.
- **HUD Fund** – This is the fund used to account for all the transactions of the HUD Awards. The primary objectives of this program is the development of viable communities by providing decent housing, rent assistance, a suitable living environment and expanded economic opportunities, principally for persons of low and moderate income. The uses and limitations of each Hud fund are specified by federal statutes.

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- **State Assignment Fund** – This is the fund used to account for all the transactions of the State Assignment by Legislature Resolutions. The primary objectives of this assignment is to development of minor projects on communities, not-for-profit organizations and indirect assignment to persons of low and moderate income.
- **Other Governmental Funds** – Other Governmental Funds are all non-major governmental funds, used by the Municipality to account for the proceeds of specific revenue sources that are restricted or committed to expenditure for specified purposes. The uses and limitations of each fund are specified by municipal ordinances or federal and state statutes. However, resources restricted to expenditure for purposes normally financed from the general fund are reported in the Municipality's general fund provided that all applicable legal requirements are appropriately satisfied. In this case, other governmental funds to account for such kind of transactions will be used only if legally mandated.

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

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

Based on the aforementioned criteria, the Municipality's major governmental funds reported in the accompanying governmental fund financial statements are: (1) the general fund, (2) the HUD fund, and (3) the state assignment fund.

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

**HUD Fund** – This is the fund used to account for all the transactions of the HUD Awards. The primary objectives of this program is the development of viable communities by providing decent housing, rent assistance, a suitable living environment and expanded economic opportunities, principally for persons of low and moderate income.

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**State Assignment Fund** – This is the fund used to account for all the transactions of the State Assignment by Legislature Resolutions. The primary objectives of this assignment is to development of minor projects on communities, not-for-profit organizations and indirect assignment to persons of low and moderate income.

e) **Measurement Focus and Basis of Accounting**

**Government-wide financial statements** – The accompanying GWFS are prepared using the economic resources measurement focus and the accrual basis of accounting. Subject to the additional rules and limitations detailed below, revenues (including interest income) are generally recorded when earned and expenses are generally recorded when a liability is incurred, regardless of the timing of related cash flows.

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

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

All revenues, expenses, gains, losses and assets resulting from nonexchange transactions are recorded using the criteria set forth by GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions* (GASB No. 33). In a nonexchange transaction, the Municipality gives (or receives) value without directly receiving (or giving) equal value in return. This is different from an exchange transaction, in which each party receives and gives up essentially equal values. The Municipality groups its nonexchange transactions into the following four classes in the accompanying basic financial statements: (a) derived tax revenues, (b) imposed nonexchange revenues, (c) government mandated nonexchange transactions, and (d) voluntary nonexchange transactions.

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

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

Government-mandated non-exchange transactions (such as grants and contributions) result when a government at one level (such as the federal or state government) provides resources to another

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government (such as the Municipality), and the provider government requires the recipient government to use those resources for a specific purpose or purposes established in the provider's enabling legislation. In these types of transactions, receivables and revenues are generally recorded as follows:

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

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

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

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

All general capital assets and the unmatured long-term liabilities are recorded only in the accompanying statement of net assets. The measurement focus and the basis of accounting used in the accompanying GWFS differ significantly from the measurement focus and basis of accounting used in the preparation of the accompanying governmental fund financial statements. Therefore, the accompanying governmental fund financial statements include reconciliations, as detailed in the accompanying table of contents, to better identify the relationship between the GWFS and the governmental fund financial statements.

**Governmental fund financial statements** – The accompanying GFFS are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are generally recognized as soon as they are both measurable and available. Revenues are generally considered to be available when they are collectible within the current year or soon enough thereafter to pay liabilities of the current year. For this purpose, the Municipality considers most revenues to be available if collected within 90 days after June 30, 2011, except for property taxes for which the availability period is 60 days. Revenue sources not meeting this availability criterion or collected in advance are recorded as deferred revenues at June 30, 2011. The principal revenue sources considered susceptible to accrual include property taxes,

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municipal license taxes, intergovernmental grants and contributions and interest income. These principal revenue sources meet both measurability and availability criteria in the accompanying GFFS, except for amounts recorded as deferred (earned and unavailable) revenues.

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

All revenues, expenses, gains, losses and assets resulting from non-exchange transactions are recorded in a similar manner to the GWFS, using the previously discussed criteria set forth by GASB No. 33 for non-exchange transactions, but subject to and limited by the availability criteria discussed above. Accordingly, property tax and municipal license tax receivables are also generally recorded in the fiscal year when an enforceable legal claim has arisen while property tax and municipal license tax revenues (net of amounts considered not collectible) are also generally recorded in the fiscal year when resources are required to be used or the first fiscal year that the use of the resources is permitted. Receivables and revenues from reimbursement-type grants, contributions, donations and entitlements are also generally recorded as qualifying reimbursable expenditures are incurred, while receivables and revenues from other types of grants are recorded when all eligibility requirements imposed by the provider have been met.

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

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

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

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- Principal and interest on bonds payable are recorded when they mature (when payment is due), except for principal and interest due on July 1, 2011, which have been recorded as governmental fund liabilities at June 30, 2011, which is the date when resources are available in the debt service fund (generally, June 30).
- Notes payable, obligations under capital leases, compensated absences, and amounts subject to accrued claims and judgments under litigation are recorded only when they mature (when payment is due).
- Certain accrued liabilities not due and payable or not normally expected to be liquidated with current available and expendable financial resources are recorded in the accompanying statement of net assets. Such liabilities are recorded in the governmental funds when they mature.
- Executory purchase orders and contracts are recorded as assignments of fund balance in the governmental funds FFS.

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

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

All general capital assets and the unmaturing long-term liabilities (determined using the modified accrual basis of accounting) are incorporated into the accompanying statement of net assets.

*f) Stewardship, Compliance and Accountability*

**Budgetary Control**

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

The Mayor must submit an annual budgetary resolution project (the Project) to the Commissioner of Municipal Affairs of Puerto Rico (the Commissioner) and the Municipal Legislature no later than each May 10 and May 31, respectively. The Commissioner preliminarily verifies that the

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Project complies with all the applicable laws and regulations and may provide comments and suggestions to the Mayor on or before each June 15.

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

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

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

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

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

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

**Budgetary Accounting**

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

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

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

The accompanying budgetary comparison schedule provides information about the general fund's original budget, the amendments made to such budget, and the actual general fund's results of operations under the budgetary basis of accounting for the fiscal year ended June 30, 2011. Further details of the Municipality's budgetary control at the legal level may be obtained from the Budgetary Liquidation Report for the fiscal year ended June 30, 2011. Copies of that report may be obtained by writing to the Municipality's Director of Finance and Budget.

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

The Municipality does not legally adopt budgets for the State Assignment Fund and HUD Fund. The financial resources received by these funds are not subject to budgeting by the Municipality since the resources received each year from the respective grantors varies from year to year, and the respective amounts are granted at their discretion.

***g) Unrestricted and Restricted Deposits***

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

The Municipality follows the practice of pooling cash. The balance in the pooled cash account is available to meet current operating requirements. Under the laws and regulations of the Commonwealth, public funds deposited by the Municipality in commercial banks must be fully collateralized for the amounts deposited in excess of the federal depository insurance generally provided by the Federal Deposits Insurance Corporation (FDIC). All securities pledged as

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collateral are held by agents designated by the Secretary of the Treasury of the Commonwealth, but not in the Municipality's name.

Restricted assets include cash and cash equivalents in commercial banks, GDB and CRIM. These cash balances are classified as restricted assets since its use is limited for the specified purposes discussed below, which are established by applicable agreements or required by law.

Restricted cash with fiscal agent in the general and debt service funds represent property tax collections which are retained and restricted for the payment of the Municipality's debt service, as established by law. Restricted cash in fiscal agent in other governmental funds consists of unspent proceeds of bonds and notes, and the balance of interest and noninterest bearing accounts which are restricted for: (1) the acquisition, construction or improvement of major capital assets and the operations of federal and state funded programs.

***h) Unrestricted and Restricted Accounts and Notes Receivable***

In the accompanying GWFS, receivables consist of all revenues earned but not collected at June 30, 2011. Major receivable balances for the governmental activities include property taxes municipal license and intergovernmental receivables.

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

Intergovernmental receivables are composed of: (1) amounts owed to the Municipality for reimbursement of expenditures incurred pursuant to federal and state funded programs (recorded in the general fund, special revenue funds and capital project funds), and (2) contributions in lieu of taxes from the Puerto Rico Electric Power Authority, recorded in the general fund.

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

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

***i) Capital Assets***

Capital assets used in governmental activities include land and land improvements, buildings, structures and building improvements, machinery and equipment, furniture and fixtures, licensed vehicles, construction in progress, and infrastructure. These assets are capitalized and reported in

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the accompanying statement of net assets. Infrastructure assets are generally stationary in nature and include roads, bridges, streets and sidewalks, drainage systems and other similar assets.

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

The Municipality's capitalization levels are \$500 on personal property. For improvements other than buildings, the capital outlay must be greater than \$10,000, extend the estimated useful life for ten years, and be greater than 10% of the original cost of the asset.

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

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

<u>Capital Asset</u>	<u>Years</u>
Buildings	30
Improvement Other Than Buildings	30
Equipment	3-10
Vehicles	5
Recreation facilities	15-20
Infrastructure	10-50

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

Review of Carrying Value of Capital Assets for Impairment - The Municipality reviews the carrying value of capital assets for impairment whenever a significant and unexpected decline in service utility of capital assets occurs.

**j) *Deferred Revenues***

The Municipality reports deferred revenue on its GFFS and GWFS. In the GFFS, deferred revenue arises when:

- Potential revenue does not meet both the “measurable” and “available” criteria for revenue recognition in the current period. As previously discussed, available is defined as due (or past due) at June 30, and collected within 90 days (60 days for property taxes) thereafter to pay obligations due at June 30, or;

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- The Municipality receives resources before it has a legal claim to them. In subsequent periods, when the revenue recognition criterion is met, the liability for deferred revenue is removed and revenue is recognized.

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

**k) *Compensated Absences***

Compensated absences are accounted for under the provisions of Statement No. 16, *Accounting for Compensated Absences*, issued by GASB (GASB No. 16). Compensated absences include paid time off made available to employees in connection with vacation, sick leave and compensatory time. The liability for compensated absences recorded in the accompanying statement of net assets is limited to leave that: (1) is attributable to services already rendered on or before June 30, 2011 and (2) is not contingent on a specific event (such as illness) that is outside the control of the Municipality and the employee. The liability for compensated absences includes salary-related costs, which are directly and incrementally related to the amount of salary paid to the employee (such as employer's share of social security taxes and medicare taxes).

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

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

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

**l) *Long-term Debt***

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

All long-term debt to be repaid from governmental resources is reported as liabilities in the accompanying statement of net assets. Principal and interest payments on bonds due in July 1 of the following fiscal year are recorded as fund liabilities in the GFFS when resources are available

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in the debt service fund (generally at June 30). In the GFFS, the face amount of debt issued is reported as other financing sources when issued.

**m) Accounting for Pension Costs**

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

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.

**n) Risk Management**

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

The Municipality carries insurance coverage for death and bodily injuries caused by automobile accidents. This insurance is obtained through the Automobile Accidents Compensation Administration ("ACAA", by its Spanish acronym), a discretely component unit of the Commonwealth. This insurance is compulsory for all licensed vehicles used on public roads and highways in Puerto Rico. The annual premium is \$35 per licensed motor vehicle, which is paid directly to ACAA.

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

The Municipality obtains unemployment compensation, non-occupational disability, and drivers' insurance coverage for its employees through various insurance programs administered by the

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

The Municipality also obtains medical insurance coverage for its employees. The current insurance policies have not been cancelled or terminated at June 30, 2011. In the past three years, the Municipality has not settled claims that exceeded insurance coverage.

***o) Fund Balances***

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

Pursuant to the provisions of GASB No. 54, the accompanying GFFS report fund balance amounts that are considered restricted, committed, assigned, and unassigned, based on the relative strength of constraints that control how specific amounts can be spent. The Municipality has recorded the following types of fund balance classifications in the governmental funds:

- ***Restricted*** – Represent resources that can be spent only for the specific purposes stipulated by constitutional provisions, external resource providers (externally imposed by creditor or grantors), or through enabling legislation (that is, legislation that creates a new revenue source and restricts its use). 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 Municipal's highest level of decision making authority (Municipal Legislature through resolutions and ordinances) and can only be changed by a similar law, ordinance or resolution, no later than the end of fiscal year.
- ***Assigned*** – Represent resources intended to be used by the Municipality for specific purposes but do not meet the criteria to be classified as restricted or committed (generally executive orders approved by the Mayor). Intent can be expressed by the Municipal Legislature, the Mayor or by an official or body to which the Municipal Legislature delegates authority in conformity with the Law No. 81 of August 30, 1991, as amended, known as *Autonomous Municipalities Act of the Commonwealth of Puerto Rico* (Act No. 81). In governmental funds other than the general fund, assigned fund balance represents the remaining amount that is not restricted or committed.
- ***Unassigned*** – Represent the residual classification for the Municipality's general fund and includes all spendable amounts not contained in the other classifications. In other funds, the

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unassigned classification is used only to report a deficit balance resulting from overspending for specific purposes for which amounts had been restricted, committed, or assigned.

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

The Municipality reports resources constrained to stabilization as a specified purpose (restricted or committed fund balance in the general fund) only if: (1) such resources meet the other criteria for those classifications, as described above and (2) the circumstances or conditions that signal the need for stabilization are identified in sufficient detail and are not expected to occur routinely. However, the Municipality has not entered into any stabilization-like arrangements, nor has set aside material financial resources for emergencies and has not established formal minimum fund balance amounts as of and for the fiscal year ended June 30, 2011.

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

**p) Interfund Activities**

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

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

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

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**q) Use of Estimates**

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

**r) Future Adoption of Accounting Pronouncements**

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

- GASB Statement No. 57, *Fund OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans* (GASB No. 57). The objective of this Statement is to address issues related to the use of the alternative measurement method and the frequency and timing of measurements by employers that participate in agent multiple-employer other postemployment benefit (OPEB) plans (that is, agent employers).. : The provisions of Statement No. 57 related to the use and reporting of the alternative measurement method are effective immediately. The provisions related to the frequency and timing of measurements are effective for actuarial valuations first used to report funded status information in OPEB plan financial statements for periods beginning after June 15, 2011.
- GASB Statement No. 59, *Financial Instruments Omnibus* (GASB No. 59). The objective of this Statement is to update and improve existing standards regarding financial reporting and disclosure requirements of certain financial instruments and external investment pools for which significant issues have been identified in practice. This Statement is effective for periods beginning after June 15, 2011.
- GASB Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements* (GASB No. 60). The objective of this Statement is to improve financial reporting by addressing issues related to service concession arrangements (SCAs), which are a type of public-private or public-public partnership. This Statement is effective for periods beginning after December 15, 2011.
- GASB Statement No. 61, *The Financial Reporting Entity: Omnibus—an amendment of GASB Statements No. 14 and No. 34* (GASB No. 61). The objective of this Statement is to improve financial reporting for a governmental financial reporting entity. The requirements of Statement No. 14, *The Financial Reporting Entity*, and the related financial reporting requirements of Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, were amended to better meet user needs and to address reporting entity issues that have arisen since the issuance of those Statements. This Statement is effective for periods beginning after June 15, 2012.
- GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained 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

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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 Standard 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 Procedure. This Statement is effective for periods beginning after December 15, 2011.

- GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, which establishes guidance for reporting deferred outflows of resources, deferred inflows of resources, and net position in a statement of financial position. The provisions of this Statement are effective for financial statements for periods beginning after December 15, 2011.
- GASB Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions—an amendment of GASB Statement No. 53*. The objective of this Statement is to clarify whether an effective hedging relationship continues after the replacement of a swap counterparty or a swap counterparty's credit support provider. This Statement sets forth criteria that establish when the effective hedging relationship continues and hedge accounting should continue to be applied. The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2011.

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

## 2. DEPOSITS

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

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

- **Credit risk** – This is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. In compliance with the laws and regulations of the Commonwealth, the Municipality has adopted, as its custodial credit risk policy, the *Statement of Investment Guidelines for the Government of the Commonwealth of Puerto Rico*. Accordingly, the Municipality is only allowed to invest its obligations of the Commonwealth, obligations of the United States of America, certificates of deposit, commercial paper, bankers' acceptances or in pools of obligations of the Municipalities of Puerto Rico, which are managed by GDB. According to the aforementioned investment guidelines, the Municipality is not allowed to invest in marketable securities or any other type of investments for which credit risk exposure may be significant. Therefore, the Municipality's management has concluded that the credit

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risk related to any possible loss related to defaults by commercial banks on the Municipality's deposits is considered low at June 30, 2011.

- **Interest rate risk** – This is the risk that changes in interest rates of debt investments will adversely affect the fair value of an investment. The Municipality manages its exposure to declines in fair values by: (1) not including debt investments in its investments portfolio at June 30, 2011, (2) limiting the weighted average maturity of its investments to periods of three months or less and (3) keeping most of its banks deposits in interest bearing accounts generating interest at prevailing market rates. At June 30, 2011, the interest rate risk associated with the Municipality's cash and cash equivalent is considered low.
  
- **Custodial credit risk** – In the case of deposits, this is the risk that in the event of a bank failure, the Municipality's deposits may not be recovered. Pursuant to the *Statement of Investment Guidelines for the Government of the Commonwealth of Puerto Rico*, the balances deposited in commercial banks by the Municipality are insured by the Federal Deposit Insurance Corporation (FDIC), generally up to a maximum of \$250,000 per depositor. In addition, public funds deposited in commercial banks by the Municipality are fully collateralized for the amounts deposited in excess of the federal depository insurance. All securities pledged as collateral are held in the Municipality's name by the agents of the Commonwealth's Secretary of Treasury. Deposits of GDB, amounting to \$11,121,447 at June 30, 2011, are uninsured and uncollateralized. However, no losses related to defaults by GDB on deposit transactions have been incurred by the Municipality through June 30, 2011. It is management's policy to only maintain deposits in banks affiliated to FDIC to minimize the custodial credit risk, except for GDB. Therefore, the Municipality's management has concluded that at June 30, 2011, the custodial credit risk associated with the Municipality's cash and cash equivalents is considered low.
  
- **Foreign exchange risk** – This is the risk that changes in exchange rates will adversely affect the value of an investment or a deposit. According to the aforementioned investment guidelines, adopted by the Municipality, the Municipality is prevented from investing in foreign securities or any other types of investments for which foreign exchange risk exposure may be significant. Accordingly, management has concluded that the foreign exchange risk related to the Municipality's deposits is considered low at June 30, 2011.

The Municipality's bank balance of deposits with financial institutions is categorized to provide an indication of the level of collateral risk assumed by the Municipality at June 30, 2011. Risk categories are described as follows:

	General Fund	HUD Fund	State Assignment Fund	Other Governmental Fund	Totals
Cash in commercial banks	\$ 69,302	\$ 78,825	\$ 46,235	\$ 437,442	\$ 631,804
Cash in GDB or CRIM, as fiscal agents	356,061	-	-	1,599,539	1,955,600
Total deposits	\$ 425,363	\$ 78,825	\$ 46,235	\$ 2,036,981	\$ 2,587,404

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NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)  
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**3. MUNICIPAL LICENSE TAXES**

The Municipality is authorized by Law No. 81 to impose and collect municipal license taxes on all trade or business activities operated by any natural or legal person within the territorial area of Villalba. This is a self-assessed tax generally based on the business volume measured by gross sales. The Municipality establishes the applicable tax rates. At June 30, 2011, the municipal tax rates imposed by the Municipality were 1.50% for financing institutions and 0.50% for other types of taxpayers.

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

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

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

Any municipal license taxes collected in advance (that is, pertaining to a future period) are recorded as deferred revenues. Deferred municipal license tax revenues recorded in the accompanying GWFS and GFFS amounted to \$1,725,896 at June 30, 2011, which represents municipal licenses collected in advance for the taxable year 2010-2011.

**4. PROPERTY TAXES**

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

Personal property taxes are self-assessed by taxpayers every year generally using the book value of personal property assets owned by the taxpayer at January 1 (assessment date) and reporting such taxable value through a personal property tax return filed on May 15 subsequent to the assessment date. The total personal property tax rate in force at June 30, 2011 was 6.78% (of which taxpayers pay 6.58% and 0.20% is reimbursed by the Department of Treasury). Real property taxes are assessed by CRIM. The assessment on real property is made every January 1 and is based on estimated current values of the property deflated to 1957 market prices. The total real property tax rate in force at June 30, 2011 was 8.78% (of which 8.58% is paid by taxpayers and 0.20% is also reimbursed by the Department of Treasury).

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NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)  
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Residential real property occupied by its owner is exempt by law from property taxes on the first \$15,000 of the assessed value (at 1957 market prices). For such exempt amounts, the Department of Treasury assumes payment of the basic tax (4% and 6% for personal and real property, respectively) to the Municipality, except for property assessed of less than \$3,500 (at 1957 market prices), for which no payment is made.

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

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

In addition, 1.75% of the total personal and real property taxes collected by CRIM is restricted for the Municipality's debt service requirements and is retained by GDB for such purposes.

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

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

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**5. SALES TAX**

On July 4, 2006, the Governor of Puerto Rico signed into law the Taxpayer Justice Act (Act No.117, H.B. 2193). The new law imposes a municipal sales tax at a rate of 1.5% (effective July 1, 2006) and the Commonwealth sales tax at the rate of 5.5%, with an effective date of November 15, 2006. Conversely, the Commonwealth of Puerto Rico eliminated the excise tax of 6.6% on some imports (taxes on cigarettes, liquor, and cars are still in effect) and implemented the sales and use tax ("sales tax") system. Accordingly with this law the municipal sales tax is administered at the local level, and the Commonwealth sales tax is administered through the Puerto Rico Treasury Department. Consequently, separate registration and filing forms are required of retailers.

In fiscal year 2007-2008, the Municipal Legislature of the Municipality of Villalba approved an Ordinance establishing a citizenship contribution of 1.0% over all business or personal transactions related to sale of goods and/or services made on the Municipalities boundaries. The resources collected due to this tax assessment will be used in local activities like improvements in health services, improvements in the control and management of solid waste disposal and recycling programs, public improvements, improvements of public safety, and maintenance of all public facilities of the Municipality.

Any person/corporation is required to register with each municipality in which it conducts commercial transactions and in the Puerto Rican Treasury to obtain a Retailer's Registration Certificate, exemption certificates, and tax returns forms. The retailers are required to file and send monthly sales tax returns by the 20th day following the month in which the tax was collected.

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

These funds are administered by the Government Development Bank for Puerto Rico. Finally, the Law restricts the use of the funds by the municipalities to certain specific activities.

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**6. INTERGOVERNMENTAL RECEIVABLE AND PAYABLE**

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

	General fund	Hud funds	State Assignment funds	Other governmental funds	Total governmental funds
<i>Intergovernmental receivables:</i>					
Puerto Rico Office of the Commissioner of Municipal Affairs- Community Development Block Grants Program	\$ -	\$ 127,754	\$ -	\$ -	\$ 127,754
Commonwealth of Puerto Rico - Executive Office - ARRA- Energy Efficiency and Conservation Block Grant Program	-	-	-	19,000	\$ 19,000
Puerto Rico Department of Labor – Act. No. 52	-	-	-	77,412	\$ 77,412
Special Communities Trust	-	-	-	926,666	\$ 926,666
Department of Transportation	-	-	-	220,381	\$ 220,381
Federal Transit Administration	-	-	-	-	\$ -
Others	8,903	-	70,098	176,011	\$ 255,012
Total intergovernmental receivables	<u>\$ 8,903</u>	<u>\$ 127,754</u>	<u>\$ 70,098</u>	<u>\$ 1,419,470</u>	<u>\$ 1,626,225</u>
<i>Intergovernmental payables:</i>					
General Services Administration	\$267,605	\$ -	\$ -	\$ -	\$ 267,605
Puerto Rico Department of Labor	46,852	-	-	-	46,852
Administration of the Retirement System	<u>188,977</u>	-	-	-	188,977
Total intergovernmental payables	<u>\$503,434</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 503,434</u>

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

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NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)  
YEAR ENDED JUNE 30, 2011

**7. INTERFUND BALANCES**

Interfund balances at June 30, 2011 consisted of the following:

		Transfers-in:			
Transfers-out:	Other Governmental Fund				
Major funds:					
General fund	\$	313,782			
<b>Total</b>	<b>\$</b>	<b>313,782</b>			
Due/advances from: Nonmajor governmental funds					
Due/advances to:	General Fund	State Assignment Fund	Other Fund	Total	
Major funds:					
General fund		\$ 1,306,117	\$ 2,268,146	\$ 3,574,263	
Hud Fund	\$56,310			56,310	
State Assignment Fund	134,383			134,383	
Other Fund	3,761,971	-		3,761,971	
<b>Total</b>	<b>\$ 3,952,664</b>	<b>\$ 1,306,117</b>	<b>\$ 2,268,146</b>	<b>\$ 7,526,927</b>	

At June 30, 2011 all amounts due to among funds are considered collectible by the Municipality's management.

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

The principal purposes of inter-fund transfers are to make a routinary transfer of resources from the general fund to the debt service fund to cover the principal and interest payment on certain bond. These debt service payments were made on January and July 2011.

Inter-fund receivables and payables represent the pending settlements of the aforementioned transfers at June 30, 2011.

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NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)  
YEAR ENDED JUNE 30, 2011

**8. CAPITAL ASSETS**

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

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

	Balance at June 30, 2010	Additions/ increases	Transfer in (out)	Balance at June 30, 2011
<b><u>COST BASIS:</u></b>				
Cost basis of capital assets, not subject to depreciation and amortization:				
Land	\$ 1,284,597	619,600	-	\$ 1,904,197
Construction in progress	5,985,284	278,758	(2,604,760)	3,659,282
Total cost basis of capital assets, not subject to depreciation and amortization	<u>7,269,881</u>	<u>898,358</u>	<u>(2,604,760)</u>	<u>5,563,479</u>
Cost basis of capital assets, subject to depreciation and amortization:				
Buildings, structures and building improvements	8,079,085	140,000	-	8,219,085
Infrastructure	5,314,682	1,009,210	-	6,323,892
Recreation Facilities	7,091,305	2,896,270	-	9,987,575
Licensed vehicles	3,136,759	172,497	-	3,309,256
Machinery and equipment	1,242,851	61,689	-	1,304,540
Total cost basis of capital assets subject to depreciation and amortization	<u>24,864,682</u>	<u>4,279,666</u>	<u>-</u>	<u>29,144,348</u>
Total cost basis of capital assets	<u>\$ 32,134,563</u>	<u>5,178,024</u>	<u>-2,604,760</u>	<u>\$ 34,707,827</u>
	<b>Balance at June 30, 2010</b>	<b>Depreciation and Amortization Expense</b>	<b>Reclassifications</b>	<b>Balance at June 30, 2011</b>
<b><u>ACCUMULATED DEPRECIATION AND AMORTIZATION:</u></b>				
Buildings, structures and building improvements	(2,158,017)	(273,982)	-	(2,431,999)
Infrastructure	(732,274)	(201,582)	-	(933,856)
Recreation Facilities	(2,895,395)	(404,673)	-	(3,300,068)
Licensed vehicles	(2,441,569)	(226,979)	-	(2,668,548)
Machinery and equipment	(737,947)	(126,722)	-	(864,669)
Total accumulated depreciation and amortization	<u>(8,965,202)</u>	<u>(1,233,938)</u>	<u>-</u>	<u>(10,199,140)</u>
<b>CAPITAL ASSETS, NET</b>	<b><u>\$ 23,169,361</u></b>			<b><u>\$ 24,508,687</u></b>
The depreciation expense is detailed as follow:				
General government				\$ 193,553
Public safety				56,166
Public works				188,197
Health and welfare				107,044
Culture recreation and education				487,396
Urban Development				201,582
Total depreciation and amortization expense				<u>\$ 1,233,938</u>

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NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)  
YEAR ENDED JUNE 30, 2011

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**9. EMPLOYEES RETIREMENT SYSTEM**

*a) Plan Description*

The Municipality's employees participate in the Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS), a cost-sharing multi-employer (as related to the Municipality's reporting entity) defined pension plan established by the Commonwealth. Substantially all full-time employees of the Commonwealth and substantially all municipalities are covered by ERS under the terms of Public Act No. 447 of May 15, 1951, as amended (Act No. 447). All regular and temporary employees of the Municipality become plan members of ERS at the date of employment, while it is optional for officers appointed.

ERS members, other than those joining it after March 31, 1990, are eligible for the benefits described below:

- *Retirement Annuity*

ERS members are eligible for a retirement annuity upon reaching the following age:

Policemen and firemen:	Other employees:
50 with 25 years of credited service	55 with 25 years of credited service
58 with 10 years of credited service	58 with 10 years of credited service

ERS members are eligible for monthly benefit payments determined by the application of the stipulated benefit ratios to the member's average compensation. Average compensation is computed based on the highest 36 months of compensation recognized by ERS. The annuity, for which a member is eligible, is limited to a minimum of \$300 per month and a maximum of 75 percent of the average compensation.

- *Merit Annuity*

ERS members are eligible for merit annuity with a minimum of 30 years or more of credited service. The annuity for which the plan member is eligible is limited to a minimum of 65 percent and a maximum of 75 percent of the average compensation.

- *Deferred Retirement Annuity*

A participating employee who ceases to be an employee of the Municipality after having accumulated a minimum of ten years of credited service qualifies for retirement benefits provided his/her contributions are left in ERS until reaching 58 years of age.

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NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)  
YEAR ENDED JUNE 30, 2011

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- ***Coordinated Plan***

On the coordinated plan, by the time the employee reaches 65 years old and begins to receive social security benefits, the pension benefits are reduced by the following:

- (a) \$165 per month, if retired with 55 years of age and 30 years of credited service.
- (b) \$110 per month, if retired with less than 55 years of age and 30 years of credited service.
- (c) All other between \$82 and \$100 per month.
- (d) Disability annuities under the coordinated plan are also adjusted at age 65 and in some cases can be reduced over \$165 per month.

- ***Non-Coordinated Plan***

On the non-coordinated plan the participating employee and does not have any change on the pension benefits upon receiving social security benefits.

- ***Reversionary Annuity***

An ERS member, upon retirement, could elect to receive a reduced retirement annuity giving one or more benefit payments to his/her dependents. The life annuity payments would start after the death of the retiree for an amount not less than \$240 per year or greater than the annuity payments being received by the retiree.

- ***Occupational Disability Annuity***

A participating employee, who as a direct result of the performance of his/her occupation is totally and permanently disabled, is eligible for a disability annuity of 50 percent of the compensation received at the time of the disability.

- ***Nonoccupational Disability Annuity***

A participating employee, totally and permanently disabled for causes not related to his/her occupation and with no less than 10 years of credited service, is eligible for an annuity of 1.50 percent of the average compensation of the first 20 years of credited services, increased by 2 percent for every additional year of credited service in excess of 20 years.

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NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)  
YEAR ENDED JUNE 30, 2011

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- *Death Benefits*

*Occupational:*

- (a) **Surviving spouse** – annuity equal to 50 percent of the participating employee's salary at the date of the death.
- (b) **Children** - \$10 per month for each child, minor or student, up to a maximum benefit per family of \$100.

*Nonoccupational:*

**Beneficiary** – the contributions and interest accumulated as of the date of the death plus an amount equal to the annual compensation at the time of the death.

*Post-retirement:*

Beneficiary with surviving spouse age 60 or over and a child, 18 or under, up to 30 percent (60 percent, if not covered under Title II of the Social Security Act) (increased to 50 percent effective January 1, 2005) of retiree's pension or otherwise the excess, if any, of the accumulated contributions at the time of retirement over the total annuity benefits received before death, limited to a minimum of \$750.

- *Refunds*

A participating employee who ceases his/her employment with the Municipality without the right to a retirement annuity has the right to a refund of the contributions to ERS plus any interest earned thereon.

- *Cost of Living Adjustment for Pension Benefits*

Public Act No. 10 of May 21, 1992 (Act No. 10) provided for increases of 3 percent every three or more years of retirement. Act No. 10 requires further legislation to grant this increase every three years subject to the presentation of actuarial studies regarding its costs and the source of financing. To protect the financial health of ERS, the increase granted during 2001 and the one granted on January 1, 2005 are being financed by the Municipality and the other participating employers.

To avoid any economic impact on ERS, the employers are responsible for contributing to ERS the amounts to cover the benefit payments and the employer and employee contributions with respect to the participants covered until the participants reach the normal retirement age.

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NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)  
YEAR ENDED JUNE 30, 2011

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- ***Amendment to Act No. 447 effective January 1, 2000 to create a Defined Contribution Plan***

On September 24, 1999, Public Act No. 305, an amendment to Act No. 447, was enacted to establish a defined contribution plan, known as System 2000, to cover employees joining ERS on or after January 1, 2000.

Employees that participated in the original plan as of December 31, 1999, had the opportunity to elect to either stay in the defined benefit plan or transfer to System 2000. Employees that joined the Municipality on or after January 1, 2000, were only allowed to become members of System 2000.

System 2000 is a hybrid defined contribution plan, also known as a cash balance plan. Under this new plan, there is a pool of plan assets, which is invested by the System, together with those of the cost-sharing multi-employer defined benefit plan. Neither the Commonwealth nor the Municipality guarantee benefits at retirement age. The annuity is based on a formula which assumes that each fiscal year the employee's contribution (with a minimum of 8.28 percent of the employee's salary up to a maximum of 10 percent) is invested as instructed by the employee in an account which either: (1) earns a fixed rate based on the two-year Constant Maturity Treasury Notes, (2) earns a rate equal to 75 percent of the return of the ERS' investment portfolio (net of management fees), or (3) earns a combination of both alternatives. Participants receive periodic account statements similar to those of defined contribution plans showing their accrued balances. Disability benefits are not granted under System 2000, rather are provided to those participants that voluntarily elect to participate in a private insurance long-term disability program. The employers' contributions (9.28 percent of the employee's salary) with respect to employees under System 2000 will continue and will be used to fund the cost-sharing multi-employer defined benefit plan.

System 2000 reduced the retirement age from 65 years to 60 for those employees who joined the current plan on or after January 1, 2000.

Historically, the state government of the Commonwealth of Puerto Rico has reported ERS and System 2000 in its basic financial statements as pension trust funds. Accordingly, the Commonwealth is currently assuming any actuarial deficiency that may exist or arise related to the Municipality's participating employees because ERS does not allocate to the Municipality any actuarial deficiencies pertaining to participating municipal employees. The Municipality is only required by law to make statutory contributions at the rates detailed below.

- ***Recent Amendments to Act No. 447***

The Senate and the House of Representatives of the Commonwealth of Puerto Rico have the authority for establishing or amending the contribution requirements of System 2000 by approving the necessary amendments or laws, subject to the final approval of the Governor of the Commonwealth of Puerto Rico.

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NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)  
YEAR ENDED JUNE 30, 2011

In June and July 2003, the Governor of the Commonwealth signed three Public Acts that provided the following certain benefits to retirees:

- (a) Increase in minimum monthly pension payments to \$300, effective January 1, 2005.
- (b) Triennial 3 percent increase in all pensions, effective January 1, 2005.
- (c) Increase in widow and/or beneficiaries to 50 percent of the benefit received by the deceased pensioner, effective January 1, 2005.

All the benefits granted will be funded through budgetary assignments in the Municipality's general fund with respect to its retired employees.

The Board of Trustees of ERS approved, effective November 17, 2003, an increase in the amount granted on personal loans to participating employees from \$3,000 to \$5,000.

**b) Funding Policy**

The contribution requirement to ERS is established by law and is not actuarially determined. These contributions are as follows:

Municipality and other employers	9.28 percent of applicable payroll
Employees:	
Coordination plan:	5.78 percent of gross salary up to \$6,600 per year, plus 8.28 percent gross salary in excess of \$6,600.
Supplementation plan:	8.28 percent of gross salary. This is the only choice available to policemen, firemen and mayors

The contribution requirement to System 2000 is also established by law and is not actuarially determined. These contributions are as follows:

Municipality and other employers	9.28 percent of applicable payroll
Employees:	5.78 percent of gross salary up to \$6,600 per year, plus 8.28 percent gross salary in excess of \$6,600.

**c) Annual Contribution**

The actual combined employer and employee contributions to ERS and System 2000 for the current and past two years, which are equal to the statutory required contributions, are as follows:

Type of Contribution	Contributions to Retirement Plan					
	June 30, 2011		June 30, 2010		June 30, 2009	
	Law 447	Reforma 2000	Law 447	Reforma 2000	Law 447	Reforma 2000
Required	\$ 82,812	\$ 156,157	\$ 118,819	\$ 214,068	\$ 116,428	\$ 192,115
Actual	\$ 82,812	\$ 156,157	\$ 118,819	\$ 214,068	\$ 116,428	\$ 192,115

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NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)  
YEAR ENDED JUNE 30, 2011

**10. LONG-TERM DEBT**

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

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

In addition, before any new bonds or notes are issued, the revenues of the debt service fund should be sufficient to cover the projected debt service requirement. At June 30, 2011, the Municipality is in compliance with the debt limitation requirements. The general long-term debt activity for the year ended June 30, 2011 was as follows:

	Balance at June 30, 2010.	Borrowings or Additions	Payments or Deductions	Balance at June 30, 2011	Due Within One Year
Bonds and bond anticipation notes payables	\$8,882,000	\$ -	\$ (450,000)	\$ 8,432,000	\$ 285,000
Notes payable to:					
CRIM:					
Advances over collections through fiscal year 2000	1,744,119		(38,930)	1,705,189	25,746
Act No.146 -Financing of delinquent property tax accounts sold	62,235		(2,828)	59,407	23,167
LIMS Reimbursement	21,012		(13,802)	7,210	7,210
Convertible Line Of Credit	1,550,000	213,497	-	1,763,497	-
Compensated absences	1,810,615	925,811	(1,174,052)	1,562,374	1,084,038
Retirement System Administration	81,759		(81,759)	-	-
Puerto Rico Water and Sewage Authority		184,972	(19,587)	165,385	108,875
Puerto Rico Department of Labor	890,643	339,898	(137,560)	1,092,981	189,658
<b>Total</b>	<u>\$ 15,042,383</u>	<u>\$ 1,664,178</u>	<u>\$ (1,918,518)</u>	<u>\$ 14,788,043</u>	<u>\$ 1,723,694</u>

**a) Bonds Payable**

The Municipality issues general and special (public improvements) obligations bonds and notes to provide for the acquisition and construction of major capital facilities and equipment, as well as, to cover certain operating needs. Bonds and notes payable at June 30, 2011 is composed of the following debts:

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<u>General and Special Obligations:</u>	<u>Outstanding Amount</u>
\$435,000 Series 1991, for construction purposes, payable in annual installments ranging from \$10,000 to \$31,000 excluding interest at 5.0%, through January 1, 2016	\$ 138,000
\$295,000 Series 2001, for construction purposes, payable in annual installments ranging from \$5,000 to \$30,000, excluding interests from 2.89% to 5.6%, through July 1,	240,000
\$1,320,000, Series 2001, for construction purposes, payable in annual installments ranging from \$34,000 to \$94,000, excluding interests at 4.75%, through January 1, 2026	1,036,000
\$100,000, Series 2006, for construction purposes, payable in annual installments \$5,000, excluding interests at 6.50%, through July 1, 2025	75,000
\$85,000, Series 2006, for construction purposes, payable in annual installments ranging from \$5,000 to \$10,000, excluding interests at 6.75%, through January 1, 2020	60,000
\$245,000, Series 2006, for construction purposes, payable in annual installments ranging from \$5,000 to \$20,000, excluding interests at 7.5%, through January 1, 2031	225,000
\$165,000, Series 2008, for construction purposes, payable in annual installments ranging from \$5,000 to \$15,000, excluding interests at 7.5%, through January 1, 2031	145,000
\$2,110,000, Series 2007, for claim and judgment debt purposes, payable in annual installments ranging from \$30,000 to \$175,000, excluding interests at 7.5%, through January 1,	1,970,000
\$505,000, Series 2006, for construction purposes, payable in annual installments ranging from \$10,000 to \$40,000, excluding interests at 5.0%, through July 1, 2029	435,000
\$165,000, Series 2007, for construction purposes, payable in annual installments ranging from \$5,000 to \$15,000, excluding interests at 7.50 %, through July 1, 2032	150,000
\$440,000, Series 2006 Rent, for construction purposes, payable in semiannual installments ranging from \$7,000 to \$37,000, excluding interests at 7.5%, through July 1, 2033	425,000

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<b><u>General and Special Obligations:</u></b>	<b><u>Outstanding Amount</u></b>
\$35,000, Series 2008, for construction purposes, payable in semiannual installments ranging from \$5,000 to \$15,000, excluding interests at 7.5%, through July 1,	25,000
\$67,000, Series 2009, for construction purposes, payable in semiannual installments ranging from \$2,000 to \$7,000, excluding interests at 7.5%, through July 1, 2023	62,000
\$160,000, Series 2009, for construction purposes, payable in semiannual installments ranging from \$5,000 to \$15,000, excluding interests at 7.5%, through July 1, 2034	155,000
\$105,000, Series 2006, for construction purposes, payable in annual installments ranging from \$10,000 to \$20,000, excluding interests from 4.23% to 4.73%, through July 1, 2012	35,000
\$175,000 Series 2006, for construction purposes, payable in annual installments ranging from \$20,000 to \$30,000, excluding interests from 6.62% to 7.5%, through July 1, 2013	85,000
\$105,000 Series 2006, for construction purposes, payable in annual installments ranging from \$5,000 to \$10,000, excluding interests from 6.60% to 7%, through July 1, 2021	85,000
\$1,486,000, Series 2008, for construction purposes, payable in semiannual installments ranging from \$22,000 to \$131,000, excluding interests at 7.5%, through July 1, 2033	1,441,000
\$645,000, Series 2008, for construction purposes, payable in semiannual installments ranging from \$10,000 to \$55,000, excluding interests at 7.5%, through July 1, 2033	625,000
\$605,000, Series 2008, for construction purposes, payable in semiannual installments ranging from \$5,000 to \$50,000, excluding interests at 7.5%, through July 1, 2033	590,000
\$440,000, Series 2008, for construction purposes, payable in semiannual installments ranging from \$5,000 to \$40,000, excluding interests at 7.5%, through July 1, 2033	430,000
<b>Total bonds</b>	<b>\$ 8,432,000</b>

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

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

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

Interest rates on serial bonds subject to variable rates are reviewed periodically by GDB and are based on the fluctuation of GDB's weighted average rate for its commercial paper program, not to exceed 8%. Under this program, GDB issues commercial paper in the U.S. taxable and tax-exempt markets, in the Eurodollar market and to corporations that have tax exemption under the Commonwealth's Industrial Incentives Act and qualify for benefits provided by the U.S. Internal Revenue Code Section 936.

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

<u>Year ended June 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2012	\$ 285,000	\$ 320,397	\$ 605,397
2013	311,000	550,456	861,456
2014	312,000	530,606	842,606
2015	280,000	512,171	792,171
2016	294,000	494,350	788,350
2017-2021	1,622,000	2,182,282	3,804,282
2022-2026	2,094,000	1,593,760	3,687,760
2027-2031	2,126,000	859,220	2,985,220
2032-2036	1,108,000	121,413	1,229,413
Totals	<u>\$ 8,432,000</u>	<u>\$ 7,164,655</u>	<u>\$ 15,596,655</u>

**b) Convertible Line of Credit**

Non revolving line of credit of \$1,550,000, for the construction of bowling alley, to be converted in a revenue bond at due date. Interest of 7% will be payable on January 1 and July 1 yearly after finishing construction of the bowling facility. Accrued interest of line of credit as of conversion date will be included as part of the revenue bond. As of June 30, 2011, the accrued interest amounted \$213,497.

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c) *Notes Payable to CRIM*

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

In addition, on July 1, 2002, the Municipality entered into a repayment agreement with GDB and CRIM to pay off the remaining \$1,982,632 of excess of property tax advances through fiscal year 2000 and 2001. CRIM retains the principal and interest from the property tax advances of the Municipality. The amounts retained by CRIM are remitted to GDB on July 1 of each year through July 1, 2032. The repayment agreement bears interest at variable rates determined by GDB. The outstanding principal balances of the note payable to CRIM amounted \$1,705,189, at June 30, 2011. The principal and interest maturities are as follows:

2012	\$ 41,281	\$ 104,885	\$ 146,166
2013	43,874	102,292	146,166
2014	46,631	99,535	146,166
2015	49,561	96,605	146,166
2016	52,675	93,491	146,166
2017-2021	317,386	413,444	730,830
2022-2026	430,438	300,392	730,830
2027-2031	583,760	147,070	730,830
2032	139,583	6,583	146,166
Total	\$ 1,705,189	1,364,297	\$ 3,069,486

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**Financing of delinquent property tax accounts sold** – On July 1, 2007, the Municipality entered into a financing agreement with CRIM in the amount of \$70,722 for the payment of delinquent property tax account sold to private investors. The financing agreement in the form of a line of credit bearing interests at 6.50% during the first 5 years, and variable interests 125 points over LIBOR rate during the next 25 years. At June 30, 2011, the outstanding principal balances amounted to \$59,407. The principal and interest maturities are as follows:

<u>Year ending June 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2012	\$ 2,829	\$ 3,694	\$ 6,523
2013	2,829	3,518	6,347
2014	2,829	3,342	6,171
2015	2,829	3,166	5,995
2016	2,829	2,990	5,819
2017-2021	14,145	12,310	26,455
2022-2026	14,145	7,910	22,055
2027-2031	14,144	3,070	17,214
2032	2,828	174	3,002
Total	<u>\$ 59,407</u>	<u>40,174</u>	<u>\$ 99,581</u>

**LIMS**– On June 28, 2001, the Municipality entered into a financing agreement with CRIM for the payment of the Municipality’s share of the cost of an information management system, acquired by CRIM on behalf of all municipalities, for the management of a digital database of taxpayers properties located in Puerto Rico. The face amount of the loan was \$110,718 and bears no interest. The note is payable in monthly installments of \$7,424 through November 1, 2011. This note has an imputed interest rate of 5.95%. At June 30, 2011, the balance of this note amounted to \$7,210. The principal and interest maturities are as follows.

<u>Year ending June 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2012	\$ 7,210	\$ 214	\$ 7,424
Total	<u>\$ 7,210</u>	<u>\$ 214</u>	<u>\$ 7,424</u>

**d) Compensated Absences**

At June 30, 2011, the liability for compensated absences is composed as follows:

	<u>Due within One year</u>	<u>Due after one year</u>	<u>Total</u>
Vacations and sick leave	<u>\$ 1,084,038</u>	<u>\$ 478,336</u>	<u>\$1,562,374</u>
Total	<u>\$ 1,084,038</u>	<u>\$ 478,336</u>	<u>\$1,562,374</u>

MUNICIPALITY OF VILLALBA  
COMMONWEALTH OF PUERTO RICO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)  
YEAR ENDED JUNE 30, 2011

*e) Puerto Rico Department of Labor*

On April 26, 2011, the Municipality entered into a funding agreement with the Department of Labor in the amount of \$ 1,375,598 for the payment of unemployment debt. The amount will be retained through CRIM beginning June 5, 2011. The face amount of loan was \$1,375,578 and no interest. This note has an imputed interest rate of 5%. The first payment will be \$137,559 with 48 payments of \$20,000 and a final payment of \$275,261. At June 30, 2011, the balance of this account amounted to \$1,092,981. The maturities of principal and interest are as follows:

<u>Year ending June 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2012	\$ 189,658	\$ 50,342	\$ 240,000
2013	199,361	40,639	240,000
2014	209,561	30,439	240,000
2015	220,282	19,718	240,000
2016	274,119	1,142	275,261
Total	<u>\$ 1,092,981</u>	<u>142,280</u>	<u>\$ 1,235,261</u>

*f) Puerto Rico Water and Sewage Authority*

On May 25, 2011, the Municipality entered into a financing agreement with the Water and Sewage Authority in the amount of \$ 191,595 for the payment of debt service water and sanitary sewer. The amount will be retained through CRIM beginning in June 2011. The face amount of loan was \$191,595 and has no interest. This note has an imputed interest rate of 5%. The first payment will be \$19,587 and 18 payments of \$9,556. At June 30, 2011, the balance of this account amounted to \$165,385. The maturities of principal and interest are as follows.

<u>Year ending June 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2012	108,876	5,797	\$ 114,673
2013	56,509	827	57,336
2014	-	-	-
2015	-	-	-
2016	-	-	-
Total	<u>\$ 165,385</u>	<u>6,624</u>	<u>\$ 172,009</u>

MUNICIPALITY OF VILLALBA  
COMMONWEALTH OF PUERTO RICO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)  
YEAR ENDED JUNE 30, 2011

**11. FUND BALANCE (DEFICIT)**

As of June 30, 2011, fund balance (deficit) is comprised of the following:

Fund balances (deficit)	General Fund	HUD Fund	State Assignment Fund	Nonmajor funds	Total
<i>Nonspendable:</i>					
Inventories	\$ -	\$ -	\$ -	\$ -	\$ -
Other assets	-	-	-	-	-
<i>Restricted for:</i>					
General government	229,842	-	-	-	229,842
Public safety	113,688	-	-	-	113,688
Public works	464,684	-	1,226,532	435,234	2,126,450
Health and welfare	-	79,400	-	-	79,400
Culture and recreation	-	-	-	-	-
Economic development	-	-	-	-	-
Education	-	-	-	-	-
Debt service	-	-	-	788,428	788,428
<i>Committed to:</i>					
General government	66,421	-	-	-	66,421
Public safety	11,330	-	-	-	11,330
Public works	151,771	-	-	-	151,771
Health and welfare	40,136	-	-	-	40,136
Culture and recreation	20,083	-	-	-	20,083
Economic development	-	-	-	-	-
Education	-	-	-	-	-
Public safety	-	-	-	-	-
<i>Assigned to:</i>					
General government	-	-	-	-	-
Public safety	-	-	-	-	-
Public works	-	-	-	-	-
Health and welfare	-	-	-	-	-
Culture and recreation	-	-	-	-	-
Economic development	-	-	-	-	-
Education	-	-	-	-	-
Public safety	-	-	-	-	-
<i>Unassigned</i>					
	(3,247,829)	-	-	-	(3,247,829)
Total fund balances (deficit)	<u>(\$2,149,874)</u>	<u>\$ 79,400</u>	<u>\$1,226,532</u>	<u>\$1,223,662</u>	<u>\$ 379,720</u>

**12. COMMITMENTS AND CONTINGENCIES**

**Litigations**

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

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

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

MUNICIPALITY OF VILLALBA  
COMMONWEALTH OF PUERTO RICO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)  
YEAR ENDED JUNE 30, 2011

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**Federal Programs**

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

**Commitments**

The Municipality has reported, outstanding encumbrances amounting to \$289,741 in the general fund at June 30, 2011. The municipality intends to honor these encumbrances, which will continue to be liquidated under the current year's budget during a lapse of period that extends into the subsequent fiscal year.

**Construction Commitments**

The Municipality has commitments at June 30, 2011 of approximately \$1,806,622 for construction, improvements or renovation of certain capital assets.

**13. SUBSEQUENT EVENTS**

On June 16, 2011, the Legislature of the Commonwealth of Puerto Rico issued Act No. 94, which established an incentive plan for the payment of real and personal property taxes due, beginning on July 14, 2001. This Act provides a tax relief for the payment of real and personal property taxes eliminating accrued interested, penalties and charges over unpaid principal of past due property tax liability. The period that taxpayers have to enjoy for such benefits is for exactly ninety ((90) days beginning on July 14 through October 11, 2011. The unpaid property taxes covered under this Act are those related to fiscal years 2009-2010 and earlier (for real property taxes) and for years 2008 and earlier for personal property taxes. Also, To get the benefit of this Act, it is required that the property taxes for the fiscal year 2010-2011 and for the first semester 2011-2012 are paid.

On November 7, 2011, the Commonwealth approved Law Act No. 218. Act No. 218 establishes an amnesty program available until February 29, 2012, in which taxpayers may pay, outstanding income, estate, donations and special real property tax debts with a discount of 100% of any penalties, interest and surcharges ("the Program"). To benefit from the Program the taxpayer must pay the total amount of the outstanding debt as of the date of payment on or before February 29, 2012. This legislation extends the benefits to those taxpayers with outstanding debts subject to payments plans, payroll discounts and those who have tax returns under investigation.

On November 22, 2011, the Commonwealth approved law Act No. 231 which creates the Municipal Improvements Fund. The Municipal Improvements Fund will receive .01% of the deposits collected from the .05% municipal sales and uses tax collected by the Secretary of the Treasury. The collections will be deposited in an account or special fund in GDB to be distributed through legislation by the Legislative Assembly for public permanent projects and improvements in the municipalities.

MUNICIPALITY OF VILLALBA  
COMMONWEALTH OF PUERTO RICO

BUDGETARY COMPARISON SCHEDULE- GENERAL FUND

FOR THE YEAR ENDED JUNE 30, 2011

Revenues:	Budgeted amounts		Actual amounts (budgetary basis)	Variance with final budget – over (under)
	Original	Final		
Property taxes	\$ 1,068,584	\$ 1,068,584	\$ 1,057,377	\$ (11,207)
Municipal license taxes	1,434,837	1,434,837	1,619,298	184,461
Sales taxes	315,250	315,250	324,440	9,190
Construction excise taxes	1,318,613	1,318,613	375,840	(942,773)
Intergovernmental grants and contributions	6,666,047	6,666,047	6,574,385	(91,662)
Rent	54,000	54,000	56,445	2,445
Miscellaneous	526,152	526,152	317,621	(208,531)
Total revenues	11,383,483	11,383,483	10,325,406	(1,058,077)
<b>Expenditures:</b>				
Mayor and Municipal Legislature	1,614,443	2,138,156	1,902,339	235,817
General government	5,616,668	5,837,235	4,463,205	1,374,030
Health and welfare	689,571	606,241	534,972	71,269
Public works	1,539,467	955,750	894,061	61,689
Public safety	951,961	935,307	856,415	78,892
Culture, recreation and education	601,636	541,057	526,082	14,975
Total expenditures	11,013,746	11,013,746	9,177,074	1,836,672
Excess (deficiency) of revenues over expenditure	369,737	369,737	1,148,332	778,595
<b>Other financing Sources (uses):</b>				
Transfer out to other governmental funds	369,737	369,737	313,782	(55,955)
Total Other Financing Sources (uses)	369,737	369,737	313,782	(55,955)
<b>Net change in fund balance (deficit)</b>	\$ -	\$ -	\$ 834,550	\$ 834,550
<b>Reconciliation of differences:</b>				
Sources/inflows of financial resources:				
Actual amounts (budgetary basis) "available for appropriations" from the budgetary comparison schedule				\$ 10,325,406
Differences - budgetary basis to GAAP:				
Differences in bases of accounting:				
GAAP adjustment to revenues				346,327
Total revenues and as reported on the statement of revenues, expenditures and changes in fund balances				\$ 10,671,733
Uses/outflows of financial resources:				
Actual amounts (budgetary basis) "total charges to appropriations" from the budgetary comparison schedule (including transfer out to other funds)				\$ 9,490,856
Differences - budgetary basis to GAAP:				
Timing differences:				
Current year encumbrances recorded as expenditures for budgetary purposes				(740,441)
Prior year encumbrances recorded as expenditures for GAAP purposes				79,279
Entity differences:				
Non-budgeted expenditures				1,763,393
Total expenditures and transfer out to other funds as reported on the statement of revenues, expenditures and changes in fund balances				\$ 10,593,087

MUNICIPALITY OF VILLALBA  
COMMONWEALTH OF PUERTO RICO

FINANCIAL DATA SCHEDULE  
YEAR ENDED JUNE 30, 2011

<b>Program Balance Sheet Summary Fiscal Year End: 06/30/2011</b>	<b>14,871 Housing Choice Vouchers</b>
111 Cash - Unrestricted	\$30,848
113 Cash - Other Restricted	\$47,729
<b>100 Total Cash</b>	<b>\$78,577</b>
121 Accounts Receivable - PHA Projects	\$6,163
<b>120 Total Receivables, Net of Allowances for Doubtful Accounts</b>	<b>\$6,163</b>
<b>150 Total Current Assets</b>	<b>\$84,740</b>
164 Furniture, Equipment & Machinery - Administration	\$51,631
166 Accumulated Depreciation	-\$50,818
<b>160 Total Capital Assets, Net of Accumulated Depreciation</b>	<b>\$813</b>
<b>180 Total Non-Current Assets</b>	<b>\$813</b>
<b>190 Total Assets</b>	<b>\$85,553</b>
312 Accounts Payable <= 90 Days	\$259
321 Accrued Wage/Payroll Taxes Payable	\$5,081
322 Accrued Compensated Absences - Current Portion	\$2,408
<b>310 Total Current Liabilities</b>	<b>\$7,748</b>
<b>350 Total Non-Current Liabilities</b>	<b>\$0</b>
<b>300 Total Liabilities</b>	<b>\$7,748</b>
508.1 Invested In Capital Assets, Net of Related Debt	\$813
511.1 Restricted Net Assets	\$47,729
512.1 Unrestricted Net Assets	\$29,263
<b>513 Total Equity/Net Assets</b>	<b>\$77,805</b>
<b>600 Total Liabilities and Equity/Net Assets</b>	<b>\$85,553</b>

MUNICIPALITY OF VILLALBA  
COMMONWEALTH OF PUERTO RICO

FINANCIAL DATA SCHEDULE  
YEAR ENDED JUNE 30, 2011

Program Revenue and Expense Summary Fiscal Year End: 6/30/11	14.871 Housing Choice Vouchers
70600 HUD PHA Operating Grants	\$523,365
71500 Other Revenue	\$12,598
<b>70000 Total Revenue</b>	<b>\$535,963</b>
91100 Administrative Salaries	\$58,890
91600 Office Expenses	\$20,163
<b>91000 Total Operating - Administrative</b>	<b>\$79,053</b>
<b>96900 Total Operating Expenses</b>	<b>\$79,053</b>
<b>97000 Excess of Operating Revenue over Operating Expenses</b>	<b>\$456,910</b>
97300 Housing Assistance Payments	\$446,086
97400 Depreciation Expense	\$1,421
<b>90000 Total Expenses</b>	<b>\$526,560</b>
<b>10000 Excess (Deficiency) of Total Revenue Over (Under) Total</b>	<b>\$9,403</b>
11020 Required Annual Debt Principal Payments	\$0
11030 Beginning Equity	\$68,402
11170 Administrative Fee Equity	\$30,076
11180 Housing Assistance Payments Equity	\$47,729
11190 Unit Months Available	1008
11210 Number of Unit Months Leased	1003

MUNICIPALITY OF VILLALBA  
COMMONWEALTH OF PUERTO RICO

NOTES TO FINANCIAL DATA SCHEDULE  
YEAR ENDED JUNE 30, 2011

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**NOTE A – BASIS OF PRESENTATION**

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

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

MUNICIPALITY OF VILLALBA  
COMMONWEALTH OF PUERTO RICO

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
YEAR ENDED JUNE 30, 2011

Federal Grant/ Pass-through Grantor/ Program or Cluster Title	Federal CFDA Number	Pass-through Entity Identifying Number	2010-2011 Federal Expenditures
<b>U.S. Department of Housing and Urban Development:</b>			
Pass-through the Commonwealth of Puerto Rico - Office of the Commissioner of Municipal Affairs:			
Community Development Block Grant / State's Program Cluster:			
Community Development Block Grant Program	14.228	FC-66/AB-66/FC-DR-66/AB-DR-66	\$ 885,670
ARRA - Community Development Block Grant	14.255	08-AB-AR-66-001	208,578
Total Pass-through the Commonwealth of Puerto Rico - Office of the Commissioner of Municipal Affairs:			1,094,248
Pass-through the Commonwealth of Puerto Rico - Department of Family:			
ARRA - Homelessness Prevention and Rapid Re-Housing Program	14.257	122-2010-000223	199,466
Pass-through the Commonwealth of Puerto Rico - Puerto Rico Housing Administration:			
Public and Indian Housing	14.850	RQ3073/RQ5164/RQ3073	521,648
Direct Program:			
Section 8 Housing Choice Voucher Program	14.871	N/A	535,963
<b>Total U.S. Department of Housing and Urban Development:</b>			<b>2,351,325</b>
<b>U.S. Department of Justice:</b>			
Pass-through the Commonwealth of Puerto Rico - Department of Justice:			
ARRA - Recovery Act - Victim Assistance Formula Grants	16.801	2009-SG-MV-0112	25,517
<b>Total U.S. Department of Justice:</b>			<b>25,517</b>
<b>U.S. Department of Transportation:</b>			
Direct Program:			
ARRA - Federal Transit - Formula Grants	20.507	N/A	148,465
<b>Total U.S. Department of Transportation:</b>			<b>148,465</b>
<b>U.S. Department of Energy:</b>			
Pass-through the Commonwealth of Puerto Rico - Executive Office:			
ARRA - Energy Efficiency and Conservation Block Grant	81.128	0013-A-022	19,000
<b>Total U.S. Department of Energy:</b>			<b>19,000</b>
<b>U.S. Department of Health and Human Service:</b>			
Pass-through the Commonwealth of Puerto Rico - Office of Governor, Elderly Office:			
Special Program for Aging, Title, Part B	93.044	N/A V	36,075
<b>Total U.S. Department of Health and Human Services:</b>			<b>36,075</b>
<b>U.S. Department of Homeland Security:</b>			
Pass-through the Commonwealth of Puerto Rico -Governor Authorized Representative (GAR):			
Disaster Grants – Public Assistance	97.036	149-99149-00 (1798-DR/ 1946-DR)	352,297
<b>Total U.S. Department of Homeland Security:</b>			<b>352,297</b>
<b>TOTAL EXPENDITURES OF FEDERAL AWARDS</b>			<b>\$ 2,932,679</b>

See accompanying Notes to Schedule of Expenditures of Federal Awards.

MUNICIPALITY OF VILLALBA  
COMMONWEALTH OF PUERTO RICO

NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
YEAR ENDED JUNE 30, 2011

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NOTE 1: BASIS OF PRESENTATION

The accompanying schedule of expenditures of federal awards includes the federal grant activity of the Municipality of Villalba, Commonwealth of Puerto Rico (the Municipality) for the year ended June 30, 2011. The Municipality's reporting entity is disclosed in Note 1 to the Municipality's basic financial statements as of and for the fiscal year ended June 30, 2011.

The accompanying schedule of expenditures of federal awards is presented on the modified accrual basis of accounting.

The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

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

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

NOTE 3: FEDERAL CFDA NUMBER

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

NOTE 4: PASS THROUGH GRANTOR'S NUMBER

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

NOTE 5: MAJOR PROGRAMS

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

END OF NOTES



**MENDOZA & RAMOS**  
Contadores Públicos Autorizados, C.S.P.

P.O. Box 35 • Guayama, Puerto Rico 00785

To the Honorable Mayor and  
Members of the Municipal Legislature  
MUNICIPALITY OF VILLALBA, PUERTO RICO

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

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the Municipality of Villalba, Puerto Rico (the "Municipality") as of and for the fiscal year ended June 30, 2011, which collectively comprise Municipality of Villalba's basic financial statements and have issued our report thereon dated December 4, 2012. The report's opinion on governmental wide financial statement was disclaimed because does not maintained adequate records regarding capital assets, accumulated depreciation and related depreciation expense reported in the governmental activities. The report's opinion on fund financial statements was qualified because the Municipality did not maintain complete and accurate records of all interfund transactions in the due from and to accounts balance for the fiscal year 2010-11. Except as discussed in the preceding sentences, we conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

**INTERNAL CONTROL OVER FINANCIAL REPORTING**

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

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying schedule of findings and questioned costs, we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses and other deficiencies that we considered to be significant deficiencies.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or

INDEPENDENT AUDITOR'S REPORT  
MUNICIPALITY OF VILLALBA

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detect misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies identified as finding 11-01 in the accompanying schedule of findings and questioned costs to be material weakness.

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies identified as finding 11-02 in the accompanying schedule of findings and questioned costs to be significant deficiencies.

**COMPLIANCE AND OTHER MATTERS**

As part of obtaining reasonable assurance about whether the Municipality's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matter that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule of findings and questioned costs as findings 11-01 and 11-02.

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

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

*Mendoza & Ramos CPAs*  
MENDOZA & RAMOS  
CERTIFIED PUBLIC ACCOUNTANTS, C.S.P.

Guayama, Puerto Rico  
December 4, 2012

Stamp number 2573182 was  
affixed to the original of this report.





**MENDOZA & RAMOS**  
Contadores Públicos Autorizados, C.S.P.

P.O. Box 35 • Guayama, Puerto Rico 00785

To the Honorable Mayor and  
Members of the Municipal Legislature  
MUNICIPALITY OF VILLALBA, PUERTO RICO

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

**COMPLIANCE**

We have audited the compliance of the Municipality of Villalba, Puerto Rico (the "Municipality") with the types of compliance requirements described in the *U. S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that could have direct and material effect on each of the Municipality's major federal programs for the year ended June 30, 2011. The Municipality's major federal programs are identified in the summary of auditor's results section of the accompanying Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each major federal programs is the responsibility of the Municipality's management. Our responsibility is to express an opinion of the Municipality's compliance based on our audit.

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

As described in the accompanying Schedule of findings and questioned costs, the Municipality did not comply with the requirements that are applicable to its major programs, as follows:

Reference Number	Compliance Requirement	Major Program
11-03	Procurement	Community Development Block Grant / State's Program
11-04	Suspension and Debarment	Community Development Block Grant / State's Program
11-05	Special Tests	Community Development Block Grant / State's Program
11-07	Procurement	Disaster Grants – Public Assistance
11-08	Suspension and Debarment	Disaster Grants – Public Assistance

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

INDEPENDENT AUDITOR'S REPORT  
MUNICIPALITY OF VILLALBA

In our opinion, except for the noncompliance described above, the Municipality complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2011.

**INTERNAL CONTROL OVER COMPLIANCE**

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

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over compliance that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as discussed below, we identified certain deficiencies in internal control over compliance that we consider to be material weakness.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A material weakness in internal control over compliance is a deficiency, or a combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. We consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs as items 11-03, 11-04, 11-05, 11-06, 11-07 and 11-08 to be material weaknesses.

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

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

*Mendoza & Ramos* CPA's  
MENDOZA & RAMOS  
CERTIFIED PUBLIC ACCOUNTANTS, C.S.P.

Guayama, Puerto Rico  
December 4, 2012  
Stamp number 2573183 was  
affixed to the original of this report.



MUNICIPALITY OF VILLALBA  
COMMONWEALTH OF PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2011

**SECTION I-SUMMARY OF AUDITOR'S RESULTS**

Financial Statements

Type of auditors' report issued:

- Unqualified Opinion, except for disclaimer opinion for government-wide financial statement  
 Qualified Opinion  
 Adverse Opinion  
 Disclaimer Opinion

Internal control over financial reporting:

- Material weakness (es) identified?  Yes  No
- Significant deficiencies identified that are not considered to be material weakness (es)?  Yes  None Reported
- Noncompliance material to financial statements noted?  Yes  No

Federal Awards

Internal control over major programs:

- Material weakness (es) identified?  Yes  No
- Significant deficiencies identified that are not considered to be material weakness (es)?  Yes  None Reported

Type of auditors' report issued on compliance for Major Programs:

- Unqualified Opinion  
 Qualified Opinion  
 Adverse Opinion  
 Disclaimer

Any audit findings disclosed that are required to be reported in accordance with 510(a) OMB Circular A-133?

- Yes  No

The Municipality's major programs were:

CFDA Number	Name of Federal Program
14.228	Community Development Block Grant
14.255	ARRA- Community Development Block Grant
14.871	Section 8 Housing Choice Vouchers
14.850	Public and Indian Housing
97.036	Disaster Grants – Public Assistance

Dollar threshold used to distinguish between Type A and Type B Programs:  
Auditee qualified as low-risk auditee?

- \$300,000  
 Yes  No

MUNICIPALITY OF VILLALBA  
COMMONWEALTH OF PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2011

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**SECTION II – FINANCIAL STATEMENTS FINDINGS AND QUESTIONED COSTS**

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<b>FINDING</b>	<b>11-01</b>
<b>CATEGORY</b>	INTERNAL CONTROL
<b>NONCOMPLIANCE</b>	CAPITAL ASSETS
<b>TOPIC SENTENCE</b>	<b>FIXED \ CAPITAL ASSETS AND EXPENDITURES – SUBSIDIARY LEDGER</b>
<b>CONDITION</b>	The Municipality has not maintained complete and adequate records in order to obtain sufficient, competent evidential matter with respect to the Capital Assets reported in governmental activities and, accordingly, the amount by which this departure would affect the assets, net assets, and expenses of the governmental activities is not determinable.
<b>CRITERIA</b>	Chapter IX, Article 9.002 of State Act Number 81 of August 30, 1991 states that the municipality should maintain updated property accounting records. Also the GASB Statements No. 34 <i>Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments</i> require that all capital assets, including infrastructure, must be presented in the Statements of Net Assets and that these assets must be depreciated during its useful life. Also, provisions of GASB Statement No. 42, <i>Accounting and Financial Reporting of Impairments of Capital Assets and for Insurance Recoveries</i> , requires the Municipality to evaluate prominent events or changes in circumstances affecting capital assets to determine whether an impairment of a capital asset has occurred. Furthermore, provisions of GASB Statement No. 51, <i>Accounting and Financial Reporting for Intangible Assets</i> , require that all intangible assets not specifically excluded by its scope provisions be classified as capital assets.
<b>CAUSE</b>	Competent and sufficient evidential matter related to the capital assets was not available to support the value, completeness and ownership of these assets.
<b>EFFECT</b>	The Municipality’s Government Wide Financial Statements do not present fairly, the financial position of the governmental activities, and the change in financial position of the Municipality.
<b>RECOMMENDATION</b>	We recommend that the Municipality should continue the compilation of documents to support the value, completeness and ownership of its capital assets, to comply with the requirements of the GASB Statement No. 34, GASB Statement No. 42 and GASB Statement No.51.

MUNICIPALITY OF VILLALBA  
COMMONWEALTH OF PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2011

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**SECTION II – FINANCIAL STATEMENTS FINDINGS AND QUESTIONED COSTS**

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**FINDING**

**11-01 (CONTINUED)**

**QUESTIONED COSTS**

NONE

MANAGEMENT RESPONSE  
AND CORRECTIVE ACTION PLAN

The Municipality had gathered relevant information related to the capital assets but it has not been sufficient so far. The person in charge of the Property Division is working very hard in obtaining as much information as possible and for the most part, the situation will be resolved for next year.

Implementation Date: December 31, 2012

Responsible Person: Mrs. Joan Quiñonez  
Finance Department Director

MUNICIPALITY OF VILLALBA  
COMMONWEALTH OF PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2011

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**SECTION II – FINANCIAL STATEMENTS FINDINGS AND QUESTIONED COSTS**

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<b>FINDING</b>	<b>11-02</b>
<b>CATEGORY</b>	INTERNAL CONTROLS
<b>TOPIC SENTENCE</b>	<b>ACCOUNTING SYSTEM</b>
<b>CONDITIONS</b>	<p>The accounting system and manuals registers used by the Municipality to account and register the financial transactions during the fiscal year does not provide for the summarization of transactions that permit the preparation of Municipality's financial statements in conformity with the General Accepted Accounting Principles of the United States of America (GAAP).</p> <p>There are no internal controls or records to account for the inter fund receivable and payables balances between Municipality's funds. Monthly program's expenditures financed by the Municipality's general fund are not being register, monitored nor accounted for by the Programs' accountants. In addition, inter fund transactions regarding the reimbursement of money between funds were not supported by an analysis.</p> <p>The Municipality does not count with an account receivable subsidiary ledger.</p>
<b>CRITERIA</b>	<p>According to Article 8.010 (a) and (b) of Law Num. 81 for the Municipalities of Puerto Rico, the computerized system and the procedures of accounting and property will be design so that it allows the Municipality to carry out its functions, at the same time as they serve to maintain an uniform and coordinated accounting, that provide a complete picture of the financial operations of the Municipality and the necessary financial information that assist the Municipality Legislature, the Governor, and the Secretary of the Puerto Rico Treasury Department in the performance of its respective responsibilities. Municipalities accounting will be based on funds, Generally Accepted Accounting Principles and the requirements established by the Governmental Accounting Standard Board. Also the pronouncements of the National Committee on Governmental Accounting and the "Blue Book" will be used to design municipalities' accounting systems and fiscal procedures.</p>
<b>CAUSES</b>	<p>Municipality's accounting system and financial reports are subject to State's agencies requirements which does not allow nor provide the Municipality with the necessary tools capable of recapturing the financial information and provide financial statements.</p>

MUNICIPALITY OF VILLALBA  
COMMONWEALTH OF PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2011

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**SECTION II – FINANCIAL STATEMENTS FINDINGS AND QUESTIONED COSTS**

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<b>FINDING</b>	<b>11-02 (CONTINUED)</b>
<b>EFFECT</b>	<p>The lack of an adequate accounting system which can capture all the financial information and generate Municipality's financial statements for each fiscal year affect the Municipality's ability to measure the financial and nonfinancial performance of programs and activities; adequately safeguard significant assets and properly record various transactions; and hinder the Municipality from having reliable financial information to operate in an economical, efficient, and effective manner.</p> <p>Sound decisions on the current results and future direction of vital programs and policies are made more difficult without timely, reliable and useful financial performance information.</p>
<b>RECOMMENDATION</b>	<p>The Municipality should establish and implement the necessary measures that allow the summarization of the financial transactions in order to prepare the financial statements in conformity with GAAP.</p>
<b>QUESTIONED COSTS</b>	None
<b>MANAGEMENT RESPONSE AND CORRECTIVE ACTION PLAN</b>	<p>The Finance Director is implementing new internal accounting procedures related to the financial information in the Department in order to prepare the information according to GAAP. This situation will be solved promptly.</p> <p>Implementation Date: January 31, 2013 Responsible Person: Mrs. Joan Quiñonez Finance Department Director</p>

MUNICIPALITY OF VILLALBA  
COMMONWEALTH OF PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2011

**SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

<b>FINDING</b>	<b>11-03</b>
FEDERAL PROGRAM	COMMUNITY DEVELOPMENT BLOCK GRANT/STATE'S PROGRAM (CDBG) (CFDA NO. 14.228) DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT PASS THROUGH STATE-OFFICE OF COMMISSIONER OF MUNICIPAL AFFAIRS
CATEGORY	INTERNAL CONTROL / COMPLIANCE
NONCOMPLIANCE	PROCUREMENT STANDARDS
TOPIC SENTENCE	<b>LACK OF REQUIRED CONTRACT CLAUSES AND PROCUREMENT DOCUMENTATION</b>
CONDITION	<p>In testing compliance with the procurement requirement, we examined five contracts for construction projects which were paid during the fiscal year 2010-11. In relation to such examination we determined the following:</p> <ol style="list-style-type: none"><li>1. Absence of contract clauses required by the program regulation, as follows:<ul style="list-style-type: none"><li>• three contracts did not include clauses regarding contractual legal remedies when contractor violates term and granting access to GAO and other federal agencies to books and documents,</li><li>• five contracts did not require compliance with Executive Order 11246 of September 24, 1965, entitled "Equal Employment Opportunity," as amended by Executive Order 11375 of October 13, 1967, and as supplemented in Department of Labor regulations (41 CFR chapter 60) and with the Copeland "Anti-Kickback" Act (18 U.S.C. 874) as supplemented in Department of Labor regulations (29 CFR Part 3),</li><li>• Two construction contracts over \$100,000 did not include clauses regarding Compliance with all applicable standards, orders, or requirements issued under section 306 of the Clean Air Act (42 U.S.C. 1857(h)), section 508 of the Clean Water Act (33 U.S.C. 1368), Executive Order 11738, and Environmental Protection Agency regulations (40 CFR part 15).</li></ul></li></ol>

MUNICIPALITY OF VILLALBA  
COMMONWEALTH OF PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2011

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**SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

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<b>FINDING</b>	<b>11-03 (CONTINUED)</b>
	2. Absence of evidence regarding the documents that should be required to the contractor, such as Payment and Performance Bond, evidence of payment of municipal license tax and construction charges, State Insurance Fund (one case) and, Department of Treasury, CRIM and Department of Labor negative certifications.
<b>CRITERIA</b>	<p>Code of Federal Regulations, Subpart C, 24 CFR Section 85.36 (i) (1-13) states that subgrantee's contract must contain provisions in paragraph (i) of these Sections. Federal agencies are permitted to require changes, remedies, changed conditions, access and records retention, suspension of work, and other clauses approved by the Office of Procurement Policy.</p> <p>The 24 CFR 85.36 (h) states the requirements regarding Payment and Performance Bond on the part of the contractor for 100 percent of the contract price for construction contracts.</p> <p>Chapter IX, Section 2, of the Municipal Management Regulation states the documents that the Municipality should require to the contractors.</p>
<b>CAUSE</b>	The Municipality did not maintain appropriate procurement standard procedures in order to assure that contractor complies with program requirements.
<b>EFFECT</b>	Municipality is not in compliance with the mentioned federal and state regulations.
<b>RECOMMENDATION</b>	We recommend management to update contract model according with the federal requirement and establish internal controls to assure that all required documentation is obtained from the contractor during the procurement process.
<b>QUESTIONED COSTS</b>	None
<b>MANAGEMENT RESPONSE AND CORRECTIVE ACTION PLAN</b>	<p>To correct this condition, we will modify our master contract to include all the general clauses required by Federal and State laws. Also, we will improve our internal controls and procedures to ensure that all procurement documentation is properly safeguarded on file, and available as requested for audit procedures.</p> <p>Implementation Date: December 31, 2012 Responsible Person: Mr. Wilfredo Santos Municipal Secretary</p>

MUNICIPALITY OF VILLALBA  
COMMONWEALTH OF PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2011

**SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

<b>FINDING</b>	<b>11-04</b>
FEDERAL PROGRAM	COMMUNITY DEVELOPMENT BLOCK GRANT/STATE'S PROGRAM (CFDA NO. 14.228) DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT PASS THROUGH STATE-OFFICE OF COMMISSIONER OF MUNICIPAL AFFAIRS
CATEGORY	INTERNAL CONTROL / COMPLIANCE
NONCOMPLIANCE	SUSPENSION AND DEBARMENT
TOPIC SENTENCE	<b>ABSENCE OF CONTROLS TO ASSURE COMPLIANCE WITH SUSPENSION AND DEBARMENT</b>
CONDITIONS	As determined by interviews to Program personnel and by examination of projects files, the Municipality did not maintain adequate controls and procedures to assure that the individuals and entities which are granted with contracts are not suspended or debarred from participation in federal programs.
CRITERIA	As stated in 24 CFR 85.35 grantee and subgrantee must not make any award or permit any award (subgrant or contract) at any tier to any party which is debarred or suspended or is otherwise excluded from or ineligible for participation in Federal assistance programs under Executive Order 12549, "Debarment and Suspension".
CAUSE	The Municipality has no policies and procedures for the use of the List of Parties Excluded from federal procurement or non-procurement programs to assure that they do not award assistance to listed parties.
EFFECT	As a result of this deficiency, the Municipality could have procured goods or services from organizations and individuals that are suspended or debarred which could result in cost disallowances by the federal awarding agency.
RECOMMENDATION	The Municipality should amend their procurement procedures and include a step to verify whether or not the individual or entity is on the list of parties excluded from federal participation in procurement and non-procurement programs. The Municipality should also require the entities or individuals to submit a certification stating that they are not suspended or debarred or add a clause or condition to the covered transaction with that entity.

MUNICIPALITY OF VILLALBA  
COMMONWEALTH OF PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2011

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**SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

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**FINDING** 11-04 (CONTINUED)

**QUESTIONED COSTS** None

**MANAGEMENT RESPONSE  
AND CORRECTIVE ACTION PLAN**

We will include in our procurement procedures a step to verify through the electronic version available on the Internet (<http://epls.arnet.gov>) whether or not the individual or entity is on the list of parties excluded from federal participation in procurement and non-procurement programs.

Implementation Date: December 31, 2012

Responsible Person: Mr. Wilfredo Santos  
Municipal Secretary

MUNICIPALITY OF VILLALBA  
COMMONWEALTH OF PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2011

**SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

<b>FINDING</b>	<b>11-05</b>
FEDERAL PROGRAM	COMMUNITY DEVELOPMENT BLOCK GRANT/STATE'S PROGRAM (CFDA NO. 14.228) DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT PASS THROUGH STATE-OFFICE OF COMMISSIONER OF MUNICIPAL AFFAIRS
CATEGORY	INTERNAL CONTROL / COMPLIANCE
NONCOMPLIANCE	SPECIAL TEST
TOPIC SENTENCE	<b>COMMITMENT OF FUNDS BEFORE APPROVAL OF A RELEASE OF FUNDS</b>
CONDITIONS	<p>In testing compliance with the special test regarding HUD's approval for the release of funds, we determined that CDBG funds were committed before the required request for release of funds (RROF) was approved and received from the correspondent State's Agency (OCAM).</p> <p>During the fiscal year 2010-11, funds amounting \$117,000 were encumbered and paid for three contracts regarding construction work (pluvial systems). Such funds were committed before the approval of the request for release of funds from OCAM. Contracts were awarded in September, October and November 2010 while the related RROF was approved by OCAM in January 2011. Notices to proceed with the work were granted in the same month the contract was signed. Projects should be commenced on or before January 11, 2011 according to those notices. The corresponding purchase orders were registered in January 2011 after the RROF approval but also after receiving all or part of the services contracted.</p>
CRITERIA	<p>As stated in 24 CFR 58.22(a) neither a recipient nor any participant in the development process, including public or private nonprofit or for-profit entities, or any of their contractors, may commit HUD assistance under a program listed in Sec. 58.1(b) on an activity or project until HUD or the state has approved the recipient's RROF and the related certification from the responsible entity. In addition, until the RROF and the related certification have been approved, neither a recipient nor any participant in the development process may commit non-HUD funds on or undertake an activity or project under a program listed in Sec. 58.1(b) if the activity or project would have an adverse environmental impact or limit the choice of reasonable alternatives.</p>

MUNICIPALITY OF VILLALBA  
COMMONWEALTH OF PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2011

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**SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

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FINDING	<b>11-05 (CONTINUED)</b>
CAUSE	The main cause for this condition was that construction services were contracted, before the CDBG Program would have received the approval of a request for release of funds from OCAM.
EFFECT	Expenditures could be questioned from the State CDBG Program or the Federal Government and be adversely affected in the benefits they are entitled to receive in the future.
RECOMMENDATION	No funds should be committed for any activity or project until HUD or the State has approved the recipient's RROF and the related certification from the responsible entity. In addition, until the RROF and the related certification have been approved, neither a recipient nor any participant in the development process may commit non-HUD funds.
QUESTIONED COSTS	Questioned costs amounted \$117,000.
MANAGEMENT RESPONSE AND CORRECTIVE ACTION PLAN	The Municipality's administration does not accept the finding as described because although the contracts were granted before the release of funds letter, the Municipality does not obligated such finds until the release of fund letter arrived. To corroborate that information, the OCAM have approved the certification for payments of the mentioned contractors. If any irregularity, such as the one you mentioned had occurred, the OCAM does not have approved those certifications for payment.  Responsible Person: Mrs. Sara Robles Federal Programs Director

MUNICIPALITY OF VILLALBA  
COMMONWEALTH OF PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2011

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**SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

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<b>FINDING</b>	<b>11-06</b>
FEDERAL PROGRAM	DISASTER GRANTS – PUBLIC ASSISTANCE (CFDA NO. 97.036) DEPARTMENT OF HOMELAND SECURITY PASS THROUGH COMMONWEALTH OF PUERTO RICO -GOVERNOR AUTHORIZED REPRESENTATIVE (GAR):
CATEGORY	INTERNAL CONTROLS
NONCOMPLIANCE	FISCAL REQUIREMENTS
TOPIC SENTENCE	<b>LACK OF ACCOUNTING RECORDS AND INADEQUATE CONTROLS</b>
CONDITIONS	<p>During our internal control auditing procedures we observe the following:</p> <ol style="list-style-type: none"><li>1. The Disaster Grants – Public Assistance Program (the Program) does not maintain an adequate fiscal control and accounting records over the management, use and registering of funds granted by the Lead Agency (GAR). Among the deficiencies founds were the following:<ul style="list-style-type: none"><li>- The Program does not count with a general ledger or any other related subsidiary ledger. For such reason, during the fiscal year 2010-11 financial transactions were not registered neither reconciled, at least, on a monthly basis.</li><li>- The lack of accounting records does not provide for the preparation of annual financial statements.</li><li>- The existing financial information does not provide the amount of funds that were expended, encumbered or unobligated at the end of the fiscal year for each disaster and project.</li><li>- There are no internal controls neither records to account for the inter fund receivable and payables balances. Program's expenditures financed by the Municipality's general fund are not being register, monitored nor accounted for by the Program's accountant. In addition, inter fund transactions regarding the reimbursement of money between funds were not supported by an analysis.</li></ul></li><li>2. During our internal control tests to nine disbursement transactions, we observe that in 6 cases the disbursement voucher was not marked as paid and in one case the order was registered after receiving the services.</li></ol>

MUNICIPALITY OF VILLALBA  
COMMONWEALTH OF PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2011

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**SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

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FINDING	11-06 (CONTINUED)
CRITERIA	<p>As stated in 44 CFR 13.20, (a) A State must expand and account for grant funds in accordance with State laws and procedures for expending and accounting for its own funds. Fiscal control and accounting procedures of the State, as well as its subgrantees and cost-type contractors, must be sufficient to— (1) Permit preparation of reports required by this part and the statutes authorizing the grant, and (2) Permit the tracing of funds to a level of expenditures adequate to establish that such funds have not been used in violation of the restrictions and prohibitions of applicable statutes. (b) The financial management systems of other grantees and subgrantees must meet the following standards: (1) Financial reporting. Accurate, current, and complete disclosure of the financial results of financially assisted activities must be made in accordance with the financial reporting requirements of the grant or subgrant. (2) Accounting records. Grantees and subgrantees must maintain records which adequately identify the source and application of funds provided for financially-assisted activities. These records must contain information pertaining to grant or subgrant awards and authorizations, obligations, unobligated balances, assets, liabilities, outlays or expenditures, and income. (3) Internal control. Effective control and accountability must be maintained for all grant and subgrant cash, real and personal property, and other assets. Grantees and subgrantees must adequately safeguard all such property and must assure that it is used solely for authorized purposes.</p>
CAUSE	<p>The Municipality's and Program's management have not established the procedures and adequate internal controls to ensure the adequate recording of all related financial information.</p>
EFFECT	<p>These conditions inhibit the Municipality from having current accurate and reliable financial reports and information necessary for management to take efficient and effective actions, including corrective actions plans. On the other hand, the awarding agency inhibits from monitoring the programs financial performance.</p>
RECOMMENDATION	<p>The Municipality should establish a plan and implement the corresponding internal controls to ensure that all Program's transactions and activities are properly recorded and fairly presented in accordance with program requirements and that all financial transactions' supporting documents are properly safeguarded. In addition, should establish and maintain a subsidiary ledger to accurately account for inter fund transactions.</p>
QUESTIONED COSTS	None

MUNICIPALITY OF VILLALBA  
COMMONWEALTH OF PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2011

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**SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

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MANAGEMENT RESPONSE  
AND CORRECTIVE ACTION PLAN

The Program Accountant will implement a set of manual books in order to provide complete and accurate Financial Information regarding the Disaster Grants – Public Assistance projects.

Implementation Date: December 31, 2012  
Responsible Person: Mrs. Joan Quiñonez  
Finance Director

MUNICIPALITY OF VILLALBA  
COMMONWEALTH OF PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2011

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**SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

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<b>FINDING</b>	<b>11-07</b>
FEDERAL PROGRAM	DISASTER GRANTS – PUBLIC ASSISTANCE (CFDA NO. 97.036) DEPARTMENT OF HOMELAND SECURITY PASS THROUGH COMMONWEALTH OF PUERTO RICO -GOVERNOR AUTHORIZED REPRESENTATIVE (GAR):
CATEGORY	INTERNAL CONTROL / COMPLIANCE
NONCOMPLIANCE	PROCUREMENT STANDARDS
TOPIC SENTENCE	<b>LACK OF REQUIRED CONTRACT CLAUSES AND PROCUREMENT DOCUMENTATION</b>
CONDITION	<p>In testing compliance with the procurement requirement, we examined 7 contracts for construction (6) and design (1). In relation to such examination we determined the following:</p> <ol style="list-style-type: none"><li>1. Absence of contract clauses required by the program regulation, as follows:<ul style="list-style-type: none"><li>• Seven contracts did not include a clause granting access to GAO and other federal agencies to books and documents,</li><li>• Six construction contracts did not include a clause regarding compliance with Executive Order 11246 of September 24, 1965, entitled “Equal Employment Opportunity,” as amended by Executive Order 11375 of October 13, 1967, and as supplemented in Department of Labor regulations (41 CFR chapter 60) and with the Copeland “Anti-Kickback” Act (18 U.S.C. 874) as supplemented in Department of Labor regulations (29 CFR Part 3),</li><li>• Two construction contracts over \$100,000 did not include clauses regarding Compliance with all applicable standards, orders, or requirements issued under section 306 of the Clean Air Act (42 U.S.C. 1857(h)), section 508 of the Clean Water Act (33 U.S.C. 1368), Executive Order 11738, and Environmental Protection Agency regulations (40 CFR part 15).</li></ul></li><li>2. Absence of evidence regarding the documents that should be required to the contractor, such as evidence of payment of municipal license tax and construction charges, State Insurance Fund and, Department of Treasury, CRIM and Department of Labor negative certifications.</li></ol>

MUNICIPALITY OF VILLALBA  
COMMONWEALTH OF PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2011

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**SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

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<b>FINDING</b>	<b>11-07 (CONTINUED)</b>
<b>CRITERIA</b>	<p>Code of Federal Regulations, 44 CFR Section 13.36 (i) (1-13) states that subgrantee's contract must contain provisions in paragraph (i) of these Sections. Federal agencies are permitted to require changes, remedies, changed conditions, access and records retention, suspension of work, and other clauses approved by the Office of Procurement Policy.</p> <p>Chapter IX, Section 2, of the Municipal Management Regulation states the documents that the Municipality should require to the contractors.</p>
<b>CAUSE</b>	<p>The Municipality did not maintain appropriate procurement standard procedures in order to assure that contractor complies with program requirements.</p>
<b>EFFECT</b>	<p>Municipality is not in compliance with the mentioned federal and state regulations.</p>
<b>RECOMMENDATION</b>	<p>We recommend management to update contract model according with the federal requirement and establish internal controls to assure that all required documentation is obtained from the contractor during the procurement process.</p>
<b>QUESTIONED COSTS</b>	<p>None</p>
<b>MANAGEMENT RESPONSE AND CORRECTIVE ACTION PLAN</b>	<p>To correct this condition, we will modify our master contract to include all the general clauses required by Federal and State laws. Also, we will improve our internal controls and procedures to ensure that all procurement documentation is properly safeguarded on file, and available as requested for audit procedures.</p> <p>Implementation Date: December 31, 2012</p> <p>Responsible Person: Mr. Wilfredo Santos Municipal Secretary</p>

MUNICIPALITY OF VILLALBA  
COMMONWEALTH OF PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2011

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**SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

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<b>FINDING</b>	<b>11-08</b>
FEDERAL PROGRAM	DISASTER GRANTS – PUBLIC ASSISTANCE (CFDA NO. 97.036) DEPARTMENT OF HOMELAND SECURITY PASS THROUGH COMMONWEALTH OF PUERTO RICO -GOVERNOR AUTHORIZED REPRESENTATIVE (GAR):
CATEGORY	INTERNAL CONTROL / COMPLIANCE
NONCOMPLIANCE	SUSPENSION AND DEBARMENT
TOPIC SENTENCE	<b>ABSENCE OF CONTROLS TO ASSURE COMPLIANCE WITH SUSPENSION AND DEBARMENT</b>
CONDITIONS	As determined by interviews to Program personnel and by examination of projects files, the Municipality did not maintain adequate controls and procedures to assure that the individuals and entities which are granted with contracts are not suspended or debarred from participation in federal programs.
CRITERIA	As stated in 44 CFR 13.35 grantee and subgrantee must not make any award or permit any award (subgrant or contract) at any tier to any party which is debarred or suspended or is otherwise excluded from or ineligible for participation in Federal assistance programs under Executive Order 12549, “Debarment and Suspension”.
CAUSE	The Municipality has no policies and procedures for the use of the List of Parties Excluded from federal procurement or non-procurement programs to assure that they do not award assistance to listed parties.
EFFECT	As a result of this deficiency, the Municipality could have procured goods or services from organizations and individuals that are suspended or debarred which could result in cost disallowances by the federal awarding agency.
RECOMMENDATION	The Municipality should amend their procurement procedures and include a step to verify whether or not the individual or entity is on the list of parties excluded from federal participation in procurement and non-procurement programs. The Municipality should also require the entities or individuals to submit a certification stating that they are not suspended or debarred or add a clause or condition to the covered transaction with that entity.

MUNICIPALITY OF VILLALBA  
COMMONWEALTH OF PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2011

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**SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

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**FINDING**

**11-08 (CONTINUED)**

**QUESTIONED COSTS**

None

**MANAGEMENT RESPONSE  
AND CORRECTIVE ACTION PLAN**

We will include in our procurement procedures a step to verify through the electronic version available on the Internet (<http://epls.arnet.gov>) whether or not the individual or entity is on the list of parties excluded from federal participation in procurement and non-procurement programs.

Implementation Date: December 31, 2012

Responsible Person: Mr. Wilfredo Santos  
Municipal Secretary

END OF SCHEDULE

MUNICIPALITY OF VILLALBA  
COMMONWEALTH OF PUERTO RICO

SUMMARY SCHEDULE OF PRIOR YEARS FINDINGS AND QUESTIONED COSTS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2011

(1) Audit Findings that have been Fully Corrected:

Finding Number	CFDA	Questioned Cost	Comments
10-03 Equipment and Real Property Management	14.228	None	Corrected
10-07 Davis- Bacon	14.228	None	Corrected
10-09 Special Test and Provisions	14.871	None	Corrected
10-10 Reporting	14.871	None	Corrected
09-03 Equipment and Real Property Management	14.228	None	Corrected
09-07 Special Test and Provisions	14.871	None	Corrected
09-08 Special Test and Provisions	14.871	None	Corrected
08-03 Equipment and Real Property Management	14.228	None	Corrected

(2) Audit Findings not corrected or Partially Corrected:

Finding Number	CFDA	Questioned Cost	Comments
10-04 Procurement	14.228	None	Situation still prevails.
10-05 Procurement	14.228	None	Situation still prevails.
10-06 Suspension and Debarments	14.228	None	Situation still prevails.
10-07 Special Test and Provisions	14.228	None	Partially Corrected.
09-04 Procurement	14.228	None	Situation still prevails.
09-05 Special Test and Provisions	14.228	None	Situation still prevails.
09-06 Suspension and Debarment	14.228	None	Situation still prevails.
08-04 Suspension and Debarment	14.228	None	Situation still prevails.
07-03 Suspension and Debarment	14.228	None	Situation still prevails.
06-04 Suspension and Debarment	14.228	None	Situation still prevails.

(3) Corrective action taken is significantly different from corrective action previously reported:

NONE

(4) Audit findings is no longer valid:

Finding Number	CFDA	Questioned Cost	Comments
10-11 Reporting	14.850	None	No longer valid.
09-09 Reporting	14.850	None	No longer valid.
08-07 Reporting	14.850	None	No longer valid

END OF SCHEDULE