

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

**MUNICIPIO DE AIBONITO
AUDITORÍA 2015-2016
30 DE JUNIO DE 2016**

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO**

**SINGLE AUDIT REPORT
Fiscal Year Ended
June 30, 2016**

**BASIC FINANCIAL STATEMENTS AND
SUPPLEMENTAL SCHEDULES**

With Independent Auditors' Report Thereon
June 30, 2016

Commonwealth of Puerto Rico
Municipality of Aibonito
Table of Contents
Fiscal Year ended June 30, 2016

Independent Auditors' Report	1-4
Required Supplementary Information (Part I):	
Management's Discussion and Analysis	5-21
Basic Financial Statements:	
Government-wide Financial Statements:	
Statement of Net Position.....	22-23
Statement of Activities.....	24
Governmental Fund Financial Statements:	
Balance Sheet – Governmental Funds	25
Reconciliation of the Balance Sheet –	
Governmental Funds to the Statement of Net Position	26
Statement of Revenues, Expenditures and	
Changes in Fund Balances – Governmental Funds	27
Reconciliation of the Statement of Revenues,	
Expenditures and Changes in Fund Balances –	
Governmental Funds to the Statement of Activities.....	28
Statement of Fund Net Position – Proprietary Fund	29
Statement of Revenues, Expenses and Changes in	
Fund Net Position – Proprietary Fund	30
Statement of Cash Flows – Proprietary Fund	31
Notes to Basic Financial Statements	32-79
Required Supplementary Information (Part II):	
Budgetary Comparison Schedule - General Fund.....	80
Notes to the Budgetary Comparison Schedule - General Fund.....	81
Schedule of Expenditures of Federal Awards	82
Notes to Schedule of Expenditures of Federal Awards.....	83
Internal Control and Compliance (Part III):	
Report on Compliance and on Internal Control over Financial	
Reporting based on an audit of Financial Statements performed	
in accordance with Government Auditing Standards	84-85
Report on Compliance for each major program and on internal	
control over compliance in accordance by Uniform Guidance	86-88
Audit Findings and Questioned Costs (Part IV):	
Schedule of Findings and Questioned Costs	89-96
Summary Schedule of Prior Audit Findings	97-100



Independent Auditors' Report on Basic Financial Statements and Supplementary Schedule of Expenditures of Federal Awards

The Honorable Mayor, Members of the
Municipal Legislature and People of
the Municipality of Aibonito
Aibonito, Puerto Rico

Report on the Financial Statements

We have audited the accompanying financial statements of the governmental activities, the business –type activities, each major fund, and the aggregate remaining fund information of the Municipality of Aibonito of the Commonwealth of Puerto Rico (the “Municipality”), as of and for the year ended June 30, 2016, and the related notes to the financial statements, which collectively comprise the Municipality’s basic financial statements as listed in the accompanying table of contents.

Management’s Responsibility for the Financial Statements

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

Auditors’ Responsibility

Our responsibility is to express opinions on these financial statements based our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States of America. 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 involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor’s judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider the auditor considers internal control relevant to the entity’s preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity’s internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Basis for Qualified Opinion on Governmental Activities and Note Disclosure Regarding Pensions

As discussed in Note 13 to the basic financial statements, the Municipality has not adopted the provisions of Statement No. 68 of the Governmental Accounting Standards Board, *Accounting and Financial Reporting for Pensions, an amendment of GASB Statement No. 27*. On November 30, 2015, the Puerto Rico Treasury Department issued an unaudited report of the preliminary estimate of the Municipality's net pension obligation amounting to \$25 million as of June 30, 2014 (latest estimate available). However, an updated unaudited estimate of the net pension obligations was not available as of June 30, 2016 and for the fiscal year then ended. For these reasons, the Municipality has not been able to account for its proportionate share of net pension obligation, deferred inflow of resources and deferred outflow of resources related to pension costs as of June 30, 2016 in the accompanying statement of net position, and has not been able to recognize the effect of the changes in net pension obligation, deferred outflow of resources and deferred inflow of resources in the accompanying statement of activities for the fiscal year then ended as these relate to pension costs. Furthermore, it is not practical for the management of the Municipality to determine the financial impact of the implementation of GASB 68 in future financial statements of the Municipality.

Accounting principles generally accepted in the United States of America require that pension related liability, deferred outflow of resources, deferred inflow of resources, as applicable, be recognized in accordance with the parameters established by Statement No. 68, as well as the effect of current period changes of the aforementioned amounts that must be recognized in pension expense during the current period. Recognition of the amounts would increase liabilities, increase deferred outflow of resources, increase deferred inflow of resources, decrease net position and change the pension expenses of the governmental activities. The amounts by which this departure would affect liabilities, deferred outflow of resources, deferred inflow of resources, and expenses of the governmental activities has not been determined.

The accompanying notes to the basic financial statements do not disclose the pension cost information required by Statement No. 68. In our opinion, disclosure of this information is required by accounting principles generally accepted in the United States of America.

Qualified Opinion on Governmental Activities (Government-Wide Financial Statements)

In our opinion, except for the possible effects of the matters described above in the Basis for Qualified Opinion on Government Activities and Note Disclosure Regarding Pension paragraph, the financial statements referred to above present fairly, in all material respects, the financial position of the governmental activities of the Municipality of Aibonito as of June 30, 2016 and the respective changes in financial position thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Unmodified Opinions on Governmental Fund Financial Statements and Business-Type Activities

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of each major fund, and the aggregate remaining fund information of the Municipality of Aibonito of the Commonwealth of Puerto Rico, as of June 30, 2016, 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.

Also, in our opinion, the financial statements referred to above present fairly, in all material respects, the financial position, the changes in financial position and cash flows of the business-type activities of the Municipality of Aibonito, Commonwealth of Puerto Rico, as of June 30, 2016, and the respective changes in financial position, and where applicable, cash flows thereof for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information Omitted

The Municipality has omitted the Schedule of the Municipality's Proportionate Share of the Net Pension Liability, and the Schedule of Municipality's Contributions to the Employees' Pension Plan, information that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing 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 the financial reporting for placing the basic financial statements in an appropriate operational, economic or historical context. Our opinion on the basic financial statements is not affected by this missing information.

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and the Budgetary Comparison Schedule information on pages 5 through 21 and 80 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Municipality's basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by *Title 2 U.S. Code of Federal Regulations Part 200, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* and is not a required part of the basic financial statements.

The Schedule of Expenditures and Federal Awards is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the Schedule of Expenditures of Federal Awards is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with Government Auditing Standards, we have also issued our report dated February 28, 2017, on our consideration of the Municipality of Aibonito of the Commonwealth of Puerto Rico internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards in considering the Municipality of Aibonito of the Commonwealth of Puerto Rico internal control over financial reporting and compliance.

February 28, 2017
Toa Alta, Puerto Rico

A handwritten signature in black ink, appearing to be 'B. Williams', is written over the date. To the right of the signature, the initials 'CPA-PSC' are written in a similar cursive style.

Stamp No. O2729497
was affixed to the
original report.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Management's Discussion and Analysis
Fiscal Year Ended June 30, 2016

As management of the Municipality of Aibonito (the Municipality), we offer readers the following discussion and analysis of the Municipality's financial activities reported in the accompanying basic financial statements for the fiscal year ended June 30, 2016. We encourage readers to consider the information presented here in conjunction with additional information that is furnished in the Municipality's financial statements, which follow this narrative.

FINANCIAL HIGHLIGHTS

Government-Wide Highlights:

- The Municipality's assets exceeded its liabilities and deferred inflows of resources (net position) by \$40,098,493 at June 30, 2016. The Municipality's net position increased by \$2,019,762 (5% increase) during the fiscal year ended June 30, 2016.
- The Municipality's assets increased from \$56,212,057 at June 30, 2015 to \$57,575,572 at June 30, 2016, for an increase of \$1,363,515 (2% increase).
- The liabilities of the Municipality decreased from \$15,917,706 at June 30, 2015 to \$15,139,899 at June 30, 2016, for a decrease of \$777,807 (5% decrease).
- The deferred inflows of resources of the Municipality increased from \$2,215,620 at June 30, 2015 to \$2,337,180 at June 30, 2016 for an increase of \$121,560.
- The revenues of the Municipality increased from \$13,990,283 for the fiscal year ended June 30, 2015 to \$14,311,296 for the fiscal year ended June 30, 2016, for an increase of \$321,013 (2% increase).
- The Municipality's expenses decreased from \$12,382,775 for the fiscal year ended June 30, 2015 to \$12,291,534 for the fiscal year ended June 30, 2016, for a decrease of \$91,241 (1% decrease).
- The net position of governmental activities increased \$2,009,860 while the net position of business-type activities increased \$9,902 for the fiscal year ended June 30, 2016.

Governmental Funds Highlights:

- The total fund balances of governmental funds amounted to \$12,162,132 at June 30, 2016, which increased by \$802,374 during fiscal year ended June 30, 2016.
- The total assets of governmental funds increased from \$17,620,576 at June 30, 2015 to \$18,091,325 at June 30, 2016, for an increase of \$470,749 (3% increase).
- The governmental fund's total liabilities decreased from \$3,983,684 at June 30, 2015 to \$3,560,008 at June 30, 2016, for a decrease of \$423,676 (11% decrease).
- The governmental fund's deferred inflows of resources increased from \$2,277,134 at June 30, 2015 to \$2,369,185 at June 30, 2016, for an increase of \$92,051.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Management's Discussion and Analysis
Fiscal Year Ended June 30, 2016

- The total revenues of governmental funds increased from \$13,409,765 for the fiscal year ended June 30, 2015 to \$13,756,766 for the fiscal year ended June 30, 2016, for an increase of \$347,001 (3% increase).
- The governmental fund's total expenditures increased from \$12,932,413 for the fiscal year ended June 30, 2015 to \$12,954,392 for the fiscal year ended June 30, 2016, for an increase of \$21,979.
- The total fund balances of governmental funds increased \$802,374 for the fiscal year ended June 30, 2016.

Proprietary Fund Highlights:

- The total fund net position of the proprietary fund amounted to \$1,427,459 at June 30, 2016, for an increase of \$9,902 during fiscal year ended June 30, 2016.
- The total assets of the proprietary fund decreased from \$1,944,384 at June 30, 2015 to \$1,833,524 at June 30, 2016, for a decrease of \$110,860 (6% decrease).
- The proprietary fund's total liabilities decreased from \$526,827 at June 30, 2015 to \$406,065 at June 30, 2016, for a decrease of \$120,762 (23% decrease).
- The total revenues of the proprietary fund increased from \$580,173 for the fiscal year ended June 30, 2015 to \$580,722 for the fiscal year ended June 30, 2016, for an increase of \$549.
- The proprietary fund's total expenditures decreased from \$600,851 for the fiscal year ended June 30, 2015 to \$570,820 for the fiscal year ended June 30, 2016, for a decrease of \$30,031 (5% decrease).

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, 2016. 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 five components: (1) government-wide financial statements (GWFS), (2) governmental fund financial statements (GFFS), (3) proprietary fund financial statements (PFFS), (4) notes to the basic financial statements (NBFS). This report also contains additional required and other supplementary 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.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Management's Discussion and Analysis
Fiscal Year Ended June 30, 2016

a) Government-wide Financial Statements

The GWFS are composed of: (1) the statements of net position (SNP) 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 business. 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, 2016. The GWFS are prepared using methods that are similar to those used by most private businesses.

1. Statement of Net Position

The purpose of SNP is to attempt to report all assets owned and all liabilities owed by the Municipality. The Municipality reports of all of its assets when it acquires ownership over the assets and reports all of its liabilities when they are incurred. For example, the Municipality reports buildings and infrastructure as assets, even though they are not available to pay the obligations incurred by the Municipality.

On the other hand, the Municipality reports liabilities even though these liabilities might not be paid until several fiscal years into the future.

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

2. Statement of Activities

The SA presents information showing how the Municipality's net position changed during the fiscal year ended June 30, 2016, 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 position*, which is essentially the same concept.

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Management's Discussion and Analysis
Fiscal Year Ended June 30, 2016

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

b) Governmental Fund Financial Statements

The Municipality's GFFS 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 and 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, deferred inflows of resources, fund equity, revenue, and expenditures. Fund accounting segregates funds according to their intended purpose and is used to aid management in demonstrating compliance with legal, financial and contractual provisions.

Governmental funds are used to account for all 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 GFFS is directed to specific activities of the Municipality rather than the Municipality as a whole; therefore, GFFS report the Municipality's operations in more detail than the GWFS.

GFFS 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) debt service fund, (3) special revenue funds, and (4) capital projects funds.

GFFS are prepared on an accounting basis that is significantly different from that used to prepare GWFS. In general, GFFS focus on near-term inflows and outflows of expendable financial resources, consequently, generally 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 very short period after the end of the fiscal year. The difference between a fund's total assets and total liabilities and deferred inflows of resources is reported as the fund balance, and generally indicates the amount that can be used to finance the next fiscal year's activities. Likewise, the operating statement for

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Management's Discussion and Analysis
Fiscal Year Ended June 30, 2016

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 GFFS 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 (4) major governmental funds. Each major fund is presented in a separate column in the governmental funds' balance sheet and the governmental funds' statement of revenues, expenditures and changes in fund balances. The four (4) major governmental funds are: (1) general fund, (2) capital projects fund, (3) legislative joint resolutions fund, and (4) debt service fund.

c) Proprietary Fund Financial Statements

The proprietary fund financial statements (PFFS) consist of: (1) the statement of fund net position – proprietary fund, (2) the statement of revenues, expenses and changes in fund net position – proprietary fund, and (3) the statement of cash flows – proprietary fund. These statements present the financial position, results of operations and cash flows of *Las Flores Apartments Fund* (FmHA and HUD Project No. 63-005-660-43-3572), which accounts for the leasing operations and maintenance of a residential real estate property originally acquired through the issuance of mortgage notes payable.

The activities of Las Flores Apartments have been reported in a proprietary fund in the accompanying basic financial statements, as accounting principles generally accepted in the United States of America allow the use of an enterprise fund to report any activity for which a fee is charged to external users of goods or services, regardless of whether the government intends to fully recover the cost of the goods or services provided. Thus, it is common to use proprietary fund reporting to account for services where the government intends to recover only a portion of its costs through fees or user charges. Proprietary funds provide the same type of information as the GWFS, but in more detail.

d) Notes to Basic Financial Statements

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

e) Other Supplementary Information

The basic financial statements are followed by a section of other supplementary information consisting of the budgetary comparison schedule – general fund and the Schedule of Expenditures of Federal Awards.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Management's Discussion and Analysis
Fiscal Year Ended June 30, 2016

FINANCIAL ANALYSIS OF GOVERNMENT-WIDE FINANCIAL STATEMENTS

The Municipality's overall financial position, for the last two fiscal years are summarized as follows, based on the information included in the accompanying GWFS:

	Governmental activities		Business-type activities		Total	
	2016	2015	2016	2015	2016	2015
ASSETS						
Capital assets	\$ 38,664,477	\$ 37,911,632	\$ 1,376,415	\$ 1,415,076	\$ 40,040,892	\$ 39,326,708
Other assets	17,077,571	16,356,041	457,109	529,308	17,534,680	16,885,349
Total assets	<u>55,742,048</u>	<u>54,267,673</u>	<u>1,833,524</u>	<u>1,944,384</u>	<u>57,575,572</u>	<u>56,212,057</u>
LIABILITIES						
Current liabilities	3,121,882	3,336,577	151,528	145,079	3,273,410	3,481,656
Noncurrent liabilities	11,611,952	12,054,302	254,537	381,748	11,866,489	12,436,050
Total liabilities	<u>14,733,834</u>	<u>15,390,879</u>	<u>406,065</u>	<u>526,827</u>	<u>15,139,899</u>	<u>15,917,706</u>
DEFERRED INFLOWS OF RESOURCES	<u>2,337,180</u>	<u>2,215,620</u>	-	-	<u>2,337,180</u>	<u>2,215,620</u>
NET POSITION						
Net investment in capital assets	31,348,025	31,186,873	1,014,065	935,514	32,362,090	32,122,387
Restricted for:						
Debt service	1,575,944	1,066,864	-	-	1,575,944	1,066,864
Capital projects	-	-	270,675	381,510	270,675	381,510
Federal and state funded programs	3,873,082	3,218,416	18,489	11,192	3,891,571	3,229,608
Unrestricted	<u>1,873,983</u>	<u>1,189,021</u>	<u>124,230</u>	<u>89,341</u>	<u>1,998,213</u>	<u>1,278,362</u>
Total net position	<u>\$ 38,671,034</u>	<u>\$ 36,661,174</u>	<u>\$ 1,427,459</u>	<u>\$ 1,417,557</u>	<u>\$ 40,098,493</u>	<u>\$ 38,078,731</u>

At June 30, 2016, the Municipality's assets, amounting to \$57,575,572, are mainly composed of capital assets, net of accumulated depreciation (\$40,040,892) and cash in commercial banks and deposits with governmental bank (\$13,908,441). As previously mentioned, the total assets of the Municipality increased \$1,060,163 (8% increase) in comparison with the prior fiscal year.

Capital assets increased by \$714,184 due to the excess of current year additions (\$2,379,685) over depreciation expense (\$1,665,363) for the fiscal year ended June 30, 2016. The principal additions to capital assets for the current fiscal year were related to construction in progress (\$747,006), buildings, structures, and improvements (\$1,136,550), infrastructure (\$238,656), and machinery and equipment, and furniture and fixtures (\$257,473).

The cash and cash equivalents in commercial banks balances, and deposits with governmental bank, include restricted cash of \$8,841,905 which is legally designated for: (1) the payment of debt service, (2) the acquisition, construction and improvement of major capital assets, and (3) the operations of federally and state funded grant award programs.

At June 30, 2016, the Municipality's current liabilities amounting to \$3,273,410 are mainly composed of accounts payable and accrued liabilities (\$2,070,475), and the current portions of long-term obligations (\$1,202,935). Deferred inflows of resources (\$2,337,180) consist principally of unearned revenues associated with municipal license taxes and intergovernmental grants and contributions.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Management's Discussion and Analysis
Fiscal Year Ended June 30, 2016

The Municipality's non-current liabilities, amounting to \$11,866,489 at June 30, 2016, are mainly composed of portions due after one year of bonds and notes payable (\$10,907,909) and compensated absences (\$939,642).

As noted earlier, net position may serve over time as a useful indicator of the Municipality's financial statement position. The assets of the Municipality exceeded liabilities and deferred inflows of resources by \$40,098,493 at June 30, 2016. The most significant portion of net position (\$32,362,090) reflects the Municipality's investment in capital assets (e.g. land, buildings, machinery, equipment, infrastructure, etc.), net of all related debt still outstanding that was issued to acquire, construct or improve those assets. The Municipality uses its 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, as capital assets cannot be used to liquidate these liabilities. Another significant portion of net position at June 30, 2016, represents resources that are restricted for debt service payments (\$1,575,944) and the operations of state and federally funded grant award programs and capital projects (\$4,162,246). The remaining component of total net position consists of unrestricted balance of \$1,998,213 at June 30, 2016.

The total net position of the Municipality increased by \$2,019,762 for the fiscal year ended June 30, 2016, which is explained in the following section of this discussion and analysis.

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The following is a comparative condensed presentation of the Municipality's results of operations as reported in the GWFS:

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Management's Discussion and Analysis
Fiscal Year Ended June 30, 2016

	Governmental activities		Business-type activities		Totals	
	2016	2015	2016	2015	2016	2015
Revenues:						
Program revenues:						
Charges for services	\$ 103,824	\$ 88,684	\$ 370	\$ 1,130	\$ 104,194	\$ 89,814
Operating grants and contributions	1,239,436	1,147,448	579,600	576,478	1,819,036	1,723,926
Capital grants and contributions	1,289,026	1,068,224	-	-	1,289,026	1,068,224
General revenues:						
Property taxes	7,138,102	6,919,422	-	-	7,138,102	6,919,422
Municipal license taxes	1,838,818	1,846,656	-	-	1,838,818	1,846,656
Sales and usages taxes	1,031,481	657,776	-	-	1,031,481	657,776
Construction excise taxes	189,547	106,922	-	-	189,547	106,922
Intergovernmental grants and contributions, not restricted to specific programs	737,963	1,112,678	-	-	737,963	1,112,678
Interests on deposits	140,166	289,754	-	-	140,166	289,754
Miscellaneous revenues	22,211	172,546	752	2,565	22,963	175,111
Total revenues	<u>13,730,574</u>	<u>13,410,110</u>	<u>580,722</u>	<u>580,173</u>	<u>14,311,296</u>	<u>13,990,283</u>
Expenses:						
Program expenses:						
General government	3,972,889	4,156,593	-	-	3,972,889	4,156,593
Public safety	151,060	148,656	-	-	151,060	148,656
Public housing and welfare	1,086,025	1,110,672	570,820	600,851	1,656,845	1,711,523
Urban economic development	3,576,575	3,592,431	-	-	3,576,575	3,592,431
Culture, recreation and education	1,648,764	1,618,294	-	-	1,648,764	1,618,294
Health and sanitation	838,421	647,040	-	-	838,421	647,040
Interests on bonds and notes payable	446,980	508,238	-	-	446,980	508,238
Total expenses	<u>11,720,714</u>	<u>11,781,924</u>	<u>570,820</u>	<u>600,851</u>	<u>12,291,534</u>	<u>12,382,775</u>
Net increase (decrease) in net position	<u>2,009,860</u>	<u>1,628,186</u>	<u>9,902</u>	<u>(20,678)</u>	<u>2,019,762</u>	<u>1,607,508</u>
Net position at beginning of fiscal year	<u>36,661,174</u>	<u>35,032,988</u>	<u>1,417,557</u>	<u>1,438,235</u>	<u>38,078,731</u>	<u>36,471,223</u>
Net position at end of fiscal year	<u>\$ 38,671,034</u>	<u>\$ 36,661,174</u>	<u>\$ 1,427,459</u>	<u>\$ 1,417,557</u>	<u>\$ 40,098,493</u>	<u>\$ 38,078,731</u>

As previously mentioned, the Municipality's net position increased by \$2,019,762 during the current fiscal year. Approximately 71% of the Municipality's total revenues for the current fiscal year came from property, municipal license, construction excise taxes and sales and use taxes (\$10,197,948). Grants contributions and charges for services (program revenues), amounting to \$3,370,249, provided 25% of the total revenues for the current fiscal year. Miscellaneous revenues and interest on deposits, amounting to \$162,377, provided 1% of total revenues.

The Municipality's expenses cover a wide range of services. The largest expenses of the Municipality for the fiscal year ended June 30, 2016 were related to: (1) general administrating and operating costs (\$3,972,889), which were classified as "general government", (2) health and sanitation (\$838,421), (3) public housing and welfare (\$1,607,360), (4) urban and economic development (\$3,576,575), (5) public safety (\$151,060), and (6) culture, recreation and education (\$1,648,764). These expenses include depreciation of capital assets in the amount of \$1,665,363 for the fiscal year ended June 30, 2016.

As previously mentioned, the Municipality's expenses decreased from \$12,382,775 for the fiscal year ended June 30, 2015 to \$12,291,534 for the fiscal year ended June 30, 2016, for a net decrease of \$91,241. The most significant fluctuations between the current fiscal year's expenses and those of the prior fiscal year occurred in the general government expenses, which decreased \$183,704 during current fiscal year.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Management's Discussion and Analysis
Fiscal Year Ended June 30, 2016

FINANCIAL ANALYSIS OF GOVERNMENTAL FUNDS

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, 2016, the total assets of governmental funds amounted to \$18,091,325, which consisted principally of: (1) cash and cash equivalents of \$7,656,789, (2) deposits with governmental bank of \$5,808,743, (3) accounts receivable, \$3,586,483, net of reserve for doubtful accounts, and (4) inter-fund receivables of \$1,039,310. Such assets are restricted for debt service, capital projects, encumbrances, and other specific purposes.

At June 30, 2016, the total liabilities and deferred inflows of resources of governmental funds amounted to \$5,929,193, which consisted principally of: (1) accounts payable and accrued liabilities of \$1,861,512, (2) deferred inflows of resources of \$2,369,185, (3) inter-fund payables of \$1,039,310, and (4) matured bonds and interest due and payable of \$659,186.

The fund balance of governmental funds increased by \$802,374 during the fiscal year ended June 30, 2016.

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Management's Discussion and Analysis
Fiscal Year Ended June 30, 2016

Condensed Balance Sheet - Governmental Funds
June 30, 2016 and 2015

Assets:	2016	2015
Total assets - major governmental funds	\$ 14,787,051	\$ 14,387,357
Total assets - other governmental funds	3,304,274	3,233,219
Combined assets	<u>\$ 18,091,325</u>	<u>\$ 17,620,576</u>
 Liabilities:		
Total liabilities - major governmental funds	\$ 3,399,353	\$ 3,767,777
Total liabilities - other governmental funds	160,655	215,907
Combined liabilities	<u>3,560,008</u>	<u>3,983,684</u>
 Deferred inflows of resources	<u>2,369,185</u>	<u>2,277,134</u>
 Fund balances:		
Non-spendable	826,803	826,803
Spendable:		
Assigned - general fund	430,116	210,753
Restricted - other major governmental funds	5,216,462	5,696,077
Restricted - other governmental funds	2,243,737	2,243,951
Unassigned - general fund	3,445,014	2,382,174
Combined fund balances	<u>12,162,132</u>	<u>11,359,758</u>
 Total liabilities, deferred inflows of resources, and fund balances	 <u>\$ 18,091,325</u>	 <u>\$ 17,620,576</u>

Major Governmental Funds

General fund (GF) - The GF is the principal operating fund of the Municipality. The GF's total assets amounted to \$7,389,878 at June 30, 2016. Such assets consist principally of: (1) cash in commercial banks (\$5,066,536), (2) intergovernmental grants and contributions receivable (\$931,597), and (3) taxes receivable (\$1,178,569).

The GF's total liabilities amounted to \$2,054,153 at June 30, 2016. Such liabilities are composed of: (1) intergovernmental payables (\$1,043,998), (2) accounts payable and accrued liabilities (\$182,850), and due to other funds (\$827,305).

At the end of the current fiscal year, unassigned fund balance of the GF's amounted to \$3,445,014, while total fund balance reached \$3,875,130. As a measure of the GF's liquidity, it may be useful to compare both unreserved fund balance and total fund balance to total fund expenditures. Unassigned fund balance represents 37 percent of the total GF's expenditures, while total fund balance represents 41 percent of that same amount. The increase of \$1,282,203 in total fund balances is strictly related to the current year excess of revenues over expenditures and other sources, net.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Management's Discussion and Analysis
Fiscal Year Ended June 30, 2016

Capital projects fund (CPF) – The CPF is a major capital projects fund used to account for the financial resources arising principally from bond issuance proceeds and intergovernmental grants and contributions used in the acquisition or construction of major capital facilities, other assets, and permanent improvements. The CPF's total assets amounted to \$3,528,916 at June 30, 2016, which consists mainly of restricted deposits with governmental bank (unspent bond proceeds of \$3,194,636). The CPF's total liabilities and deferred inflows of resources amounted to \$690,940 at June 30, 2016, which are mainly composed of: (1) accounts payable and accrued liabilities (\$632,286), and (2) amounts due to other funds (\$49,946). At the end of the current fiscal year, CPF's total and restricted fund balance reached \$2,837,976.

Legislative joint resolutions fund (LJRF) - The LJRF is a major capital projects fund used to account for the financial resources arising from program-specific capital grants and contributions awarded by the Legislature of the Commonwealth of Puerto Rico, which are principally used in the acquisition or construction of major capital facilities, other assets and permanent improvements. The LJRF's total assets amounted to \$1,631,723 at June 30, 2016, which consist of restricted cash in commercial banks (unspent grant awards and contributions) from the Legislature of the Commonwealth of Puerto Rico amounting to \$804,656 and the amount of \$826,803 due from other governmental funds. At the end of the current fiscal year, LJRF's total and restricted fund balance reached \$1,629,345. Such fund balance increased \$425,767 due the excess of revenues over capital outlays and other financing uses.

Debt service fund (DSF) - The DSF is a major fund used to account for the accumulation of resources for, and the payment of, principal and interest for bonds and notes payable. The DSF's total assets amounted to \$2,236,534 at June 30, 2016, which consists mainly of restricted cash in commercial banks (\$276,586) and deposits with governmental bank (\$1,958,481). The DSF's total liabilities amounted to \$660,590 at June 30, 2016, which are mainly composed of: (1) matured bonds due and payable (\$475,000) and (2) matured interests due and payable (\$184,186). At the end of the current fiscal year, DSF's total and restricted fund balance reached \$1,575,944.

Other governmental funds (OGF) - The OGF's is a non-major major special revenue funds principally used to account for the financial resources arising from program-specific operating grants and contributions awarded by state and federal agencies. The OGF's total assets amounted to \$3,304,274 at June 30, 2016, which consist mainly of restricted cash in commercial banks and deposits with governmental bank (\$2,003,415). The OGF's total liabilities and deferred inflows of resources amounted to \$1,060,537 at June 30, 2016, which are mainly composed of unearned grant revenues (\$899,882) and amounts due to other funds (\$160,655).

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Management's Discussion and Analysis
Fiscal Year Ended June 30, 2016

**Condensed Statement of Revenues, Expenditures and
Changes in Fund Balance -Governmental Funds
Fiscal Years Ended June 30, 2016 and 2015**

Revenues:	2016	2015
Total revenues - major governmental funds	\$ 13,288,581	\$ 13,001,423
Total revenues - other governmental funds	468,185	408,342
Combined total revenues	<u>13,756,766</u>	<u>13,409,765</u>
 Expenditures:		
Total expenditures - major governmental funds	12,494,356	12,496,560
Total expenditures - other governmental funds	460,036	435,853
Combined total expenditures	<u>12,954,392</u>	<u>12,932,413</u>
 Excess of revenues over expenditures	<u>802,374</u>	<u>477,352</u>
 Other financing sources (uses), net:		
Other financing sources, net - major governmental funds	192,073	2,027,285
Other financing uses, net - other governmental funds	(192,073)	(2,027,285)
Combined other financing sources, net	<u>-</u>	<u>-</u>
 Excess of revenues and other financing sources over expenditures and other financing uses	<u>802,374</u>	<u>477,352</u>
 Fund balances, at beginning of fiscal year	11,359,758	10,882,406
 Fund balances, at end of fiscal year	<u>\$ 12,162,132</u>	<u>\$ 11,359,758</u>

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Management's Discussion and Analysis
Fiscal Year Ended June 30, 2016

Analysis of Operating Results of Governmental Funds

The following is a detailed analysis of the results of operations of governmental funds for the fiscal year ended June 30, 2016:

General fund (GF) – The total fund balance of the GF increased by \$1,282,203 during current fiscal year. Approximately 91% (\$9,507,182) of the GF's total revenues for the current fiscal year came from property, municipal license, construction excise taxes, and sales and use taxes, 7% (\$737,963) resulted from intergovernmental grants and contributions, and 1% (\$184,796) resulted from interests, charges for services, and miscellaneous revenues.

The largest expenses of the GF for the fiscal year ended June 30, 2016 were related to: (1) general administrating and operating costs (\$3,650,183), (2) construction, rehabilitation and preservation of new or existing housing, (\$3,111,313), which were classified as "urban and economic development, (3) public housing and welfare (\$326,294), (4) health and sanitation (\$719,768), (4) public safety (\$137,098), (6) culture, recreation and education (\$998,604), and capital outlays (\$396,551).

Capital projects fund (CPF) – The most significant transactions of this fund for the current fiscal year are related to capital outlays (\$1,791,950) and interests on deposits (\$69,834). The total fund balance of the CPF decreased \$1,414,462 during current fiscal year. Total revenues, expenditures and other financing uses (net) amounted to \$758,860, \$2,135,117 and \$38,205, respectively, for the fiscal year ended June 30, 2016.

Legislative joint resolutions fund (LJRF) – The most significant transactions of this fund for the current fiscal year are related to capital outlays (\$38,448). Total revenues, expenditures, and other financing uses (net) amounted to \$602,804, \$38,448, and \$138,589 respectively, for the fiscal year ended June 30, 2016. The total fund balance of LJRF increased \$425,767.

Debt service fund (DSF) – The total fund balance of the DSF increased \$509,580 during current fiscal year. Total revenues, expenditures and other financing uses (net) amounted to \$1,496,976, \$980,980 and \$6,916, respectively, for the fiscal year ended June 30, 2016. Approximately 46 percent (\$690,766) of DSF's total revenues for the current fiscal year came from restricted property taxes, while 53 percent (\$798,345) came from intergovernmental grants and contributions.

All expenditures of the debt service fund were related to principal and interest expenditures on bonds and notes payable amounting to \$980,980 during the current fiscal year.

Other governmental funds (OGF) – The total fund balance of the OGF decreased by \$214 during current fiscal year. Total revenues, expenditures and other financing uses (net) amounted to \$468,185, \$460,036 and \$8,363, respectively, for the fiscal year ended June 30, 2016.

One hundred percent (\$467,283) of OGF's total revenues for the current fiscal year came from intergovernmental grants and contributions. Approximately 36 percent (\$164,552) of OGF's total expenditures for the current fiscal year came from general government and 64 percent (\$295,484) from public housing and welfare.

FINANCIAL ANALYSIS OF PROPRIETARY FUND BUSINESS-TYPE ACTIVITIES

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Management's Discussion and Analysis
Fiscal Year Ended June 30, 2016

The proprietary fund (PF) accounts for the leasing operations and maintenance of a residential real estate property originally acquired through the issuance of mortgage notes payable.

The capital assets of the PF, amounting to \$1,376,415, represent 75% of its total assets. Such assets are composed principally of buildings and structures. During the current fiscal year such capital assets decreased \$38,661 (net), due to the net effect of depreciation expense (\$191,259) current year assets retirement amounting to (\$117,379) and the current year acquisitions of equipment and other capital assets (\$152,736).

The total liabilities of the PF amounted to \$406,065, of which \$362,350 (89% of total liabilities) represents the outstanding balance of mortgage notes payable. The decrease in total liabilities is principally due to the decrease of \$117,212 in mortgage notes payable caused by the current year debt service payments made.

During the current fiscal year, the PF suffered a net increase in fund net position of \$9,902. As in prior fiscal years, the net operating loss of \$547,057 is partially offset by non-operating revenues, principally related to intergovernmental grants and contributions not specifically restricted to capital purposes (\$579,600), which are awarded by the U.S. Department of Housing and Urban Development.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

The Municipality has invested \$57,126,392 in capital assets used in governmental activities, which have an accumulated depreciation of \$18,461,915 at June 30, 2016. Capital assets increased \$752,845 during the current fiscal year due to the excess of current year additions (\$2,226,949) over depreciation expense (\$1,474,104) for the fiscal year ended June 30, 2016. The principal additions to capital assets for the current fiscal year were related to: the municipal buildings and structures (\$1,059,638), and permanent improvements to municipal roads and other infrastructure assets (\$238,656).

We encourage readers to consider the information presented here in conjunction with more detailed capital assets information furnished in Note 10 to the accompanying notes to the financial statements.

Debt and Long-Term Obligations 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, 2016, the Municipality's total bonded debt amounted to \$11,147,310, consisting of bonds payable. Such debt is backed by the full faith and credit of the Municipality. During the current fiscal year bonds payable decreased by \$604,000 due to the current year debt service payments.

The Municipality has also mortgage notes payable with an outstanding balance of \$362,350. Such notes decreased \$117,212 also due to the current year debt service payments.

Government Development Bank for Puerto Rico (GDB)

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Management's Discussion and Analysis
Fiscal Year Ended June 30, 2016

As more fully described in note 3, GDB has traditionally served as interim lender to the Commonwealth of Puerto Rico and its public corporations and municipalities in anticipation of the issuance of long-term bonds and notes by such entities in the municipal bond market. GDB has also historically provided financing to the Commonwealth and its instrumentalities to finance their respective budget deficits, collateral requirements under swap agreements and to meet mandatory payments of obligations.

Loans to the Commonwealth and its instrumentalities constitute a significant portion of GDB's assets. As a result, GDB's liquidity and financial condition depends to a large extent on the repayment of loans made by the Commonwealth and its instrumentalities, which currently face significant fiscal and financial challenges.

The Commonwealth currently faces a severe fiscal and liquidity crisis, the culmination of many years of significant governmental deficits, a prolonged economic recession (which commenced in 2006), high unemployment, population decline, and high levels of debt and pension obligations, among other factors. These factors have resulted in delays in the repayment by the Commonwealth and its instrumentalities of outstanding loans with GDB, which delays, in turn, have limited GDB's ability to continue providing liquidity to the Commonwealth and its instrumentalities.

As a result of the reductions in liquidity experienced, GDB took a number of liquidity enhancing and conservation measures, and explored the sale of assets and other alternatives to address its liquidity needs. In April 2016, the Governor of the Commonwealth imposed on GDB certain emergency operational restrictions and declared a moratorium on debt service payments and to stay related creditor remedies through January 31, 2017, with a possible two-month extension at the Governor's discretion.

On April 8, 2016, the Governor signed Executive Order No. 2016-10 declaring GDB to be in state of emergency pursuant to Act 21 of 2016, known as the "*Puerto Rico Emergency Moratorium and Financial Rehabilitation Act*", as amended.

Management of GDB has determined that, even under the framework of the aforementioned emergency measures, GDB will require additional sources of liquidity, in particular, through appropriations for the payment of debt service by the Commonwealth in fiscal year 2017 on GDB's appropriation loans or some other appropriation to GDB and the consummation of a comprehensive restructuring of its debt obligations for GDB to continue operating in fiscal year 2017 and beyond.

If GDB does not obtain adequate funding from the Commonwealth for fiscal year 2017 and is not able to consummate a comprehensive debt restructuring, or otherwise obtain additional funding or other arrangements with its creditors, GDB may not be able to continue as a going concern and may need to pursue the resolution processes provided for by GDB's enabling act and its receivership provisions.

Management of the Municipality has concluded that there are no material impairments on the carrying amounts of the deposits held by the Municipality with GDB at June 30, 2016. Accordingly, the accompanying financial statements do not include any adjustments or reserves over these balances at June 30, 2016.

CURRENTLY KNOWN FACTS

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Management's Discussion and Analysis
Fiscal Year Ended June 30, 2016

Failure to Implement Requirements of New Accounting Standard for Pensions

As disclosed in Note 13 to the basic financial statements, the Municipality was not able to implement the requirements of Statement No. 68 of the Governmental Accounting Standards Board, *Accounting and Financial Reporting for Pension*, (GASB 68). The Municipality's inability to implement the requirements of GASB 68 resulted from the unavailability of the required information that was expected to be provided by The Employee Retirement System of the Commonwealth of Puerto Rico and its Instrumentalities (ERS), a pension trust fund of the Commonwealth, which is not under the Municipality's management and control. Therefore, as of the date of this report, it is not known when the required information shall be provided to enable the Municipality to implement the requirements GASB 68 and, therefore, the Municipality is not able to determine the possible impact on its basic financial statements. This situation resulted in the expression of a qualified opinion from our external auditors, on the governmental activities of the Municipality.

RECENT LEGISLATION RELATED TO MUNICIPAL SALES AND USAGE TAXES

On January 24, 2014, Act No.18, known as *Municipal Administration Fund Act* (Act No. 18), and Act No. 19, known as *Municipal Finance Corporation Act* (Act No. 19) were enacted to, among other things, amend Sections 4020.01, 4020.02 and 6080.14 of Act No. 1 of January 31, 2011, known as *Internal Revenue Code for a New Puerto Rico*.

Effective July 1, 2014, Act No. 18 reduced the statutory municipal sales and usage tax rate of all municipalities from one point five percent (1.5%) to one point zero percent (1.0%). Simultaneously, Act No.19 created the *Municipal Finance Corporation* (MFC), an affiliated public company of GDB, which is authorized to issue bonds and use other financing mechanisms to directly or indirectly pay or refinance all or part of the municipal long-term debt incurred by the Municipality in previous fiscal years, that are payable from or backed by the municipal sales and usage taxes.

In order to mitigate the effects of the reductions in the municipal sales and usage tax rate referred to above, Act No. 18 established the mechanisms to protect the financial stability of the Municipality by allowing the it to continue receiving the economic benefits lost as a consequence of the reduction in the statutory municipal sales and usage tax rate referred to above. For these purposes, effective July 1, 2014, Act No. 18 requires that an amount equal to zero point five percent (0.5%) of the state sales and usage taxes collected by the Commonwealth of Puerto Rico be deposited in a special fund to be known as *Municipal Administration Fund* (MAF) in the name and for the benefit of the Municipality.

Accordingly, since July 1, 2014, the Commonwealth of Puerto Rico has made advances from the collections arising from the zero point five percent (0.5%) of the state sales and usage taxes to the MAF of the Municipality. The advances have been made and distributed to the Municipality on a monthly basis as follows in accordance with Section 4050 of Act No. 1, as amended:

- i.* Forty percent (40%) of the amounts transferred has been available to cover general operating expenses of the *General Fund* of each municipality;
- ii.* Forty percent (40%) of the of the amounts transferred has been available and restricted in the MFC's redemption fund to guarantee the repayment of any municipal loan, bond, note, or other evidence of debt whose repayment source is the monies deposited therein under the custody of GDB.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Management's Discussion and Analysis
Fiscal Year Ended June 30, 2016

- iii.* Twenty percent (20%) of the amounts transferred has been available and restricted in the capital projects fund to finance the acquisition, construction and improvement of major capital assets.

THE PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT

As more fully described in note 14, The Puerto Rico Oversight, Management, and Economic Stability Act, Pub. Law 114-187 ("PROMESA" or the "Act"), was enacted into federal law on June 30, 2016, one day before the Commonwealth of Puerto Rico was expected to, and did, default on substantial payment obligations. PROMESA includes a variety of provisions applicable to Puerto Rico, its instrumentalities and their liabilities and operations, including the establishment of an oversight board, the requirements of fiscal plans and budgets to the Commonwealth of Puerto Rico, the establishment of an automatic stay, and debt adjustments, among others.

On October 14, 2016, the Commonwealth of Puerto Rico submitted a fiscal plan for the review and approval of the Oversight Board which includes, among other things, the following aspects for financial and operational recovery:

- Minimization of Impact of Austerity on Economic Growth
- Improving Budgetary Controls and Financial Transparency
- Rationalization of Expenditures and Tax Policy to Promote Efficiency
- Enacting Structural Economic Measures and Investing in Growth
- Protection of Vulnerable Stakeholders
- Creation of a Sustainable Debt Level That Allows for Economic Growth
- Partner with the Federal Government to Generate Growth

Upon the initial review, in December 2016, the Oversight Board rejected the fiscal plan and requested the Commonwealth of Puerto Rico to review and modify the plan to ensure full compliance with all of the fourteen (14) fiscal plan requirements set forth by PROMESA.

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. Questions concerning any of the information provided in this report or requests for additional information should be addressed to: Municipality of Aibonito, Department of Finance.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Statement of Net Position
June 30, 2016

Assets	<u>Governmental activities</u>	<u>Business-type activities</u>	<u>Total</u>
Current assets:			
Cash in commercial banks	\$ 5,066,536	-	\$ 5,066,536
Accounts receivable, net of allowance for doubtful accounts:			
Taxes:			
Property taxes	1,083,017	-	1,083,017
Municipal license taxes	10,743	-	10,743
Sales and usage taxes	84,809	-	84,809
Intergovernmental grants and contributions	931,597	-	931,597
Other current assets	1,171	-	1,171
Restricted assets:			
Cash and cash equivalents in commercial banks	2,590,253	442,909	3,033,162
Deposits with governmental bank	5,808,743	-	5,808,743
Accounts receivable:			
Intergovernmental grants and contributions	1,472,992	-	1,472,992
Accrued interests on deposits	2,154	-	2,154
Rent receivable from tenants	-	2,841	2,841
Other restricted current assets	-	10,722	10,722
Total current assets	<u>17,052,015</u>	<u>456,472</u>	<u>17,508,487</u>
Non-current assets:			
Capital assets, at cost:			
Non-depreciable capital assets	16,575,005	126,150	16,701,155
Depreciable capital assets, net of accumulated depreciation of \$18,461,915 and \$ 3,963,607 for governmental and business-type activities, respectively	22,089,472	1,250,265	23,339,737
Other non-current assets	25,556	637	26,193
Total non-current assets	<u>38,690,033</u>	<u>1,377,052</u>	<u>40,067,085</u>
Total assets	<u>\$ 55,742,048</u>	<u>1,833,524</u>	<u>\$ 57,575,572</u>

(Continued)

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Statement of Net Position
June 30, 2016

Liabilities

	Governmental activities	Business-type activities	Total
Current liabilities (due within one year):			
Accounts payable and accrued liabilities:			
Trade accounts payables and accrued liabilities	\$ 182,850	24,777	\$ 207,627
Intergovernmental payables	1,043,998	-	1,043,998
Accrued interests on bonds and notes payable	184,186	-	184,186
Liabilities related to restricted assets - accounts payable and accrued liabilities	634,664	-	634,664
Current portion of long-term obligations:			
Bonds payable	475,000	-	475,000
Mortgage payable	-	126,751	126,751
Compensated absences	601,184	-	601,184
Total current liabilities	3,121,882	151,528	3,273,410
Non-current liabilities, excluding current portion (due in more than one year) :			
Non-current portion of liabilities related to restricted assets:			
Bonds payable	10,672,310	-	10,672,310
Mortgage payable	-	235,599	235,599
Compensated absences	939,642	-	939,642
Other non-current liabilities	-	18,938	18,938
Total non-current liabilities	11,611,952	254,537	11,866,489
Total liabilities	14,733,834	406,065	15,139,899
Deferred inflows of resources	2,337,180	-	2,337,180
Net position:			
Net investment in capital assets	31,348,025	1,014,065	32,362,090
Restricted:			
Debt service	1,575,944	-	1,575,944
Capital projects	-	270,675	270,675
Federal and state funded programs	3,873,082	18,489	3,891,571
Total restricted net position	5,449,026	289,164	5,738,190
Unrestricted	1,873,983	124,230	1,998,213
Total net position	\$ 38,671,034	1,427,459	\$ 40,098,493

(Concluded)

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Statement of Activities
Fiscal Year Ended June 30, 2016

Functions / programs	Program revenues				Net revenues (expenses) and changes in net position		
	Expenses, including depreciation	Charges for services	Program-specific operating grants and contributions	Program-specific capital grants and contributions	Governmental activities	Business-type activities	Total
Governmental activities:							
General government	\$ 3,972,889	-	164,552	-	(3,808,337)	-	\$ (3,808,337)
Urban and economic development	3,576,575	103,824	-	1,289,026	(2,183,725)	-	(2,183,725)
Health and sanitation	838,421	-	-	-	(838,421)	-	(838,421)
Public safety	151,060	-	-	-	(151,060)	-	(151,060)
Public housing and welfare	1,086,025	-	276,539	-	(809,486)	-	(809,486)
Culture, recreation and education	1,648,764	-	-	-	(1,648,764)	-	(1,648,764)
Interests on bonds and notes payable	446,980	-	798,345	-	351,365	-	351,365
Total governmental activities	<u>11,720,714</u>	<u>103,824</u>	<u>1,239,436</u>	<u>1,289,026</u>	<u>(9,088,428)</u>	<u>-</u>	<u>(9,088,428)</u>
Business-type activities:							
Las Flores Apartments - public housing and welfare, including interests on mortgage notes payable of \$30,032	570,820	370	579,600	-	-	9,150	9,150
Totals	<u>\$ 12,291,534</u>	<u>104,194</u>	<u>1,819,036</u>	<u>1,289,026</u>	<u>(9,088,428)</u>	<u>9,150</u>	<u>\$ (9,079,278)</u>
General revenues:							
Taxes:							
Property taxes					\$ 7,138,102	-	\$ 7,138,102
Municipal license taxes					1,838,818	-	1,838,818
Sales and usage taxes					1,031,481	-	1,031,481
Construction excise taxes					189,547	-	189,547
Total tax revenues					<u>10,197,948</u>	<u>-</u>	<u>10,197,948</u>
Intergovernmental grants and contributions, not restricted to specific programs					737,963	-	737,963
Interests on deposits					140,166	-	140,166
Miscellaneous revenues					22,211	752	22,963
Total general revenues					<u>11,098,288</u>	<u>752</u>	<u>11,099,040</u>
Net increase (decrease) in net position					<u>2,009,860</u>	<u>9,902</u>	<u>2,019,762</u>
Net position at beginning of fiscal year					<u>36,661,174</u>	<u>1,417,557</u>	<u>38,078,731</u>
Net position at end of fiscal year					<u>\$ 38,671,034</u>	<u>1,427,459</u>	<u>\$ 40,098,493</u>

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Balance Sheet – Governmental Funds
June 30, 2016

Assets	Major governmental funds					Total governmental funds
	General fund	Capital projects fund	Legislative joint resolutions fund	Debt service fund	Other governmental funds	
Cash in commercial banks	\$ 5,066,536	-	-	-	-	\$ 5,066,536
Accounts receivable, net of allowance for doubtful accounts:						
Taxes:						
Property taxes	1,083,017	-	-	-	-	1,083,017
Municipal license taxes	10,743	-	-	-	-	10,743
Sales and usage taxes	84,809	-	-	-	-	84,809
Intergovernmental grants and contributions	931,597	-	-	-	-	931,597
Other	1,171	-	-	-	-	1,171
Due from other governmental funds	212,005	-	-	-	-	212,005
Restricted assets:						
Cash in commercial banks	-	161,222	804,656	276,586	1,347,789	2,590,253
Deposits with governmental bank	-	3,194,636	-	1,958,481	655,626	5,808,743
Intergovernmental grants and contributions	-	172,663	-	-	1,300,329	1,472,992
Accrued interests on deposits	-	395	264	1,467	28	2,154
Due from other governmental funds	-	-	826,803	-	502	827,305
Total assets	<u>\$ 7,389,878</u>	<u>3,528,916</u>	<u>1,631,723</u>	<u>2,236,534</u>	<u>3,304,274</u>	<u>\$ 18,091,325</u>
Liabilities						
Accounts payable and accrued liabilities	\$ 182,850	-	-	-	-	\$ 182,850
Intergovernmental payables	1,043,998	-	-	-	-	1,043,998
Due to other governmental funds	827,305	-	-	-	160,655	987,960
Liabilities related to restricted assets:						
Accounts payable and accrued liabilities	-	632,286	2,378	-	-	634,664
Due to other governmental funds	-	49,946	-	1,404	-	51,350
Matured bonds due and payable	-	-	-	475,000	-	475,000
Matured interests due and payable	-	-	-	184,186	-	184,186
Total liabilities	<u>2,054,153</u>	<u>682,232</u>	<u>2,378</u>	<u>660,590</u>	<u>160,655</u>	<u>3,560,008</u>
Deferred inflows of resources	<u>1,460,595</u>	<u>8,708</u>	<u>-</u>	<u>-</u>	<u>899,882</u>	<u>2,369,185</u>
Fund balances						
Non-spendable	-	-	826,803	-	-	826,803
Spendable:						
Assigned	430,116	-	-	-	-	430,116
Restricted	-	2,837,976	802,542	1,575,944	2,243,737	7,460,199
Unassigned	3,445,014	-	-	-	-	3,445,014
Total fund balances	<u>3,875,130</u>	<u>2,837,976</u>	<u>1,629,345</u>	<u>1,575,944</u>	<u>2,243,737</u>	<u>12,162,132</u>
Total liabilities, deferred inflows of resources and fund balances	<u>\$ 7,389,878</u>	<u>3,528,916</u>	<u>1,631,723</u>	<u>2,236,534</u>	<u>3,304,274</u>	<u>\$ 18,091,325</u>

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
 Reconciliation of the Balance Sheet – Governmental Funds to the Statement of Net Position
 June 30, 2016

The amounts of governmental activities reported in the statement of net position and the balance sheet - governmental funds are different for the following reasons:

Total fund balances reported in the balance sheet - governmental funds	\$ 12,162,132
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Except for those reported on the debt service fund, the following assets used in governmental activities are not considered current available financial resources, therefore, are not reported in the governmental fund financial statements:

Other current assets	25,556
Capital assets, net of accumulated depreciation of \$18,461,915	38,664,477

The following long-term liabilities are not due (mature) in the current fiscal year, therefore are not reported in the governmental funds at June 30, 2016:

Bonds payable	(10,672,310)
Compensated absences	(1,540,826)

Intergovernmental grants and contributions considered revenues for government-wide financial reporting in the statement of activities, while are reported as deferred inflows of resources in the governmental fund financial statements

32,005

Total net position of governmental activities, as reported in the statement of net position	<u><u>\$ 38,671,034</u></u>
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The accompanying notes to the basic financial statements are an integral part of this statement.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Statement of Revenues, Expenditures and
Changes in Fund Balances – Governmental Funds
Fiscal Year Ended June 30, 2016

	Major governmental funds					Total governmental funds
	General fund	Capital projects fund	Legislative joint resolutions fund	Debt service fund	Other governmental funds	
Revenues:						
Taxes:						
Property taxes	\$ 6,447,336	-	-	690,766	-	\$ 7,138,102
Municipal license taxes	1,838,818	-	-	-	-	1,838,818
Sales and usage taxes	1,031,481	-	-	-	-	1,031,481
Construction excise taxes	189,547	-	-	-	-	189,547
Total tax revenues	9,507,182	-	-	690,766	-	10,197,948
Intergovernmental grants and contributions	737,963	689,026	600,000	798,345	467,283	3,292,617
Interests on deposits	58,761	69,834	2,804	7,865	902	140,166
Charges for services	103,824	-	-	-	-	103,824
Miscellaneous revenues	22,211	-	-	-	-	22,211
Total revenues	10,429,941	758,860	602,804	1,496,976	468,185	13,756,766
Expenditures:						
Current:						
General government	3,650,183	-	-	-	164,552	3,814,735
Urban and economic development	3,111,313	-	-	-	-	3,111,313
Health and sanitation	719,768	-	-	-	-	719,768
Public safety	137,098	-	-	-	-	137,098
Public housing and welfare	326,294	343,167	-	-	295,484	964,945
Culture, recreation and education	998,604	-	-	-	-	998,604
Debt service:						
Principal	-	-	-	534,000	-	534,000
Interests	-	-	-	446,980	-	446,980
Capital outlays	396,551	1,791,950	38,448	-	-	2,226,949
Total expenditures	9,339,811	2,135,117	38,448	980,980	460,036	12,954,392
Excess (deficiency) of revenues over (under) expenditures	1,090,130	(1,376,257)	564,356	515,996	8,149	802,374
Other financing sources (uses):						
Transfers from other governmental funds	192,073	-	-	-	-	192,073
Transfers to other governmental funds	-	(38,205)	(138,589)	(6,916)	(8,363)	(192,073)
Total other financing sources (uses), net	192,073	(38,205)	(138,589)	(6,916)	(8,363)	-
Net increase (decrease) in fund balances	1,282,203	(1,414,462)	425,767	509,080	(214)	802,374
Fund balances at beginning of fiscal year	2,592,927	4,252,438	1,203,578	1,066,864	2,243,951	11,359,758
Fund balances at end of fiscal year	\$ 3,875,130	\$ 2,837,976	\$ 1,629,345	\$ 1,575,944	\$ 2,243,737	\$ 12,162,132

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO

Reconciliation of the Statement of Revenues, Expenditures and Changes in Fund Balances –
Governmental Funds to the Statement of Activities
June 30, 2016

Total net increase in fund balances reported in the accompanying statement of revenues,
expenditures and changes in fund balances – governmental funds \$ 802,374

Amounts for governmental activities reported in the governmental funds financial
statements differ from the amounts reported in the statement of activities for the
following reasons:

Net change in deferred inflows of resources related to intergovernmental grants and
contributions, which are reported as revenues in the statement of activities while are
deferred in the governmental funds since are considered unavailable under the modified
accrual basis of accounting. (29,509)

Governmental funds report capital outlays as expenditures. However in the statement of
activities the cost of those assets is capitalized and allocated over their estimated useful
lives as depreciation expense. This is the amount by which capital outlay expenditures
(\$2,226,949) exceeded depreciation and amortization expense (\$1,474,104) for the fiscal
year ended June 30, 2016. 752,845

Repayment of principal of bonds and notes payable is reported as an expenditure in the
governmental funds, however, the repayment reduces bonds and notes payable in the
statement of net position. 534,000

Some expenses reported in the statement of activities do not require the use of current
financial resources, therefore, are not reported as expenditures in the governmental funds.
Those expenses are related to the net changes in the following assets and liabilities:

Other assets (2,068)
Accrued compensated absences (47,782)

Net increase in net position of governmental activities, as reported in the
accompanying statement of activities \$ 2,009,860

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Statement of Fund Net Position – Proprietary Fund
June 30, 2016

Assets	<u>Las Flores Apartments</u>
Current Assets:	
Restricted assets:	
Cash and cash equivalents in commercial banks	\$ 442,909
Rent receivable from tenants	2,841
Other current assets	<u>10,722</u>
Total current assets	<u>456,472</u>
Non-current assets:	
Non-depreciable capital assets	126,150
Depreciable capital assets, net of accumulated depreciation of \$3,889,589	<u>1,250,265</u>
Total capital assets, net	1,376,415
Other non-current assets	<u>637</u>
Total non-current assets	<u>1,377,052</u>
Total assets	<u><u>\$ 1,833,524</u></u>
Liabilities Related to Restricted Assets	
Current liabilities:	
Accounts payable and accrued liabilities	\$ 24,777
Non-current liabilities due within one year - mortgage notes payable	<u>126,751</u>
Total current liabilities	<u>151,528</u>
Non-current liabilities due in more than one year:	
Tenants' security deposits	18,938
Mortgage notes payable	<u>235,599</u>
Total non-current liabilities	<u>254,537</u>
Total liabilities	<u>406,065</u>
Fund Net Position	
Net investment in capital assets	1,014,065
Restricted for:	
Capital projects	270,675
Federal funded programs	<u>18,489</u>
Total restricted	<u>289,164</u>
Unrestricted	<u>124,230</u>
Total fund net position	<u><u>\$ 1,427,459</u></u>

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Statement of Revenues, Expenses and Changes in Fund Net Position – Proprietary Fund
Fiscal Year Ended June 30, 2016

	Las Flores Apartments
Operating revenues:	
Charges for services - rental income from tenants	\$ 370
Miscellaneous revenues	752
Total operating revenues	1,122
Operating expenses - public housing and welfare:	
General, maintenance and administrative	356,920
Depreciation expense	191,259
Total operating expenses	548,179
Net operating loss	(547,057)
Non-operating revenues (expenses):	
Intergovernmental grants and contributions, not specifically restricted for capital purposes	579,600
Interests on mortgage notes payable	(22,641)
Total non-operating revenues (expenses), net	556,959
Net decrease in fund net position	9,902
Fund net position at beginning of fiscal year	1,417,557
Fund net position at end of fiscal year	\$ 1,427,459

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Statement of Cash Flows – Proprietary Fund
Fiscal Year Ended June 30, 2016

	<u>Las Flores Apartments</u>
CASH FLOWS FROM OPERATING ACTIVITIES	
Collections from tenants	\$ 33,465
Payments to suppliers	(345,898)
Other payments on operating activities	69,629
Net cash used in operating activities	<u>(242,804)</u>
CASH FLOWS FROM BY NONCAPITAL FINANCING ACTIVITIES	
Collections of intergovernmental grants and contributions, not specifically restricted to capital purposes	<u>579,600</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES	
Acquisition, construction and improvements of capital assets	(152,736)
Principal paid on mortgage notes payable	(117,212)
Interests paid on mortgage notes payable	(22,641)
Net cash used in capital and related financing activities	<u>(292,589)</u>
NET DECREASE IN CASH AND CASH EQUIVALENTS IN COMMERCIAL BANKS	44,207
CASH AND CASH EQUIVALENTS IN COMMERCIAL BANKS AT BEGINNING OF FISCAL YEAR	<u>100,085</u>
CASH AND CASH EQUIVALENTS IN COMMERCIAL BANKS AT END OF FISCAL YEAR	<u>\$ 144,292</u>
<u>Reconciliation of Net Operating Loss to Net Cash Used in</u>	
<u>Operating Activities:</u>	
Net operating loss	\$ (547,057)
Adjustments to reconcile net operating loss to net cash used in operating activities:	
Depreciation expense	191,259
Net changes in assets and liabilities:	
Rent receivable from tenants	1,828
Other current and non-current assets	114,716
Accounts payable and accrued liabilities	(3,265)
Tenants' security deposits	(285)
Net cash used in operating activities	<u>\$ (242,804)</u>

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2016

1. Government and Summary of Significant Accounting Policies

The Municipality of Aibonito (the Municipality) is a local municipal government constituted in 1824 in the Commonwealth of Puerto Rico (the Commonwealth). The Municipality has full legislative, fiscal and all other governmental powers and responsibilities expressly assigned by Public Act No. 81 of August 30, 1991, as amended, known as *Autonomous Municipalities Act of the Commonwealth of Puerto Rico* (Act No. 81). The Municipality is one of seventy-eight municipalities legally separated from the Commonwealth's government.

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

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

a. Basis of Presentation and Financial Reporting Entity

The accompanying basic financial statements present the respective financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the Municipality of Aibonito, as of June 30, 2016, the respective changes in financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information for the fiscal year ended June 30, 2016, and the cash flows of the proprietary fund for the fiscal year ended June 30, 2016 in conformity with Accounting Principles Generally Accepted in the United States of America (GAAP), as prescribed by the Governmental Accounting Standards Board (GASB). Furthermore, the accompanying basic financial statements present the budgetary results of the general fund for the fiscal year ended June 30, 2016 in conformity with the budgetary (statutory) basis of accounting.

The accompanying basic financial statements include all departments, agencies and municipal operational units that are under the legal and administrative control of the Mayor, and whose financial resources are under the legal custody and control of the Municipality's Director of Finance and Budget.

The Municipality follows the provisions of GASB Statement No. 39, *Determining Whether Certain Organizations are Component Units – An Amendment of GASB Statement No. 14* and GASB Statement No. 61, *The Financial Reporting Entity: Omnibus- An amended of GASB Statement No. 14 and No. 34*.

Based on the criteria set forth by those two pronouncements, the Municipality concluded that there are no legally separate entities or organizations that should be reported as component units of the Municipality as of and for the fiscal year ended June 30, 2016. The management of the Municipality concluded that as of June 30, 2016 and for the fiscal year then ended, there were no legally separate entities for which the Municipality is financially accountable or entities for which their nature and

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2016

significance of their relationship with the Municipality would warrant inclusion as part of the financial reporting entity of the Municipality, including any potential entity that may be closely related to, or financially integrated with the Municipality.

On July 1, 2015, the Municipality adopted the provisions of GASB Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments* (GASB No. 76). This Statement reduced the GAAP hierarchy to two categories of authoritative GAAP and addressed the use of authoritative and non-authoritative literature in the event that the accounting treatment for a transaction or other event is not specified within a source of authoritative GAAP.

GASB No. 76 improves financial reporting by (1) raising the category of GASB Implementation Guides in the GAAP hierarchy, thus providing the opportunity for broader public input on implementation guidance; (2) emphasizing the importance of analogies to authoritative literature when the accounting treatment for an event is not specified in authoritative GAAP; and (3) requiring the consideration of consistency with the GASB Concepts Statements when evaluating accounting treatments specified in non-authoritative literature.

As a result of the implementation of GASB No. 76, the Municipality has applied financial reporting guidance with less variation, which improves the usefulness of financial statement information for making decisions and assessing accountability and enhance the comparability of financial statement information among governments.

b. Financial Reporting Model

The basic financial statements of the Municipality consist of: (1) the management's discussion and analysis (MD&A), (2) the government-wide financial statements (GWFS), (3) the governmental fund financial statements (GFFS), (4) the reconciliations of the governmental activities reported in the GWFS and the GFFS, (5) the proprietary fund financial statements (PFFS), and (6) the notes to basic financial statements.

The MD&A is a required supplementary information presented along with, but separate from, the Municipality's basic financial statements. *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, 2016, based on the Municipality's knowledge of the transactions, events and conditions reflected in the basic financial statements. The MD&A also highlights certain key fiscal policies that control the Municipality's operations.

On July 1, 2015, the Municipality adopted the provisions of GASB Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments* (GASB No. 76). This Statement reduced the GAAP hierarchy to two categories of authoritative GAAP and addressed the use of authoritative and non-authoritative literature in the event that the accounting treatment for a transaction or other event is not specified within a source of authoritative GAAP.

GASB No. 76 improves financial reporting by (1) raising the category of GASB Implementation Guides in the GAAP hierarchy, thus providing the opportunity for broader public input on implementation guidance; (2) emphasizing the importance of analogies to authoritative literature when the accounting treatment for an event is not specified in authoritative GAAP; and (3) requiring the consideration of consistency with the GASB Concepts Statements when evaluating accounting treatments specified in non-authoritative literature.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2016

As a result of the implementation of GASB No. 76, the Municipality has applied financial reporting guidance with less variation, which improves the usefulness of financial statement information for making decisions and assessing accountability and enhance the comparability of financial statement information among governments.

c. Government-Wide Financial Statements

The accompanying GWFS are composed of: (1) the statement of net position and (2) the statement of activities. These financial statements report information of all governmental and business-type activities of the Municipality as a whole. These statements are aimed at presenting a broad overview of the Municipality's finances by reporting its financial position and results of operations using methods that are similar to those used by most private businesses.

The focus of GWFS is on the operational accountability of the Municipality as a single economic unit and not on compliance with budgets, regulatory requirements or on the use of available or currently expendable financial resources (referred to as fiscal accountability). 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 position provides short-term and long-term information about the Municipality's financial position by presenting all of the Municipality's assets, liabilities and deferred inflows of resources, with the difference between these three items reported as "net position". 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 and discloses legal and contractual restrictions on resources.

Net position is classified in the accompanying statement of net position within the following three categories:

- **Net investment in capital assets** – This component of net position consists of capital assets, net of accumulated depreciation, reduced by the outstanding balances of bonds, mortgages, notes and other debts 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 debt related to the acquisition, construction or improvement of capital assets has been reduced by any related unspent debt proceeds and any unamortized debt issuance costs. Pursuant to the provisions of GASB 63, deferred outflows of resources and deferred inflows of resources that are attributable to the acquisition, construction or improvement of those assets is included in this component of net position.

In addition, for the purposes of determining the outstanding debt attributed to capital assets, the following items are excluded from the calculation: (1) bond issuance costs, (2) interest payable, (3) accrued interest on deep discount debt and non-capital accrued liabilities (e.g. compensated absences, claims and judgments, etc.), and (5) debt used to finance capital acquisitions by parties outside the Municipality. Furthermore, the computation of net investment in capital assets, net of related debt, excludes inter-fund loans and other financial assets.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2016

- **Restricted net position** – This component of net position consists of assets reduced by liabilities and deferred inflows of resources that are restricted by external parties (such as debt covenants, creditors, grantors, contributors, laws or regulations of other governments, etc.), or net position for which constraints are imposed by constitutional provisions or enabling legislation. Generally, a liability relates to restricted assets if the asset results from a resource flow that also results in the recognition of a liability or if the liability will be liquidated with the restricted assets reported.

Enabling legislation consists of 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.

On July 1, 2005, the Municipality adopted the provisions of Statement No. 46, *Net Assets Restricted by Enabling Legislation* (GASB No. 46). This Statement requires that limitations on the use of net position imposed by enabling legislation be reported as restricted net position. This Statement clarified that a legally enforceable enabling legislation restriction is one that a party external to the Municipality (such as citizens, public interest groups, or the judiciary) can compel the Municipality to honor. This Statement states that the legal enforceability of an enabling legislation should be reevaluated if any of the resources raised by the enabling legislation are used for a purpose not specified by the enabling legislation or if the Municipality has other cause for consideration. Although the determination that a particular restriction is not legally enforceable may cause the Municipality to review the enforceability of other restrictions, it should not necessarily lead the Municipality to the same conclusion for all enabling legislation restrictions.

The classification of restricted net position 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 position. These designations consist of management's plans for the use of resources, which are subject to change at the discretion of the Municipal Legislature.

The Municipality has reported the following types of restricted net position in the accompanying statement of net position and the statement of fund net position – proprietary fund as of June 30, 2016:

- (1) **Debt service** – Represent net resources restricted by bond indentures, debt covenants or certain laws and regulations that are available to cover future debt service payments of bonds, mortgages and notes payable.
- (2) **Capital projects** – Represent net resources that are available to cover the cost of the acquisition, construction and improvement of major capital assets.
- (3) **Federal and state funded programs** – Represent net resources externally restricted by grantors, contributors, creditors or certain laws and regulations that are available to carry out specific purposes of several federal and state funded programs.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2016

- **Unrestricted** – This category consists of the excess of liabilities and deferred inflows of resources over the related assets that are neither externally or legally restricted, nor invested in capital assets. However, assets reported within unrestricted net position often are designated to indicate that management does not consider them to be available for general operations. Generally, the assets recorded within this category are designated to indicate that management does not consider them to be available for general operations. Assets reported within this category 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. When unrestricted resources are used, it is the Municipality's policy to use assigned resources first and then unassigned resources as they are needed.

The accompanying statement of activities presents the Municipality's results of operations by showing, how the Municipality's net position changed during the fiscal year ended June 30, 2016, using a net (expense) revenue format. This statement presents the cost of each function/program as well 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, sales and use 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 sanitation, (5) culture, recreation and education and (6) public housing and welfare. The governmental operations of the Municipality's departments and operational units are classified within the following functions/programs in the accompanying basic financial statements:

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2016

General government:

- Municipal legislature
- Mayor's office
- Department of finance and budget
- Department of human resources
- Department of municipal secretary
- Department of internal audit
- Department of purchasing and supplies

Urban and economic development:

- Department of public works
- Department of transportation and maintenance
- Department of engineering

Health and sanitation:

- Department of recycling and environmental control

Public safety:

- Department of emergency management
- Department of municipal police

Public housing and welfare:

- Department of elderly services
- Department of service to citizens

Culture, recreation and education:

- Department of recreation and sports
- Department of culture and tourism

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.

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: (1) the net cost of the function/program that must be financed from the Municipality's general revenues or (2) the net program revenue that contributes to the Municipality's general revenues.

The accompanying statement of activities reports the following categories of program revenues for the fiscal year ended June 30, 2016:

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2016

- **Charges for services** – These revenues 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 revenues include fees charged for specific services, charges for licenses and permits, and fines and forfeitures, among others.

- **Program-specific operating and capital grants and contributions** – These revenues 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. 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. Capital grants and contributions consist of revenues or resources that are restricted for capital purposes – to purchase, construct or renovate capital assets associated with a specific program. Restricted operating and capital 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 and use taxes, and construction excise taxes are reported as general revenues. All other non-tax revenues (including unrestricted interests on deposits, intergovernmental 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 costs of other functions/programs of the Municipality. Even though some of these costs have been charged to certain funds in the GFFS as indirect cost allocations permitted under some federal programs, the Municipality has reported these indirect costs as direct expenses of the general government function. Accordingly, the Municipality generally does not allocate general government (indirect) costs to other functions.

The effects of all inter-fund governmental and business-type activities (revenues, expenditures/expenses and other financing sources/uses among governmental/proprietary funds) have been removed from the accompanying statements of net position and activities. Inter-fund services provided and used have not been eliminated in the process of consolidation.

The Municipality classifies its activities as governmental or business-type 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 GFFS while the business-type activities are also reported in the PFFS.

The Municipality has no fiduciary activities, which are those in which the Municipality would be holding or managing net position 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 financed and operated in a manner similar to private business enterprises, where the costs of providing goods or services to the general public (expenses, including depreciation) is

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2016

financed primarily through user charges; or where the governing body has decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

d. Governmental Fund Financial Statements

A fund is a fiscal and accounting entity consisting of a self-balancing set of accounts used to record assets, liabilities and residual equities, deficits or balances, and changes therein, which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with GAAP and/or special regulations, restrictions or limitations.

The accompanying governmental fund financial statements (GFFS) are composed of: (1) the balance sheet – governmental funds, and (2) the statement of revenues, expenditures and changes in fund balances – governmental.

These balance sheet – governmental funds and the statement of revenues, expenditures and changes in fund balances – governmental funds report the financial position and results operations of the Municipality's governmental funds by presenting sources, uses and balances of current financial resources.

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.

The GFFS are oriented to the fiscal accountability and the individual parts of the Municipality's government. Fiscal accountability represents the Municipality's responsibility to justify that its actions in the current fiscal year have complied with public decisions concerning the raising and spending of public moneys in the short term (generally one fiscal year).

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

By definition, the Municipality's general fund is considered a major governmental fund for financial reporting purposes. In addition, any other governmental fund would be classified as a major governmental fund in the GFFS if its total assets and deferred outflows of resources, liabilities and deferred inflows of resources, revenues or expenditures of that individual governmental fund are at least ten percent (10%) of the corresponding element total (assets and deferred outflows of resources, liabilities and deferred inflows of resources, revenues or expenditures) for all governmental funds, and if its total assets and deferred outflows of resources, liabilities and deferred inflows of resources, revenues or expenditures of that individual governmental fund are at least five percent (5%) of the corresponding element total for all governmental and proprietary funds. For the purposes of applying the aforementioned major fund criteria, no eliminations of inter-fund balances have been made. Total revenues for these purposes means all revenues, including operating and non-operating revenues (net of allowances for uncollectible accounts), except for other financing sources. Total expenditures for

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2016

these purposes mean all expenditures, including operating and non-operating expenditures, except for other financing uses.

In the case of the proprietary funds, when applying the aforementioned major fund criteria, revenues and expenses include all operating statement revenues and expenses (both operating and non-operating) including capital contributions, special items, but not extraordinary items.

Furthermore, any other non-major governmental fund would be reported as a major governmental fund in the GFFS if such fund is considered of significant interest to regulations or investors of the Municipality, as it is the case of the capital improvements bond fund described below.

Based on the aforementioned criteria, the Municipality's major governmental funds reported in the accompanying GFFS are: (1) the general fund, (2) the capital improvements bond fund, (3) the legislative joint resolutions fund, and (4) the debt service fund. In addition, Las Flores Apartments has been reported separately from governmental funds, as the only proprietary fund of the Municipality.

The Municipality reported the following major governmental funds in the accompanying GFFS:

- **General Fund** – The general fund is the Municipality's main operating fund used to account for all financial resources and governmental activities, except for financial resources required to be accounted for 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.
- **Capital Projects Fund** – The capital projects fund is a capital projects fund used to account for the financial resources arising mainly from bonds and notes issuance proceeds used in the acquisition, construction or improvement of major capital assets. Generally, the most significant transactions of this fund are related to capital outlays and debt proceeds.
- **Legislative Joint Resolutions Fund** - The legislative joint resolutions fund is a major capital projects fund used to account for the financial resources arising from program-specific capital grants and contributions awarded by the Legislature of the Commonwealth of Puerto Rico, which are principally used in the acquisition or construction of major capital facilities, other assets and permanent improvements. Generally, the most significant transactions of this fund are related to capital outlays and intergovernmental grants and contributions revenues.
- **Debt Service Fund** – The debt service fund is used by the Municipality to account for the accumulation of resources for, and the payment of, principal and interest for: (1) bonds payable for which debt service payments are legally mandated to be accounted for in a debt service fund and/or (2) bonds payable or any general long-term debt for which the Municipality is being accumulating financial resources in advance to pay principal and interest payments maturing in future years. Consistently with the prior fiscal years' financial statement presentation, during the fiscal year ended June 30, 2016, the financial activity accounted for in the debt service fund was specifically related to bonds payable.

The outstanding balance of general long-term debts for which debt service payments do not involve the advance accumulation of resources (such as obligations under capital leases) are only

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2016

accounted for in the accompanying statement of net position. The debt service payments of such debts are generally accounted for as debt service – principal and debt service – interest expenditures in the general fund.

The non-major governmental funds of the Municipality are composed of special revenue funds and capital project funds. The special revenue funds are used by the Municipality to account for revenues derived from operating grants, contributions or other revenue sources that are either self-restricted or committed by the Municipality or legally restricted by outside parties for use in specific purposes (except for revenues that are earmarked for expenditures in debt service and capital projects, which are accounted for in the debt service fund and the capital projects funds, respectively). The uses and limitations of each special revenue fund are specified by municipal ordinances or federal and state statutes. However, resources restricted to expenditures 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, a special revenue fund to account for such kind of transactions will be used only if legally mandated.

The non-major capital projects funds are used to account for federal and state intergovernmental capital grants and contributions used for the acquisition, construction or improvement of capital assets. Significant capital outlays financed from proceeds of general obligation, public improvement or special obligation bonds accounted for also in the capital projects funds.

The use of the capital projects funds in the accompanying financial statements has been reserved only for major capital acquisitions, construction or improvement activities that would distort financial resources trend data if not reported separately from the other Municipality's operating activities. The routine purchases of minor capital assets (such as furniture, office equipment, vehicles and other minor capital assets or improvements) have been reported in the governmental fund from which financial resources were used for the payment.

The Municipality periodically undertakes a comprehensive evaluation of its fund structure to ensure that complies with all aspects that are of importance to users of general purpose external financial reports. Consequently, all superfluous funds and some internal funds currently used by Municipality in the day-to-day accounting procedures have not been reported as individual governmental funds in the accompanying fund financial statements. Accordingly, the accompanying fund financial statements include only the minimum number of funds consistent with legal and operating requirements and, consequently, the following types of similar internal funds have been combined into single funds in the accompanying fund financial statements:

- The various capital improvements bond issues outstanding have been reported as a single major capital projects fund.
- Program-specific capital grants and contributions awarded by the Legislature of the Commonwealth of Puerto Rico have been combined into a single major capital projects fund, the legislative joint resolutions fund.

The accompanying GFFS are accompanied by the following schedules required by GAAP: (1) the reconciliation of the balance sheet – governmental funds to the statement of net position, and (2) the reconciliation of the statement of revenues, expenditures and changes in fund balances – governmental funds to the statement of activities.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2016

As required by GASB No. 34, the proprietary fund of the Municipality applies all pronouncements issued by the Financial Accounting Standards Board (FASB) and its predecessor bodies, such as the Accounting Principles Board (APB) and the Committee on Accounting Procedures, issued on or before November 30, 1989, provided those pronouncements do not conflict with or contradict the Standards of the Governmental Accounting Standards Board. However, the Municipality has elected to continue following more recent FASB guidance, provided it neither conflicts nor contradicts GASB pronouncements.

e. Proprietary Fund Financial Statements

The proprietary fund financial statements (PFFS) consist of: (1) the statement of fund net position – proprietary fund, (2) the statement of revenues, expenses and changes in fund net position – proprietary fund, and (3) the statement of cash flows – proprietary fund. These statements present the financial position, results of operations and cash flows of *Las Flores Apartments Fund* (FmHA and HUD Project No. 63-005-660-43-3572), which accounts for the leasing operations and maintenance of a residential real estate property originally acquired through the issuance of mortgage notes payable.

f. Measurement Focus and Basis of Accounting

- 1) **Government-wide financial statements** – The accompanying GWFS are reported using the economic resources measurement focus and the accrual basis of accounting. Subject to the additional rules and limitations detailed below, revenues (including interests on deposits) 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 non-exchange transactions are recorded using the criteria set forth by GASB Statement No. 33, *Accounting and Financial Reporting for Non-exchange Transactions* (GASB No. 33). GASB No. 33 established accounting and reporting standards for non-exchange transactions involving cash and financial or capital resources (for example, most taxes, grants and private donations). In a non-exchange 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. According to GASB No. 33, the Municipality groups its non-exchange transactions into the following four classes in the accompanying basic financial statements: (a) derived tax revenues, (b) imposed non-exchange revenues, (c) government mandated non-exchange transactions, and (d) voluntary non-exchange transactions.

In the case of derived tax revenue transactions, which result from assessments the Municipality places on exchange transactions, receivables and revenues are recorded when the underlying exchange has occurred.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2016

In the case of imposed non-exchange revenue transactions (such as property taxes, municipal license taxes, sales and use taxes and construction excise taxes), which result from assessments made by the Municipality on non-governmental 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 and municipal license are generally recorded as revenues (net of amounts considered not collectible) in the fiscal year when resources are required to be used or the first fiscal year 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 the Municipality and the provider government requires the Municipality to use those resources for a specific purpose or purposes established in the provider's enabling legislation. In these type of transactions, receivables and revenues are generally recorded when all eligibility requirements imposed by the provider have been met. For the majority of grants, 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.

Voluntary non-exchange transactions (such as donations and certain grants and entitlements) result from legislative or contractual agreements, other than exchanges, willingly entered into 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. 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. Receipts of any type of revenue sources collected in advance for use in the following fiscal year are recorded as deferred inflows of resources pursuant to the provisions of GASB 63.

According to GASB No. 34, all general capital assets and the un-matured long-term liabilities are recorded only in the accompanying statement of net position. 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 GFFS. Therefore, the accompanying GFFS include reconciliations, as detailed in the accompanying table of contents, to better identify the relationship between the GWFS and the GFFS.

- 2) **Governmental fund financial statements** – The accompanying GFFS are reported using the current financial resources measurement focus (flow of current financial resources) and the modified accrual basis of accounting. Accordingly, the accompanying statement of revenues, expenditures and changes in fund balances – governmental funds, reports changes in the amount of financial resources available in the near future as a result of transactions and events of the fiscal year reported. Therefore, revenues are generally recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current fiscal year or soon enough thereafter to pay liabilities of the current fiscal year. For this purpose, the Municipality generally considers most revenues (municipal licenses taxes, construction excise taxes, sales and use taxes, interests on deposit, intergovernmental grants and contributions and certain charges for services) to be available if collected within 90 days after June 30, 2016, 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 inflows of resources at June 30, 2016.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2016

The principal revenue sources considered susceptible to accrual include property taxes, municipal license taxes, sales and use taxes, construction excise taxes, intergovernmental grants and contributions, interests on deposits, and charges for services. These principal revenue sources meet both measurability and availability criteria in the accompanying GFFS, except for amounts recorded as deferred inflows of resources.

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 taxes 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 federal and state grants and contributions, donations and entitlements are also generally recorded when all eligibility requirements imposed by the provider have been met (generally, as qualifying reimbursable expenditures are incurred for expenditure-driven grants).

Interests on deposits are recorded when earned since these revenues are considered both measurable and available at June 30, 2016. Pursuant to the provisions of GASB Interpretation No. 6, *Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements* (GASBI 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 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 in a timely manner and in full with current available financial resources. GASBI 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 only assets that will be converted into cash to satisfy current liabilities. Long-term assets 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 un-matured 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:

- Principal and interest on bonds and notes payable are recorded when they mature (when payment is due), except for principal and interest of bonds due on July 1, 2016, which are

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2016

recorded as governmental fund liabilities of the debt service fund at June 30, 2016 which is the date when resources were available in the debt service fund.

- Obligations under compensated absences, are recorded only when they mature (when payment is due).
- Certain accounts payable, intergovernmental payables and other accrued liabilities not due and payable (un-matured) or not normally expected to be liquidated in full and in a timely manner with available and expendable financial resources, are recorded in the accompanying statement of net position. Such liabilities are recorded in the governmental funds when they mature.
- Executory purchase orders and contracts are recorded as a reservation of fund balance in the GFFS.

The measurement focus of the GFFS is on decreases of 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.

- 3) **Proprietary Fund Financial Statements** – The accompanying proprietary fund financial statements (PFFS) are reported using the economic measurement focus and the accrual basis of accounting, similar to the GWFS described above. Revenues are recorded when earned and expenses are recorded when incurred, regardless of when cash is received or paid. The statement of revenues, expenses and changes in net position distinguishes operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. Revenues and expenses not meeting this definition are reported as non-operating revenues and expenses. The major operating revenue of the Municipality's proprietary fund is from rent charges collected from tenants.

Pursuant to the provisions of GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, Las Flores Apartments Fund has elected to not apply all nongovernmental financial accounting pronouncements issued after November 30, 1989 to its business-type activities and PFFS.

g. Stewardship, Compliance and Accountability

Budgetary Control

According to Act No. 81, 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. 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 budgets are prepared.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2016

The Mayor must submit, for the fiscal year commencing on the next July 1, an annual budgetary resolution project (the Project) to the Commissioner of Municipal Affairs of the Commonwealth (the Commissioner) and the Municipal Legislature no later than May 10 and May 15, respectively. The Commissioner preliminarily verifies that the Project complies with all the applicable laws and regulations and may provide comments and suggestions to the Mayor on or before June 13.

The Municipal Legislature has ten (10) business days, up to the immediately preceding June 13, 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 six (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 eight (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 three (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 doing 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 fiscal 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 purposes, 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, capital outlays, principal expenditures, interest expenditures, etc.) within the general and debt service funds, respectively.

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 using the budgetary (statutory) basis of accounting, which is not in accordance with GAAP.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2016

According to the budgetary basis of accounting, revenue is generally recorded 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 fiscal 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 fiscal 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 - general fund, provides information about the general fund's original budget, its amendments, and the actual results of operations of such governmental fund under the budgetary basis of accounting for the fiscal year ended June 30, 2016. 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, 2016, which is prepared by the Municipality's Department of Finance and Budget. Copies of that report may be obtained by writing to the Municipality's Director of Finance and Budget.

h) Unrestricted and Restricted Deposits

The Municipality's deposits at June 30, 2016 are composed of: (1) demand deposits and cash equivalents in commercial banks and (2) demand deposits in the Government Development Bank for Puerto Rico (GDB), governmental bank.

Cash equivalents consist of short-term, highly liquid investments in certificates of deposit that are readily convertible to cash and have original maturities of three months or less.

Cash in commercial banks of \$5,066,536 in the general fund is available to meet current operating requirements of the Municipality and any excess, if any, is generally invested in certificates of deposit in commercial banks with original maturities of three months or less.

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

Cash in commercial banks and deposits with governmental bank in the debt service fund, consist principally of property tax and intergovernmental grants and contributions collections amounting to \$2,235,067 that are restricted for the payment of the Municipality's debt service, as required by law. Deposits with governmental bank recorded in the capital projects fund consist mainly of unspent proceeds of bonds amounting to \$3,194,636 that are restricted for the acquisition, construction or improvements of major capital assets.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2016

Restricted deposits with governmental bank amounting to \$655,626 in other governmental funds represent the balance of unspent capital grants and bond proceeds held in non-interest bearing accounts that are restricted to finance the operations of various federal programs and capital project.

Restricted cash in commercial banks amounting to \$161,222 in the capital projects fund represents mainly the balance of unspent debt proceeds held in interests and non-interests bearing accounts that are restricted to finance the operations of certain federal and state funded programs.

Restricted cash in commercial banks in the legislative joint resolutions fund consists of unspent program-specific capital grants and contributions amounting to \$804,656 awarded by the Legislature of the Commonwealth of Puerto Rico that are mainly restricted for the acquisition, construction or improvements of major capital assets.

Restricted cash in commercial banks for other governmental funds, amounting to \$1,347,789, represents the balance of non-interest bearing accounts restricted to finance the operations of various federal and state funded grant programs.

Restricted cash in commercial banks in the statement of fund net position – proprietary fund (Las Flores Apartments), amounting to \$442,909, represents the balance of interests and non-interests bearing accounts restricted to finance the residential project operations.

i) Unrestricted and Restricted Accounts Receivable

Receivables consist of all revenues earned but not collected at June 30, 2016. These accounts receivable 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.

Intergovernmental grants and contributions receivable represent amounts owed to the Municipality for reimbursement of expenditures incurred pursuant to federally and state funded programs.

Pursuant to the provisions of GASB Statement No. 48, *Sales and Pledges of Receivables and Future Revenues of Intra-Entity Transfers of Assets and Future Revenues* (GASB 48), transactions in which the Municipality is willing to exchange an interest in its expected future cash flows from collecting specific receivables or specific future revenues for immediate cash payments, generally, a single lump sum are either regarded as a sale or as a collateralized borrowing resulting in a liability depending on its continuing involvement with those receivables or future revenues. Accordingly, a transaction will be reported as a collateralized borrowing unless the criteria indicating that a sale has taken place are met. If it is determined that a transaction involving receivables should be reported as a sale, the difference between the carrying value of the receivables and the proceeds should be recognized in the period of the sale in the accompanying statement of activities, the statement of revenues, expenditures and changes in fund balances – governmental funds and the statement of revenues, expenses and changes in net position – proprietary fund. If it is determined that a transaction involving future revenues should be reported as a sale, the revenue is deferred and amortized, except when specific criteria are met. According to the criteria set forth by GASB No. 48, there were no transactions involving receivables that should be reported as a sale as of and for the fiscal year ended June 30, 2016.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2016

Activities among governmental funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as “due to/from other funds”.

j) Capital Assets

Capital assets used in governmental and business-type 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 the accompanying statement of net position. Infrastructure assets are generally stationary in nature and include roads, bridges, streets and sidewalks, drainage systems and other similar assets.

For financial reporting purposes, the Municipality defines capital assets as assets with an individual cost of \$500 or more at the date of acquisition, construction or improvement, and with useful lives extending beyond one year. All assets with individual costs under \$500 or with useful lives not exceeding one year, are charged directly to expense in the government-wide statement of activities. In the governmental funds, all capital assets are recorded as capital outlays (expenditures).

In the statement of net position and the statement of net position – proprietary-fund, 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. Estimated historical costs based on deflated current costs were used to value a significant portion of the infrastructure constructed or acquired prior to June 30, 2003 and certain lands, buildings, structures and building improvements. The method used to deflate the current costs with an approximate price index was used only in the case of certain items for which the historical cost documentation was not available. Actual historical costs were used to value the infrastructure acquired or constructed after June 30, 2003 as well as, construction in progress, machinery and equipment and licensed vehicles acquired prior or after such date.

Major outlays for capital assets and improvements are capitalized in the statement of net position 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 expense is recorded only in the government-wide statement of activities and the statements of revenues, expenses and changes in net position-proprietary fund. 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.

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2016

The estimated useful lives of major capital asset categories are:

	<u>Years</u>
Land improvements	20
Buildings, structures and building improvements	30 to 60
Infrastructure	20 to 60
Motor vehicles	8
Furniture and fixtures	5 to 20
Machinery and equipment, excluding those held under capital leases	5 to 20
Machinery and equipment under capital leases	3 to 5

Depreciation expense of capital assets is recorded as a direct expense 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 and economic development function.

The Municipality periodically evaluates its capital assets to consider events or changes in circumstances that may give rise to asset impairment. Among the factors considered by management as part of its evaluation are physical damages to an asset where action would be needed to restore lost service utility, changes in laws, regulations, or other environmental factors that may negatively affect service utility, technological developments that may negatively affect service utility, changes in the manner or duration of use of a capital asset that may negatively affect its service utility, and stoppage of construction or development of an asset.

k) Deferred Inflows of Resources

In the GFFS, deferred inflows of resources arise when one of the following situations occur:

- Potential revenue does not meet both the “measurable” and “available” criteria for revenue recognition in the current period (unavailable revenue). As previously discussed, available is defined as due (or past due) at June 30, 2016 and collected within sixty (60) days for property taxes and ninety (90) days for all over revenue streams thereafter to pay obligations due at June 30. In subsequent periods, when both criteria are met, the liability for unearned revenue is removed and revenue is recognized.
- 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 unearned revenue is removed and revenue is recognized.

Deferred inflows of resources in the GWFS and the PFFS arise only when the Municipality receives resources before it has a legal claim to them.

l) 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 position is limited to leave that: (1) is attributable to services already rendered on or before June 30, 2016 and (2) is not

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2016

contingent on a specific event that is outside the control of the Municipality and the employee (such as illness). Compensated absences that relate to future services or are contingent on a specific event outside the control of the employer or the employee are accounted for in the period when those services are rendered or those events take place.

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 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. In the case of compensatory time, the excess of 240 hours is paid to employees each year, if not consumed.

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 before reaching 10 years of services, such regular sick leave is not paid to the employee, if not consumed. In addition upon termination of employment, an employee does not receive compensation for compensatory time, if not consumed previously. 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 position. A liability for compensated absences is reported in the GFFS only when matured (when payment is due), for example, as a result of employee resignations or retirements.

m) Long-Term Debt

The long-term liabilities reported in the accompanying statements of net position and the statement of fund net position-proprietary fund include the Municipality's bonds payable, mortgage notes payable, other notes payables and accrued compensated absences.

All long-term debt to be repaid from governmental resources is reported as liabilities in the accompanying statement of net position. Principal and interest payments on bonds due on July 1, 2016 are recorded as governmental fund liabilities in the GFFS (debt service fund) when resources are available in the debt service fund (June 30, 2016). In the GFFS, the face amount of debt issued (gross debt reported) is reported as other financing sources when issued.

n) Risk Financing

The Municipality carries commercial insurance covering casualty, theft, tort claims and other losses. Insurance policies are negotiated by the Commonwealth's Department of Treasury (the Department of Treasury) on behalf of all municipalities of Puerto Rico. The Department of Treasury 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 the Municipal Revenue Collection Center ("CRIM", by its Spanish acronyms), a governmental entity responsible for billing and collecting property taxes on behalf of all municipalities of Puerto Rico.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2016

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), a 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 (SIFC), 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 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 cost reimbursement basis.

The Municipality also obtains medical insurance coverage from several health insurance companies for its employees. Different health insurance coverage and premium options are negotiated each year by the Department of Treasury on behalf of the Municipality. The current insurance policies have not been canceled or terminated at June 30, 2016. Premiums are paid on a monthly basis directly to the insurance company. In the past three years, the Municipality has not settled claims that exceeded insurance coverage.

o) Fair Value of Financial Instruments

On July 1, 2015, the Municipality adopted the provisions of GASB Statement No. 72, *Fair Value Measurements and Application*. The fair value measurements made in the accompanying financial statements assume that transactions take place in the Municipality's principal market, or the Municipality's most advantageous market in the absence of a principal market. Fair values have been measured assuming that general market participants would act in their economic best interest.

To determine a fair value measurements, fair values have not been adjusted for transaction costs and the Municipality has considered the unit of account of the asset or liability. The unit of account refers to the level at which an asset or a liability is aggregated or disaggregated for measurement, recognition, or disclosure purposes as provided by the accounting standards.

The Municipality has used valuation techniques that are appropriate under the circumstances and for which sufficient data are available to measure fair values. The techniques applied are consistent with one or more of the following approaches: (1) the market approach, (2) the cost approach, or (3) the income approach.

The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets, liabilities, or a group of assets and liabilities. The cost approach reflects the amount that would be required to replace the present service capacity of an asset.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2016

The income approach converts future amounts (such as cash flows or income and expenses) to a single current (discounted) amount. Valuation techniques have been applied consistently, though a change may be appropriate in certain circumstances.

The fair value measurements applied by management takes into account the highest and best use for a nonfinancial asset. A fair value measurement of a liability assumes that the liability would be transferred to a market participant and not settled with the counterparty. In the absence of a quoted price for the transfer of an identical or similar liability and if another party holds an identical item as an asset, the Municipality uses the fair value of that asset to measure the fair value of the liability.

The Municipality's financial instruments consist of cash and cash equivalents, accounts and loans receivable, other assets, accounts payable and accrued liabilities, bonds and notes payable and other long-term obligations.

The three levels of the fair value hierarchy are described as follows:

Level 1 – Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that we can access.

Level 2 – Inputs to the valuation methodology include:

- Quoted prices for similar assets or liabilities in active markets;
- Quoted prices for identical or similar assets or liabilities in inactive markets;
- Inputs other than quoted prices that are observable for the asset or liability; or
- Inputs that are derived principally from or corroborated by observable market data by correlation or other means.

If the asset or liability has a specific (contractual) term, the Level 2 input must be observable for a substantial portion of the full term of the asset or liability.

Level 3 – Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

Based on the criteria set forth above, the Municipality has classified its financial instruments as Level 2 instruments as of June 30, 2016.

The asset's or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. The Municipality's valuation techniques maximize the use of observable inputs and minimize the use of unobservable inputs.

The observability of observable market data is monitored to assess the appropriate classification of financial instruments within the fair value hierarchy. Changes in economic conditions or model-based valuation techniques may require the transfer of financial instruments from one fair value level to another. In such instances, the transfer would be reported at the beginning of the fiscal year. For the fiscal year ended June 30, 2016, there were no transfers from Level 2 to other categories.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2016

The following methods and assumptions were used to estimate the fair values of the most significant financial instruments at June 30, 2016. There have been no changes in valuation methods.

- For cash in commercial banks and with fiscal agent, accounts and loans receivable, other assets and accounts payable and accrued liabilities, their respective estimated fair values approximate their carrying amounts recorded in the accompanying financial statements. The cost or contract value (net realizable value of assets and estimated settlement amounts of liabilities) was used to determine their respective fair values of these assets and liabilities due to their short-term nature and maturity periods. In the case of cash equivalents, these assets are generally acquired and renewed at the prevailing market interest rates for this type of instruments and have no contractual restrictions or liens.
- For bonds payable, notes payable and other long-term obligations, the estimated fair values also approximate carrying amounts. These obligations have been incurred at the prevailing market interest rates and terms for these types of instruments, accordingly, the Municipality determined their fair values using valuation models that use observable market quotes.

Fair value reporting requires management to make estimates and assumptions about the effects of matters that are inherently uncertain. The judgments made in determining the estimated fair value assigned to each financial instrument is significant and can materially impact the changes in net position and fund balances of the Municipality. The valuations are based on information available at June 30, 2016 and are based on expectations and assumptions that have been deemed reasonable by management.

Estimates developed using alternate are subjective, requiring significant judgments such as the amount and timing of future cash flows and the selection of appropriate discount rates that reflects market and credit risk.

The preceding valuation methods described may produce a fair value calculation that may not be indicative of net realizable or reflective of future fair values. Furthermore, while management believes that the Municipality's valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

However, the estimated fair values and carrying values of the Municipality's financial instruments were not considered significant by management at June 30, 2016.

p) Fund Balances

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2016

Fund balances in the accompanying basic financial statements have been reported as assigned, restricted or unassigned, based on the relative strength of the constraints that control how specific amounts can be spent, as described as follows:

- a. **Assigned** – Represent net resources recorded in the general fund intended to be used by the Municipality for specific purposes but do not meet the criteria to be classified as restricted or committed (generally budgetary encumbrances or executive orders approved by the Mayor). The Municipal Legislature delegates the Mayor the authority to establish fund balance assignments.

At June 30, 2016 assigned fund balances in the general fund consist of fund balances reserved for encumbrances amounting to \$430,116.

- b. **Restricted** – Represent net resources that can be spent only for the specific purposes stipulated by constitutional provisions, external resource providers (externally imposed by creditors or grantors), or through enabling legislation (that is, legislation that creates a new revenue source and restricts its use). Effectively, restrictions may be changed or lifted only with the consent of resource providers. In the accompanying basic financial statements, restricted fund balances have been reported in the following funds and for the following purposes:

- **Capital projects fund** – restricted fund balance consist of financial resources to be used only for the acquisition, construction or improvement of capital assets under contracts and other commitments, as approved and financed by the Government Development Bank for Puerto Rico.
- **Legislative joint resolutions fund** – restricted fund balance consist of financial resources arising from grants and contributions received through resolutions of the Legislature of the Commonwealth of Puerto Rico to be used principally for the acquisition, construction or improvement of capital assets under contracts and other commitments.
- **Debt service fund** – restricted fund balance consist of financial resources available only to cover future debt service payments (principal and interest) on bonds and notes payable, which are accounted for in the debt service fund, as required by Law.
- **Other governmental funds** – restricted fund balance consist of financial resources arising from operating and capital grants and contributions from state and federal grantors that can be spent only for the specific purposes stipulated by the respective external resource providers, or through enabling legislation.

- c. **Unassigned** – Represent the residual classification for the Municipality’s general fund and includes all spendable amounts not contained in the other classifications.

The Municipality had no fund balances classified as *committed* at June 30, 2016. Those types of fund balances are generally related to financial 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), which would only be changed by a similar law, ordinance or resolution.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2016

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, 2016.

In situations when expenditure is made for a purpose for which amounts are available in multiple fund balance classifications, the Municipality uses restricted resources first, and then unrestricted resources. Within unrestricted resources, the Municipality generally spends committed resources first, followed by assigned resources, and then unassigned resources when expenditures.

The classification of the Municipality's individual funds among general, debt service, special revenue, capital projects and proprietary fund types used in prior fiscal years for financial reporting purposes was not affected by the implementation of GASB 54. In addition, the financial positions and the results of operations reported in the accompanying GFFS as of and for the fiscal year ended June 30, 2016 have not been affected for this change in accounting principle. Accordingly, the accompanying GFFS have not reported any retroactive restatements or reclassifications of fund equities as of July 1, 2015.

o) Inter-fund 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 amounts provided with a requirement for repayment, which are recorded as “due from” in the lender governmental fund and “due to” in the borrower governmental fund. Inter-fund receivables, which are not considered to be currently available financial resources, are reported as advances. For amounts not expected to be collected within a reasonable period of time, inter-fund receivables/payables are reduced to the estimated realizable value and the amount that is not expected to be repaid is reported as an operating transfer from the governmental fund that made the loan.
- ***Inter-fund transfers*** – Represent flows of assets (permanent reallocation of financial resources among governmental funds) without equivalent flows of assets in return and without a requirement for repayment. Operating transfers are reported as other financing sources in the governmental fund making transfers and as other financing sources in the governmental fund receiving transfers.
- ***Inter-fund reimbursements*** – Represent repayments 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.

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, the disclosure of contingent assets and liabilities at the date of the basic financial

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2016

statements, and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

r) *Accounting Standards Issued But Not Yet Adopted*

The Governmental Accounting Standards Board has issued the following standards that have not been adopted by the Municipality, and are currently under evaluation for their impact in future financial statements:

- a.** GASB Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68*, was issued in June 2015. The provisions in Statement 73 are effective for fiscal years beginning after June 15, 2015, except those provisions that address employers and governmental non-employer contributing entities for pensions that are not within the scope of Statement 68, which are effective for fiscal years beginning after June 15, 2016.
- b.** GASB Statement No. 74, *Financial Reporting for Postemployment Benefits Other Than Pensions*, was issued in June 2015. The provisions in Statement 74 are effective for fiscal years beginning after June 15, 2016.
- c.** GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, was issued in June 2015. The provisions in Statement 75 are effective for fiscal years beginning after June 15, 2017.
- d.** GASB Statement No. 77, *Tax Abatement Disclosures*, was issued in August 2015. The requirements of this Statement are effective for reporting periods beginning after December 15, 2015.
- e.** GASB Statement No. 78, *Pensions Provided Through Certain Multi-Employer Defined Benefits Plans*, was issued in August 2015. The requirements of this Statement are effective for reporting periods beginning after December 15, 2015.
- f.** GASB Statement No. 79, *Certain Investment Pools and Pool Participants*, was issued in December 2015. The requirements of this Statement are effective for reporting periods beginning after December 15, 2015.
- g.** GASB Statement No. 80, *Blending Requirements for Certain Component Units – an Amendment of GASB Statement No. 14*, was issued in January 2016. The requirements of this Statement are effective for reporting periods beginning after June 15, 2016.
- h.** GASB Statement No. 81, *Irrevocable Split-Interest Agreements*, was issued in March 2016. The requirements of this Statement are effective for reporting periods beginning after December 15, 2016.
- i.** GASB Statement No. 82, *Pension Issues – an Amendment of GASB statements No. 67, No. 68 and No. 73*, was issued in March 2016. The requirements of this Statement are effective for reporting periods beginning after June 15, 2016.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2016

- j. GASB Statement No. 83, *Certain Asset Retirement Obligations* was issued in November 2016. The requirements of this Statement are effective for reporting periods beginning after June 15, 2018.

2. Cash and Cash Equivalents in Commercial Banks

Custodial credit risk for cash and cash equivalents is the risk that in the event of bank failure, the Municipality's deposits may not be recovered. 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 collateral are held by agents designated by the Secretary of the Treasury of the Government of Puerto Rico, but not in the Municipality's name. The Municipality's cash and cash equivalents consist principally of unrestricted and restricted demand deposits in various commercial banks.

Unrestricted deposits of \$5,066,536 in the general fund are available to meet general operating requirements of the Municipality, including the payment of short-term obligations of the general fund, most of them which are budgeted.

Restricted cash in the legislative joint resolutions fund amounting \$804,656 consists of intergovernmental operating and capital grants contributions received from the Commonwealth of Puerto Rico.

Restricted cash in the debt service fund consist of unspent property tax and sales and usage tax collections amounting to \$276,586 that are available for the debt service payments of bonds and certain general obligations notes.

Restricted cash in other governmental funds amounting \$1,347,789 consists of intergovernmental operating and capital grants contributions received from the Commonwealth of Puerto Rico and the federal government of the United States of America that are available for the operations of several operating and capital grant programs.

3. Deposits with Governmental Bank

The Municipality maintains deposits with the Government Development Bank for Puerto Rico (GDB), a component unit of the Commonwealth of Puerto Rico. GDB's principal functions are to act as fiscal agent, paying agent and financial advisor for the Commonwealth of Puerto Rico and its instrumentalities, public corporations and municipalities; and to grant interim and long-term financing to public entities and municipalities and private enterprises to promote the economic development of Puerto Rico. The charter of the Bank provides for its perpetual existence, and no amendment to the charter, or to any other law of Puerto Rico, shall impair any outstanding obligations or commitments of GDB. Under the laws and regulations of the Commonwealth, public funds deposited by the Municipality in GDB are not insured nor collateralized representing a custodial credit risk in the event of GDB's failure.

GDB has traditionally served as interim lender to the Commonwealth of Puerto Rico and its public corporations and municipalities in anticipation of the issuance of long-term bonds and notes by such entities in the municipal bond market. GDB has also historically provided financing to the Commonwealth and its instrumentalities to finance their respective budget deficits, collateral requirements under swap agreements and to meet mandatory payments of obligations.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2016

Loans to the Commonwealth and its instrumentalities constitute a significant portion of GDB's assets. As a result, GDB's liquidity and financial condition depends to a large extent on the repayment of loans made by the Commonwealth and its instrumentalities, which currently face significant fiscal and financial challenges.

The Commonwealth currently faces a severe fiscal and liquidity crisis, the culmination of many years of significant governmental deficits, a prolonged economic recession (which commenced in 2006), high unemployment, population decline, and high levels of debt and pension obligations, among other factors. These factors have resulted in delays in the repayment by the Commonwealth and its instrumentalities of outstanding loans with GDB, which delays, in turn, have limited GDB's ability to continue providing liquidity to the Commonwealth and its instrumentalities.

As a result of the reductions in liquidity experienced, GDB took a number of liquidity enhancing and conservation measures, and explored the sale of assets and other alternatives to address its liquidity needs. In April 2016, the Governor of the Commonwealth imposed on GDB certain emergency operational restrictions and declared a moratorium on debt service payments and to stay related creditor remedies through January 31, 2017, with a possible two-month extension at the Governor's discretion.

On April 8, 2016, the Governor signed Executive Order No. 2016-10 declaring GDB to be in state of emergency pursuant to Act 21 of 2016, known as the "*Puerto Rico Emergency Moratorium and Financial Rehabilitation Act*", as amended.

Management of GDB has determined that, even under the framework of the aforementioned emergency measures, GDB will require additional sources of liquidity, in particular, through appropriations for the payment of debt service by the Commonwealth in fiscal year 2017 on GDB's appropriation loans or some other appropriation to GDB and the consummation of a comprehensive restructuring of its debt obligations for GDB to continue operating in fiscal year 2017 and beyond.

If GDB does not obtain adequate funding from the Commonwealth for fiscal year 2017 and is not able to consummate a comprehensive debt restructuring, or otherwise obtain additional funding or other arrangements with its creditors, GDB may not be able to continue as a going concern and may need to pursue the resolution processes provided for by GDB's enabling act and its receivership provisions.

Management of the Municipality has concluded that there are no material impairments on the carrying amounts of the deposits with GDB at June 30, 2016. Accordingly, the accompanying financial statements do not include any adjustments or reserves over these balances at June 30, 2016.

Restricted deposits in the capital projects fund of \$3,194,636 consist of unspent bonds and notes proceeds that are restricted for the acquisition, construction or improvements of major capital assets financed with public debt.

Restricted deposits in the debt service fund consist of unspent property tax and sales and usage tax collections amounting to \$1,958,481 that are available for the debt service payments of bonds and certain general obligations notes.

Restricted deposits in other governmental funds amounting \$655,626 consist of intergovernmental operating and capital grants contributions received from the Commonwealth of Puerto Rico and the federal government of the United States of America that are available for the operations of several operating and capital grant programs.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2016

Cash and cash equivalents in commercial banks, and deposits with governmental bank at June 30, 2016, are classified in the accompanying balance sheet – governmental and proprietary funds as follows:

	Major governmental funds						Proprietary fund
	General fund	Capital projects fund	Legislative joint resolutions fund	Debt service fund	Other governmental funds	Total governmental funds	
Unrestricted:							
Cash in commercial banks	\$ 5,066,536	-	-	-	-	\$ 5,066,536	\$ -
Restricted:							
Cash in commercial banks	-	161,222	804,656	276,586	1,347,789	2,590,253	442,909
Deposits with governmental bank	-	3,194,636	-	1,958,481	655,626	5,808,743	-
Total carrying amount of deposits	\$ 5,066,536	3,355,858	804,656	2,235,067	2,003,415	\$ 13,465,532	\$ 442,909

4. Municipal License Taxes

The Municipality is authorized by Act No. 81 to impose and collect municipal license taxes to any natural or legal person having trade or business activities within the territory of Aibonito. This is a self-assessed tax generally based on the business volume of taxpayers, measured by gross revenues. The Municipality establishes the applicable tax rates. At June 30, 2016, the municipal license tax rates imposed by the Municipality were 1.50 percent for financial institutions and 0.50 percent for other types of taxpayers. Any taxpayers that have been granted with a partial tax exemption under any of the tax incentive acts of the Commonwealth ultimately pay municipal license taxes at reduced tax rates, generally between 60 percent and 90 percent under standard rates.

Each taxpayer must assess the corresponding municipal license tax by declaring the volume of business through a tax return to be filed every April 15, based on the actual volume of business (revenues) generated in the preceding calendar year. Taxpayers with a sales volume of \$3 million or more must include audited financial statements with their tax return filings. 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 on April 15. 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 five (5) percent discount is granted automatically on the total tax amount due.

Any municipal license taxes collected in advance (that is, pertaining to a future fiscal year) are recorded as deferred inflows of resources in the GWFS and the GFFS. Deferred inflows of resources related to municipal license tax revenues recorded in the accompanying GWFS and GFFS amounted to \$1,428,590 at June 30, 2016.

Municipal license taxes receivable recorded in the general fund amounted to \$10,743 at June 30, 2016. Municipal license tax revenues amounted to \$1,838,818 for the fiscal year then ended, which has been recorded in the general fund since is available for general operating purposes.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2016

5. Property Taxes

The Municipality is authorized by Act No. 81 to impose and collect property taxes from any natural or legal person that, at January 1 of each calendar year: (1) is engaged in trade or business and is the owner of personal or real property used in trade or business or (2) owns residential real property with a value in excess of \$15,000 (at 1957 market prices).

Personal property taxes are self-assessed by taxpayers every year using the book value of personal property assets owned by the taxpayer at January 1 (lien; levy date) and reporting such taxable value through a personal property tax return filed on May 15 (due date and collection date) subsequent to the assessment date. The total personal property tax rate in force at June 30, 2016 was 6.28 percent (of which taxpayers pay 6.08 percent and the remaining 0.20 percent is paid by the Department of Treasury, as a subsidy).

Real property taxes are assessed every January 1, (lien; levy date) and is based on estimated current values of the property, deflated to 1957 market prices. Real property taxes are due and collectible on January 1 and July of every fiscal year. The total real property tax rate in force at June 30, 2016 was 8.28 percent (of which 8.08 percent is paid by taxpayers and the remaining 0.20 percent is also paid by the Department of Treasury, as a subsidy).

Residential real property occupied by its owner (not engaged in trade or business) is exempt from property taxes only on the first \$15,000 of the assessed value (at 1957 market prices). For exempt amounts, the Department of Treasury assumes the payment of the basic tax (4.00 percent and 6.00 percent for personal and real property, respectively), except for property assessed for less than \$3,500 (at 1957 market prices), for which no payment is made by the Department of Treasury.

Included within the total personal and real property tax rates of 6.28 percent and 8.28 percent, respectively, there is a portion of the tax rate in the amount of 1.05 percent that is restricted for the Municipality's debt service requirements on bonds. Such amounts are recorded in the Municipality's debt service fund.

Property tax revenues recorded in the general fund and the debt service fund amounted to \$6,447,336 and \$690,766, respectively, for the fiscal year ended June 30, 2016.

6. Sales and Usage Taxes

The Municipality imposes a municipal sales and usage tax within the territorial limits of the Municipality. This is a derived tax applied to the sale price of a taxable item or on the purchase price of all usage, storage or consumption of a taxable item. It is collected on a monthly basis through a tax return that is due ten calendar days after the end of each month.

On January 24, 2014, Act No.18, known as *Municipal Administration Fund Act* (Act No. 18), and Act No. 19, known as *Municipal Finance Corporation Act* (Act No. 19) were enacted to, among other things, amend Sections 4020.01, 4020.02 and 6080.14 of Act No. 1 of January 31, 2011, known as *Internal Revenue Code for a New Puerto Rico*.

Effective July 1, 2014, Act No. 18 reduced the statutory municipal sales and usage tax rate of all municipalities from one point five percent (1.5%) to one point zero percent (1.0%). Simultaneously, Act No.19 created the *Municipal Finance Corporation* (MFC), an affiliated public company of GDB, which is authorized to issue bonds and use other financing mechanisms to directly or indirectly pay or refinance all

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2016

or part of the municipal long-term debt incurred by the Municipality in previous fiscal years, that are payable from or backed by the municipal sales and usage taxes.

In order to mitigate the effects of the reductions in the municipal sales and usage tax rate referred to above, Act No. 18 established the mechanisms to protect the financial stability of the Municipality by allowing it to continue receiving the economic benefits lost as a consequence of the reduction in the statutory municipal sales and usage tax rate referred to above. For these purposes, effective July 1, 2014, Act No. 18 requires that an amount equal to zero point five percent (0.5%) of the sales and usage taxes collected by the Commonwealth of Puerto Rico be deposited in a special fund to be known as *Municipal Administration Fund* (MAF) in the name and for the benefit of the Municipality.

Accordingly, since July 1, 2014, the Commonwealth of Puerto Rico has made advances from the collections arising from the zero point five percent (0.5%) of the sales and usage taxes to the MAF of the Municipality. The advances have been made and distributed to the Municipality on a monthly basis as follows in accordance with Section 4050 of Act No. 1, as amended:

- i.* Forty percent (40%) of the amounts transferred are available to cover general operating expenses of the *General Fund* of each municipality;
- ii.* Forty percent (40%) of the amounts transferred are available and restricted in the MFC's redemption fund to guarantee the repayment of any municipal loan, bond, note, or other evidence of debt whose repayment source is the monies deposited therein under the custody of GDB;
- iii.* Twenty percent (20%) of the amounts transferred are available and restricted to finance the acquisition, construction and improvement of major capital assets.

Sales and usage taxes receivable recorded in the general fund amounted to \$84,809 at June 30, 2016. Sales and usage taxes revenues recorded in the general fund amounted to \$1,031,481 for the fiscal year then ended.

7. Construction Excise Taxes

The Municipality imposes and collects municipal construction excise taxes to most natural and legal persons and any governmental instrumentality that carry out activities related to construction, expansion, major repairs, relocations, alterations and other types of permanent improvements to residential, commercial and industrial buildings and structures within the territorial area of the Municipality. The tax is also applicable to infrastructure projects, the installation of machinery, equipment and fixtures, and other types of construction-related activities.

The construction excise tax generally is a self-assessed tax imposed over the cost of the project, net of certain exemptions such as the costs associated with the acquisition of land, project design and other engineering fees, licenses and permits, legal and accounting fees, and most marketing and advertising costs. The tax is paid by the taxpayer at the beginning of the project.

All single-family residential construction projects not related to housing development projects, condominiums, or any similar projects, are partially exempt from construction excise taxes. In addition, a portion of all single-family residential improvement projects are exempt from construction excise taxes.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2016

All projects carried out on buildings and structures classified as historical treasures by the Puerto Rico Planning Board have an in the tax rate applicable to construction excise taxes.

Construction excise tax revenues amounted to \$189,547 for the fiscal year ended June 30, 2016 which has been recorded in the general fund, since is available for general operating purposes.

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2016

8. Intergovernmental Receivables and Payables

Intergovernmental receivables and payables recorded in the accompanying GWFS and GFFS are as follows at June 30, 2016:

	<u>Major governmental funds</u>			Total
	General fund	Capital projects fund	Other governmental funds	
Intergovernmental receivables:				
<i>Intergovernmental grants and contributions:</i>				
Puerto Rico Treasury Department -				
Employees' Christmas bonus cost reimbursement	\$ 32,005	-	-	\$ 32,005
Rural development program fund	-	12,944	-	12,944
Government Development Bank for Puerto Rico -				
Special Communities fund	-	-	1,151,679	1,151,679
Puerto Rico Department of Labor and Human				
Resources - Department of Labor fund	-	-	127,093	127,093
U.S. Department of Housing and Urban Development:				
SBGP Block Grant	-	159,719	-	159,719
ESG program	-	-	10,265	10,265
COC program	-	-	11,292	11,292
Puerto Rico Electric Power Authority -				
contribution in lieu of municipal taxes	899,592	-	-	899,592
Total intergovernmental receivables	<u>\$ 931,597</u>	<u>172,663</u>	<u>1,300,329</u>	<u>\$ 2,404,589</u>
Intergovernmental payables:				
<i>Utilities and charges for services:</i>				
Puerto Rico Electric Power Authority - Electric power				
consumption costs	\$ 899,592	-	-	\$ 899,592
Puerto Rico Sewer and Water Authority - Sewer and				
water consumption costs	25,354	-	-	25,354
<i>Employees' benefits:</i>				
Puerto Rico Retirement System	119,052	-	-	119,052
Total intergovernmental payables	<u>\$ 1,043,998</u>	<u>-</u>	<u>-</u>	<u>\$ 1,043,998</u>

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2016

9. Inter-fund Transactions

The composition of all inter-fund balances and transactions at June 30, 2016 and for the fiscal year then ended is as follows:

Due to other governmental funds	Due from other governmental funds			Total governmental funds
	General fund	Legislative joint resolutions fund	Other governmental funds	
<i>Major governmental funds:</i>				
General fund	\$ -	826,803	502	\$ 827,305
Capital projects fund	49,946	-	-	49,946
Debt service fund	1,404	-	-	1,404
Other governmental funds	160,655	-	-	160,655
Total	<u>\$ 212,005</u>	<u>826,803</u>	<u>502</u>	<u>\$ 1,039,310</u>

Transfers to other governmental funds	Transfers from other governmental funds	
	General fund	Total governmental funds
<i>Major governmental funds:</i>		
General fund	\$ -	\$ -
Capital projects fund	38,205	38,205
Legislative joint resolutions fund	138,589	138,589
Debt service fund	6,916	6,916
Other governmental funds	8,363	8,363
Total	<u>\$ 192,073</u>	<u>\$ 192,073</u>

The principal purposes of inter-fund receivables and payables among governmental funds are:

- To recognize the outstanding balance of loans amounting to \$49,946 granted by the general fund to the capital projects fund to finance the costs of the acquisition, construction and improvement of various major capital assets.
- To recognize the outstanding balance of loans amounting to \$826,803 granted through 2009 by the legislative joint resolutions fund to the general fund for liquidity and working capital purpose.
- To recognize in the general fund the outstanding balance of \$160,655 of loans granted to other governmental funds to finance the operation of various programs.

The principal purposes of inter-fund transfers among governmental funds are:

- Make a non-routine residual equity transfer amounting to \$8,119 from the ESG program fund (reported within other governmental funds) to the general fund.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2016

- To make a routine transfer of interest income amounting to \$38,205 from the capital projects fund to the general fund, as permitted by law. This interest income was earned by the deposits held in the capital projects fund and was transferred to the general fund.
- Make a non-routine residual equity transfer amounting to \$138,589 from the legislative joint resolutions fund to the general fund.

10. Capital Assets

Capital assets activity for the fiscal year ended June 30, 2016:

	Balance at beginning of fiscal year, as restated	Additions/ depreciation expense	Balance at end of fiscal year
<u>Governmental activities:</u>			
<i>Cost basis:</i>			
Capital assets, not being depreciated -			
Land	\$ 15,827,999	-	\$ 15,827,999
Construction in progress	-	747,006	\$ 747,006
Total capital assets not being depreciated/amortized	<u>15,827,999</u>	<u>747,006</u>	<u>16,575,005</u>
Capital assets, being depreciated:			
Buildings, structures, and improvements	22,622,024	1,059,638	23,681,662
Infrastructure	12,976,543	238,656	13,215,199
Machinery and equipment, and furniture and fixtures	775,601	181,649	957,250
Licensed vehicles	2,697,276	-	2,697,276
Total capital assets, being depreciated	<u>39,071,444</u>	<u>1,479,943</u>	<u>40,551,387</u>
Total cost basis of capital assets	<u>54,899,443</u>	<u>2,226,949</u>	<u>57,126,392</u>
<i>Accumulated depreciation:</i>			
Buildings, structures, and improvements	6,996,266	1,016,777	8,013,043
Infrastructure	7,051,467	237,188	7,288,655
Machinery and equipment, and furniture and fixtures	530,338	120,548	650,886
Licensed vehicles	2,409,740	99,591	2,509,331
Total accumulated depreciation	<u>16,987,811</u>	<u>1,474,104</u>	<u>18,461,915</u>
Net capital assets	<u>\$ 37,911,632</u>	<u>752,845</u>	<u>\$ 38,664,477</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2016

Depreciation expense of governmental activities was charged to functions in the accompanying government -wide statement of activities as follows for the fiscal year ended June 30, 2016:

General government	\$ 137,673
Urban and economic development	448,371
Health and sanitation	116,130
Public safety	12,976
Public housing and welfare	116,130
Culture, recreation and education	642,824
Total depreciation expenses	\$ 1,474,104

	Balance at beginning of fiscal year, as restated	Additions/ depreciation expense	Retirements	Balance at end of fiscal year
<u>Business type activities:</u>				
<i>Cost basis:</i>				
Capital assets, not being depreciated -				
Land	\$ 126,150	-	-	\$ 126,150
Construction in progress	-	-	-	-
Total capital assets not being depreciated/amortized	126,150	-	-	126,150
Capital assets, being depreciated:				
Buildings, structures, and improvements	4,285,669	76,912	(103,795)	4,258,786
Land improvements	407,062	-	-	407,062
Machinery and equipment, and furniture and fixtures	485,784	75,824	(13,584)	548,024
Total capital assets, being depreciated	5,178,515	152,736	(117,379)	5,213,872
Total cost basis of capital assets	5,304,665	152,736	(117,379)	5,340,022
<i>Accumulated depreciation:</i>				
Buildings, structures, and improvements	3,277,041	130,972	(103,795)	3,304,218
Land improvements	237,800	22,857	-	260,657
Machinery and equipment, and furniture and fixtures	374,748	37,430	(13,446)	398,732
Total accumulated depreciation	3,889,589	191,259	(117,241)	3,963,607
Net capital assets	\$ 1,415,076	(38,523)	(138)	\$ 1,376,415

Depreciation expense of business-type activities, amounting to \$191,259 and assets retirements amounting to \$117,379 for the fiscal year ended June 30, 2016, was charged to the public housing and welfare function in the accompanying statement of activities.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2016

11. Deferred Inflows of Resources

At June 30, 2016, deferred inflows of resources recorded in the GWFS and the GFFS are as follows:

	<u>Major governmental funds</u>				<u>Statement of net position</u>
	<u>General fund</u>	<u>Capital projects fund</u>	<u>Other governmental funds</u>	<u>Total governmental funds</u>	
<i>Unavailable revenues-</i> intergovernmental grants and contributions	\$ 32,005	-	-	32,005	\$ -
<i>Unearned revenues:</i>					
Municipal license taxes	1,428,590	-	-	1,428,590	1,428,590
Intergovernmental grants and contributions	-	8,708	899,882	908,590	908,590
Total unearned revenues	1,428,590	8,708	899,882	2,337,180	2,337,180
Total deferred inflows of resources	<u>\$ 1,460,595</u>	<u>8,708</u>	<u>899,882</u>	<u>2,369,185</u>	<u>\$ 2,337,180</u>

12. Long-Term Obligations

The general long-term obligations activity for the fiscal year ended June 30, 2016 is as follows:

	<u>Balance at beginning of fiscal year</u>	<u>Borrowings or additions</u>	<u>Payments or deductions</u>	<u>Balance at end of fiscal year</u>	<u>Balance due within one year</u>
<i>Governmental activities:</i>					
Bonds payable - general obligation serial bonds	\$ 11,751,310	-	(604,000)	11,147,310	\$ 475,000
Compensated absences	1,493,044	294,591	(246,809)	1,540,826	601,184
Total governmental activities	<u>\$ 13,244,354</u>	<u>294,591</u>	<u>(850,809)</u>	<u>12,688,136</u>	<u>\$ 1,076,184</u>
<i>Business-type activities:</i>					
Mortgage notes payable	\$ 479,562	-	(117,212)	362,350	\$ 126,751
Total business-type activities	<u>\$ 479,562</u>	<u>-</u>	<u>(117,212)</u>	<u>362,350</u>	<u>\$ 126,751</u>

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2016

Historically, the general fund has been used to liquidate the notes payable to CRIM, compensated absences, and any other long-term liabilities other than bonds.

a) *Debt Limitation*

The Municipal Legislature is legally authorized to approve the contracting of debts of the Municipality. Nevertheless, the laws and regulations of the Commonwealth of Puerto Rico also provide that:

- Direct obligations of the Municipality (evidenced principally by bonds and bond anticipation notes) are backed by the full faith, credit and taxing power of the Municipality; and
- Direct obligations are not to be issued by the Municipality if the amount of the principal of, and the interest on, such bonds and bond anticipation notes (and on all 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 bond anticipation 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 and bond anticipation notes to be repaid with the proceeds of property taxes restricted for debt service.

b) *Bonds Payable*

The Municipality issues general obligation, special obligation and public improvement bonds to finance the acquisition, construction and improvement of capital assets, as well as, to finance certain operating needs, including the payment to suppliers in certain circumstances.

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

As described in Note 4, the Municipality levies an annual additional special property tax of 1.05 percent 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 are set aside to redeem the bonds payable of the Municipality in minimum annual or semiannual principal and interest payments. The collections of this special tax are recorded in the Municipality's debt service fund.

For financial reporting purposes, the outstanding balances of bonds represent the total principal to be repaid. Bonds payable is composed as follows at June 30, 2016:

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2016

	<u>Outstanding amount</u>
Municipal general obligation bond series 2006-2007 for the construction, improvements and acquisition of various capital assets (face amount of \$380,000), due in annual principal installments ranging from \$5,000 to \$35,000; plus interest at variable rates (5.00% at June 30, 2016) through July 1, 2032.	\$ 325,000
Municipal general obligation bond series 2005-2006 for the construction, improvements and acquisition of various capital assets (face amount of \$190,000), due in annual principal installments ranging from \$5,000 to \$20,000; plus interest at variable rates (5.00% at June 30, 2016) through July 1, 2021.	100,000
Municipal general obligation note series 2007-2008 for the construction, improvements and acquisition of various capital assets (face amount of \$2,965,000), due in annual principal installments ranging from \$60,000 to \$265,000; plus interest at variable rates (5.00% at June 30, 2016) through July 1, 2029.	2,425,000
Municipal general obligation bond series 2010-2011 for the construction, improvements and acquisition of various capital assets (face amount of \$1,435,000), due in annual principal installments ranging from \$5,000 to \$20,000; plus interest at variable rates (6.00% at June 30, 2016) through July 1, 2031.	1,265,000
Municipal general obligation bond series 2010-2011 for the construction, improvements and acquisition of various capital assets (face amount of \$2,710,000), due in annual principal installments ranging from \$5,000 to \$20,000; plus interest at variable rates (6.00% at June 30, 2016) through July 1, 2021.	2,475,000
Municipal general obligation bond series 2010-2011 for the construction, improvements and acquisition of various capital assets (face amount of \$705,000), due in annual principal installments ranging from \$5,000 to \$20,000; plus interest at variable rates (6.00% at June 30, 2015) through July 1, 2021.	415,000
Municipal general obligation bond series 2010-2011 for the construction, improvements and acquisition of various capital assets (face amount of \$440,000), due in annual principal installments ranging from \$50,000 to \$80,000; plus interest at variable rates (6.00% at June 30, 2016) through July 1, 2017.	150,000
Municipal general obligation bond series 2011-2012 for the construction, improvements and acquisition of various capital assets (face amount of \$166,110), due in annual principal installments ranging from \$4,200 to \$10,510; plus interest at variable rates (4.00% at June 30, 2016) through January 1, 2035.	143,310

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2016

	Outstanding amount
Municipal general obligation bond series 1995-1996 for the construction, improvements and acquisition of various capital assets (face amount of \$1,040,000), due in annual principal installments ranging from \$15,000 to \$90,000; plus interest at variable rates (6.58% at June 30, 2016) through July, 1, 2020.	395,000
Municipal general obligation bond series 1995-1996 for the construction, improvements and acquisition of various capital assets (face amount of \$332,000), due in annual principal installments ranging from \$6,000 to \$20,000; plus interest at variable rates (4.50% at June 30, 2016) through July 1, 2028.	204,000
Municipal general obligation bond series 2001-2002 for the construction, improvements and acquisition of various capital assets (face amount \$575,000), due in annual principal installments ranging from \$10,000 to \$50,000; plus interest at variable rates (4.91% at June 30, 2016) through July, 1, 2026.	385,000
Municipal general obligation bond series 2002-2003 for the construction, improvements and acquisition of various capital assets (face amount \$310,000), due in annual principal installments ranging from \$5,000 to \$10,000; plus interest at variable rates (4.62% at June 30, 2016) through July 1, 2027.	210,000
Municipal general obligation bond series 2004-2005 for the construction, improvements and acquisition of various capital assets (face amount of \$465,000), due in annual principal installments ranging from \$10,000 to \$35,000; plus interest at variable rates (4.62% at June 30, 2016) through July 1, 2029.	330,000
Municipal general obligation bond series 2005-2006 for the construction, improvements and acquisition of various capital assets (face amount of \$485,000), due in annual principal installments ranging from \$5,000 to \$35,000; plus interest at variable rates (4.62% at June 30, 2016) through July 1, 2030.	375,000
Municipal general obligation bond series 2007-2008 for the construction, improvements and acquisition of various capital assets (face amount of \$800,000), due in annual principal installments ranging from \$25,000 to \$85,000; plus interest at variable rates (7.50% at June 30, 2014) through July 1, 2022.	490,000

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2016

	<u>Outstanding amount</u>
Municipal general obligations bond series 2012-2013 (face amount of \$475,000) due in annual principal installments ranging from \$5,000 to \$40,000; plus interest at variable rates (6.00% at June 30, 2016) through July 1, 2037.	450,000
Municipal general obligations bond series 2012-2013 (face amount of \$1,060,000) due in annual principal installments ranging from \$10,000 to \$85,000; plus interest at variable rates (6.00% at June 30, 2016) through July 1, 2037.	<u>1,010,000</u>
Total bonds payables	<u><u>\$ 11,147,310</u></u>

Variable interest rates on serial bonds are reviewed periodically by GDB and are based on the fluctuation of GDB's weighted average rate for its commercial paper program. Under this program, GDB issues commercial paper: (1) in the taxable and tax-exempt markets of the United States of America, (2) in the Eurodollar market, and (3) to corporations having tax exemptions under the Industrial Incentives Acts of the Commonwealth of Puerto Rico and, which qualify for benefits provided by the U.S. Internal Revenue Code.

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

Fiscal year ending June 30,	Principal	Interest	Total
2017	475,000	767,362	1,242,362
2018	543,825	726,216	1,270,041
2019	531,025	689,717	1,220,742
2020	569,265	667,668	1,236,933
2021	575,477	674,266	1,249,743
2022-2026	2,480,033	2,806,807	5,286,840
2027-2031	2,461,712	1,532,404	3,994,116
2032-2036	2,197,592	734,611	2,932,203
2037-2038	1,313,381	189,711	1,503,092
Totals	<u><u>\$ 11,147,310</u></u>	<u><u>8,788,762</u></u>	<u><u>\$ 19,936,072</u></u>

At June 30, 2016, accrued interest payable on bonds amounted to \$184,186. Interest expense on bonds amounted to \$446,980 for the fiscal year ended June 30, 2016.

According to sections 103 and 148 to 150 of the U.S. Internal Revenue Code and sections 1.148 to 1.150 of the U.S. Treasury Regulation, the Municipality's tax-exempt bonds are subject to the arbitrage rebate requirements. At June 30, 2016, the Municipality had no federal arbitrage liability on bonds since interest income earned from the investment of unspent bond proceeds were made in bank deposits that generate yields lower than the rates applicable to the debt service payments.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2016

c) Mortgage Notes Payable – Proprietary Fund

The long-term debt of Las Flores Apartments (FmHA and HUD Project No. 63-005-660-43-3572), a proprietary fund, consists of mortgage notes payable, secured by a first mortgage on the real property of the apartments. The notes are payable in monthly installments of \$11,654 which include interest at eighth (8.00) percent per annum. At June 30, 2016, the outstanding balance of the mortgage note payable amounted to \$362,350.

Interest expense on these mortgage notes payable amounted to \$22,641 for the fiscal year ended June 30, 2016.

Annual debt service requirements of maturities of these mortgage notes are as follows:

Fiscal year ending June 30,	Principal	Interest	Total
2017	126,751	24,364	151,115
2018	137,271	13,844	151,115
2019	98,328	2,956	101,284
Totals	<u>\$ 362,350</u>	<u>41,164</u>	<u>\$ 403,514</u>

13. Employees' Retirement Systems

Substantially all full-time employees of the Municipality participate in the Employees' Retirement System of the Commonwealth of Puerto Rico and its Instrumentalities (ERS). The Employees Retirement System is a statutory trust created by Act No. 447 of May 15, 1951, as amended (Act 447) and a component unit of the Commonwealth.

On April 4, 2013, the Governor of Puerto Rico, signed into law Act No. 3 of 2013, which represents a comprehensive reform of the ERS Act No. 3 became effective on July 1, 2013 and amended the provisions of the different benefit structures under the ERS as further discussed below.

Members who had entered the Employees Retirement System before January 1, 2000 participated in a defined benefit program. Members who began to participate prior to April 1, 1990 (Act 447 Participants) were entitled to the highest benefits structure, while those who began to participate on or after April 1, 1990 (Act 1 Participants) were subject to a longer vesting period and a reduced level of benefits, as provided by Act No. 1 of February 16, 1990 (Act 1 of 1990).

In 1999, Act 447 was amended to close the defined benefit program for new participants and, prospectively, establish a new benefit structure similar to a cash balance plan (this new benefit structure is referred to as System 2000). Members who entered the ERS on or after January 1, 2000 (System 2000 Participants) participate solely in System 2000. Act 3-2013 amended the law to eliminate the lump sum distribution alternative and substitute it for a life annuity payable to the System 2000 Participant. System 2000 Participants do not benefit from any employer contributions. Instead, employer contributions made on account of System 2000 Participants are used to reduce the accumulated unfunded pension benefit obligation of the ERS. System 2000 is not a separate plan as there are no separate accounts for System 2000 Participants. Contributions received from System 2000 Participants are pooled and invested by the ERS together with the assets corresponding to the defined benefit structure of Act 447 and Act 1 of 1990

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2016

and the defined contribution structure of System 2000, as amended by Act 3-2013, will be paid from the same pool of assets of the ERS.

Retirement and related benefits provided by the ERS, and required contributions to the ERS by employers and employees, are determined by law rather than by actuarial requirements. As of July 1, 2011, after the adoption of Act 116 of July 6, 2011 (Act 116), the statutory employer contribution for the ERS increased from a minimum of 9.275% to a minimum of 10.275% of covered payroll, and will continue to increase annually until fiscal year 2021. The employer contribution rate for fiscal year 2016 is 15.525%.

Required employee contributions for the ERS vary according to how the individual employee's retirement benefits are coordinated with social security benefits. Act 3-2013 increased the employee contribution from 8.275% to 10% of covered payroll.

The ERS provides basic benefits under the defined benefit program principally consisting of a retirement annuity and death and disability benefits (collectively referred to herein as Basic System Pension Benefits). The ERS also administers benefits granted under various special laws that have provided additional benefits for the retirees and beneficiaries (collectively referred to herein as System Administered Pension Benefits). The System Administered Pension Benefits include, among others, additional minimum pension, death and disability benefits, ad-hoc cost-of-living adjustments and summer and Christmas bonuses. Act 3-2013 and Act 160-2013 amended the various laws providing some of these System Administered Pension Benefits to reduce some of the amounts payable to existing retirees while eliminating the benefits for all future retirees (those retiring after June 30, 2013 and July 31, 2014).

The System Administered Pension Benefits are funded on a pay-as-you-go basis by the participating employers, including the Municipality. The System Administered Pension Benefits corresponding to former employees of the Municipality are obligations of the Municipality. Most of the funds used to cover the System Administered Pension Benefits for other covered employees are required to be paid by the Commonwealth.

The ERS actuarial valuation as of June 30, 2014 differs from the actuarial valuation as of June 30, 2013, due to the adoption of Statement No. 67 of the Governmental Accounting Standards Board, "*Financial Reporting for Pension Plans*" (GASB 67). GASB 67 specifies certain significant changes for financial reporting purposes for the ERS.

The actuarial valuation of the Basic System Benefits and System Administered Benefits as of June 30, 2014 (most recently available) reflects a fiduciary net position of \$127 million, total pension liability of \$30.2 billion and a net pension liability of \$30.1 billion.

Statement No. 68 of the Governmental Accounting Standards Board, *Accounting and Financial Reporting for Pensions – an amendment of GASB Statement No. 27* (GASB 68) became effective for the year ended June 30, 2015. This Statement replaces the requirements of Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*, as well as the requirements of Statement No. 50, *Pension Disclosures*, as they relate to pensions that are provided through pension plans administered as trusts or equivalent arrangements that meet certain criteria as is the case of the ERS.

As of the date of the release of this report, the ERS has not issued its 2015 and 2016 basic financial statements, nor has it provided the Municipality with the required information to implement the requirements of Statement No. 68 of the Governmental Accounting Standards Board, *Accounting and Financial Reporting for Pensions – an amendment of GASB Statement No. 27* (GASB 68) as of June 30,

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2016

2015 and 2016. Therefore, the accompanying governmental activities financial statements do not have any adjustments that will be necessary for the Municipality to account for its proportionate share of the net pension liability, deferred inflow of resources and deferred outflow of resources in the statement of net assets as of July 1, 2015 and June 30, 2016, as well as the effect in the recorded pension expense in the statement of activities for the year ended June 30, 2016. Also, additional disclosures required by GASB 68 as well as required supplementary information have been omitted from these basic financial statements.

The pension costs recognized in the accompanying financial statements are equal to the statutorily required contributions, with a liability recorded for any unpaid required contributions, which is not in accordance with accounting principles generally accepted in the United States of America.

14. The Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA)

The Puerto Rico Oversight, Management, and Economic Stability Act, Pub. Law 114-187 (“PROMESA” or the “Act”), was enacted into federal law on June 30, 2016, one day before the Commonwealth of Puerto Rico was expected to, and did, default on substantial payment obligations. PROMESA includes a variety of provisions applicable to Puerto Rico, its instrumentalities and their liabilities and operations. The following is a summary of PROMESA, which is intended as a broad overview of primary provisions of PROMESA:

- a. **Oversight Board:*** The Act establishes a seven-member Oversight Board, the members of which have been designated by Congress and the President. The Oversight Board is provided with broad authority over Puerto Rico and instrumentalities of Puerto Rico which the Oversight Board designates as “covered” instrumentalities. The Oversight Board is an autonomous body that has broad authority and discretion over Puerto Rico, including the ability to place Puerto Rico itself and a “covered” instrumentality into a debt restructuring proceeding established under the Act, require and approve a fiscal plan, require and approve a budget, oversee operations and implement changes that are necessary to comply with an approved fiscal plan or budget, approve the issuance of debt, hold hearings and issue subpoenas in furtherance of its functions, enter into its own contracts, analyze a territory’s pensions and pension liability, approve voluntary settlements with creditors, and become a direct party in litigation against Puerto Rico or an instrumentality. The Oversight Board is, in effect, considered a division of the territory and can hire officers, professionals and legal counsel.
- b. **Fiscal Plans and Budgets:*** A critical component of PROMESA is the requirement of Puerto Rico and covered instrumentalities to develop and maintain a fiscal plan. A fiscal plan for the territory, or any instrumentality designated by the Oversight Board generally must contain numerous provisions governing the operation of the territory or instrumentality, as the case may be, including plans to pay debts, eliminate deficits, maintain essential public services and impose internal controls for fiscal governance and accountability.

Each fiscal plan is also required to set forth methods for the territory or instrumentality to access the capital markets. The fiscal plan must be developed by the governor, with oversight by the Oversight Board, and submitted to the Oversight Board for approval (the

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2016

Oversight Board can submit its own fiscal plan if the governor's fiscal plan is not acceptable in the sole discretion of the Oversight Board).

A fiscal plan is also required to comply with Puerto Rico law and to maintain valid liens. The Act further specifies that no budget can be submitted by the territory's governor to its legislature unless the Oversight Board has approved a fiscal plan and the budget is consistent with the fiscal plan (and, similar to fiscal plans, the Oversight Board can submit its own budget if the governor's budget is not acceptable in the sole discretion of the Oversight Board).

- c. **Automatic Stay:** Upon the enactment of the Act, effective July 1, 2016 a temporary stay or statutory injunction went into effect under Title IV thereof which stays, among other things, all actions and litigation against Puerto Rico and its instrumentalities to collect or enforce liabilities or claims and actions to possess or control their property. The stay under the Act has certain very limited exceptions, but generally all enforcement actions against Puerto Rico and its instrumentalities, or other actions to control their property, are stayed through the temporary stay period.

As provided in the Act, the stay will continue in effect until February 15, 2017 unless it is temporarily extended by the Oversight Board for seventy-five (75) days or by a federal district court for sixty (60) days. The Act's temporary stay goes into effect regardless of whether Puerto Rico or an instrumentality is subject to the Act's debt restructuring provisions discussed below. However, if Puerto Rico or an instrumentality becomes subject to the Act's debt restructuring provisions, then such restructuring provisions will impose an automatic stay during the restructuring proceedings which is substantially similar to the automatic stay under the Bankruptcy Code.

PROMESA specifies that actions taken in violation of the temporary stay are voidable. Relief from the temporary stay may be granted "for cause". The temporary stay is designed to enable Puerto Rico and its instrumentalities to, among other things, assess their respective finances and negotiate potential resolutions with creditors. The temporary stay under Title IV does not have any exceptions to such stay for pledged "special revenues" or any "safe harbors" to terminate and liquidate financial contracts such as repurchase agreements, swaps or securities contracts.

The terms of the temporary stay also preclude parties from exercising remedies, or terminating or modifying contracts, during the term of such stay if the event giving rise to the remedy is nonpayment of principal or interest or the debtor's financial condition or insolvency, notwithstanding what is provided for in the related agreement.

The stay also precludes enforcement of defaults under separate contracts, such as defaults under repurchase agreements, guaranteed investment contracts or similar agreements with bond trustees, that would otherwise occur based on the financial condition or insolvency of Puerto Rico or an instrumentality. Thus, bonds issued by Puerto Rico or its instrumentalities that are secured by special revenues are stayed during this period and parties to financial contracts such as repurchase agreements, swaps or securities contracts (whether with Puerto Rico or an instrumentality as a party, or which would be triggered by the financial condition of Puerto Rico or an instrumentality) are precluded from terminating and liquidating such contracts during this stay.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2016

The Act permits Puerto Rico and its instrumentalities to voluntarily pay liabilities during the period of the temporary stay. Thus, Puerto Rico and its instrumentalities can elect to, but are not required to, make payments on debts or other obligations during the stay period.

- d. **Debt Adjustment:*** Title III of the Act creates its own provisions under which Puerto Rico itself or an instrumentality selected by the Oversight Board can file a case to reorganize its debts in a plan of adjustment. The Act incorporates by reference numerous provisions of the Bankruptcy Code, including many from Chapter 9 (which governs bankruptcy proceedings of a municipality under the Bankruptcy Code).

Based on the incorporation of numerous Bankruptcy Code provisions into PROMESA, a debt adjustment proceeding of Puerto Rico or a covered instrumentality under Title III of PROMESA would also include (like a reorganization proceeding of a municipal debtor under Chapter 9 of the Bankruptcy Code) (i) the imposition of an automatic stay, (ii) the ability of a debtor to generally govern its operations and engage in post-petition financing and (iii) the ability of the debtor to exercise avoidance powers.

The provisions from the Bankruptcy Code that are incorporated into PROMESA include, among other things, many definitions, Sections 902, 922 and 928, which generally govern pledged “special revenues” and their treatment in a Chapter 9 bankruptcy commenced by a municipality, and Section 926, which generally exempts a municipal debtor’s payments on its bonds or notes from constituting an avoidable preference.

The special revenue provisions in Sections 902, 922 and 928 of the Bankruptcy Code would, in the Bankruptcy Code context, specify that special revenues pledged to secure a municipal debtor’s bonds can continue to be transferred in a manner consistent with the Bankruptcy Code notwithstanding the automatic stay.

In addition to incorporating the Bankruptcy Code’s Chapter 9 “special revenue” provisions, the Act also incorporates the Bankruptcy Code’s “safe harbors” for certain financial contracts to which the municipal debtor is a party. The safe harbors for specified financial contracts would, generally speaking, permit the exercise of a contractual right to terminate and liquidate the contract based on the debt adjustment proceeding, notwithstanding the automatic stay.

The criteria under PROMESA for Puerto Rico or an instrumentality to be eligible to file a debt restructuring proceeding include approval by the Oversight Board and the desire of such entity to effect a plan of adjustment. The Oversight Board, in approving the filing, must certify, among other things, that the entity has engaged in good-faith efforts to enter into voluntary agreements to restructure its debts, has an approved fiscal plan and has no “qualifying modification” of its bond debt (as addressed further below based on the collective creditor action provisions of PROMESA).

However, unlike the eligibility criteria for municipal debtors under the Bankruptcy Code, PROMESA does not require that an entity seeking to file a debt adjustment proceeding be insolvent. The Bankruptcy Code provisions for a federal court to confirm a Chapter 9 plan of adjustment are also generally incorporated into PROMESA, including that the plan be in the best interest of creditors (which is generally viewed in the Bankruptcy Code context as

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2016

treating creditors at least as, or better than, they would be treated under non-bankruptcy alternatives to a debt restructuring proceeding).

In addition to the Bankruptcy Code confirmation standards, however, PROMESA also requires that a plan of adjustment be consistent with PROMESA and the debtor's fiscal plan. The Oversight Board would continue to govern the territory or covered instrumentality during the debt restructuring proceeding and is the only entity with the authority to submit a plan of adjustment.

The reorganization proceeding would be commenced in federal district court in Puerto Rico, and such court would oversee the proceeding under PROMESA. The plan of adjustment would be submitted by the Oversight Board to such court for confirmation. The Act permits a jointly administered reorganization proceeding and a joint plan of adjustment to address various affiliates (although affiliates are not substantively consolidated).

The Federal Rules of Bankruptcy Procedure would also apply in a debt adjustment proceeding under the Act. Collective Creditor Action to Modify Bond Terms: The collective creditor action provisions of Title VI of PROMESA are, generally speaking, a method to effectuate an overall bond restructuring of Puerto Rico or an instrumentality as a general alternative to the debt adjustment provisions under Title III discussed above.

PROMESA includes, in Title VI thereof, provisions to permit the terms of bond obligations to be modified based on the collective action of applicable bondholders, but without 100% consent of all affected bondholders. Modifications to a bond financing can be proposed by the bond issuer (Puerto Rico, or an instrumentality) or by bondholders.

Generally, if modifications to bond financings of an issuer are considered, the Oversight Board, in consultation with the bond issuer, will separate similar bond claims into separate pools. Title VI of the Act provides that bonds issued by Puerto Rico or an instrumentality can be modified and become a "qualified modification" binding on all bondholders in the applicable pool of bondholders if (i) holders of at least two-thirds of the pool's principal amount who actually vote, and holders of at least fifty percent (50%) of the total principal amount outstanding in such pool vote, to approve the modification and (ii) the modification is approved by the Oversight Board. If less than one hundred percent (100%) of the related pool of bond obligations does not approve the proposed modification, the modification will not become effective and binding on such holders until a federal district court has approved the modification.

The collective creditor action provisions appear designed to permit resolution of all bond obligations of Puerto Rico or an instrumentality as bond issuer based generally on negotiated and voluntary agreements with a requisite percentage of bond claims in all related pools. These provisions, which permit modification of bond terms without one hundred percent (100%) holder consent, do not appear to have precedent in municipal bond law. These provisions also operate outside of traditional confirmation standards for a plan of adjustment (such as the "best interest of creditors" test), which could otherwise provide some protection to minority bondholders. Although these provisions appear designed to provide for a resolution of bond claims generally against a particular issuer, it is unclear how such provisions would be applied, especially if presented to a court for approval. Additional Provisions: The Act addresses several other economic initiatives, including (i)

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2016

infrastructure revitalization, (ii) appointment of a revitalization coordinator under the authority of the Oversight Board and (iii) provisions permitting Puerto Rico to temporarily lower the minimum wage of younger workers.

On October 14, 2016, the Commonwealth of Puerto Rico submitted a fiscal plan for the review and approval of the Oversight Board which includes, among other things, the following aspects for financial and operational recovery:

- Minimization of Impact of Austerity on Economic Growth
- Improving Budgetary Controls and Financial Transparency
- Rationalization of Expenditures and Tax Policy to Promote Efficiency
- Enacting Structural Economic Measures and Investing in Growth
- Protection of Vulnerable Stakeholders
- Creation of a Sustainable Debt Level That Allows for Economic Growth
- Partner with the Federal Government to Generate Growth

Upon the initial review, in December 2016, the Oversight Board rejected the fiscal plan and requested the Commonwealth of Puerto Rico to review and modify the plan to ensure full compliance with all of the fourteen (14) fiscal plan requirements set forth by PROMESA.

15. Commitments and Contingencies

The Municipality has reported outstanding encumbrances amounting to \$430,116 in the general fund at June 30, 2016. The Municipality intends to honor these encumbrances, which will continue to be liquidated under the current year's budget during a lapse period that extends into the subsequent fiscal year.

16. Fund Balances

As of June 30 2016, fund balances are comprised of the following

	<i>Governmental funds</i>						Las Flores Apartments - Proprietary fund
	General fund	Capital projects fund	Legislative joint resolutions fund	Debt service fund	Other governmental funds	Total governmental funds	
<i>Non - spendable - long - term interfund receivable</i>	\$ -	-	826,803	-	-	\$ 826,803	\$ -
<i>Spendable:</i>							
<i>Assigned for:</i>							
Budgetary encumbrances - general government	430,116	-	-	-	-	430,116	-
<i>Restricted for:</i>							
Capital projects - capital outlays related to the acquisition, construction and improvement of buildings, structures, infrastructure and other capital assets	-	2,837,976	802,542	-	951,503	4,592,021	-
Debt service of bonds and mortgage notes payable	-	-	-	1,575,944	-	1,575,944	-
Operation of state and federally funded programs - public housing and welfare	-	-	-	-	1,292,234	1,292,234	1,427,459
<i>Unassigned</i>	3,445,014	-	-	-	-	3,445,014	-
Total fund balances	<u>\$ 3,875,130</u>	<u>2,837,976</u>	<u>1,629,345</u>	<u>1,575,944</u>	<u>2,243,737</u>	<u>\$ 12,162,132</u>	<u>\$ 1,427,459</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
 Budgetary Comparison Schedule – General Fund
 Fiscal Year Ended June 30, 2016

	Budgeted Amounts		Actual amounts (Budgetary basis) (See Note 1)	Variance with Final Budget - Over (Under)
	Original	Final		
REVENUES:				
Property taxes	\$ 6,437,183	\$ 6,437,183	\$ 6,437,183	\$ -
Municipal license taxes	1,710,000	1,834,893	1,838,818	3,925
Sales and usage taxes	640,000	797,595	1,031,481	233,886
Construction excise taxes	125,000	196,550	189,547	(7,003)
Charges for services	75,000	66,409	103,824	37,415
Interests on deposits	75,000	58,117	128,595	70,478
Intergovernmental grants and contributions	956,260	936,125	936,125	-
Miscellaneous revenues	180,500	270,090	5,692	(264,398)
Total revenues	<u>10,198,943</u>	<u>10,596,962</u>	<u>10,671,265</u>	<u>74,303</u>
EXPENDITURES:				
Current:				
General government	4,339,054	4,520,702	3,788,106	(732,596)
Public safety	135,700	135,700	123,747	(11,953)
Health and sanitation	367,838	367,838	719,768	351,930
Culture and recreation	988,984	1,029,584	1,005,322	(24,262)
Public Housing and welfare	342,588	342,588	315,533	(27,055)
Urban development	3,549,779	3,732,750	3,072,925	(659,825)
Capital outlays	475,000	467,800	396,551	(71,249)
Total expenditures	<u>10,198,943</u>	<u>10,596,962</u>	<u>9,421,952</u>	<u>(1,175,010)</u>
REVENUES OVER (INDER) EXPENDITURES	-	-	1,249,313	1,249,313
Other financing sources - prior year's budgetary cash surplus readjustment			-	
REVENUES AND OTHER FINANCING SOURCES OVER EXPENDITURES AND OTHER FINANCING USES				
	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,249,313</u>	<u>\$ 1,249,313</u>
Explanation of Differences:				
<u>Sources/inflows of resources:</u>				
Actual amounts (budgetary basis) "available for appropriation" from the budgetary comparison schedule				\$ 10,671,265
Differences - budgetary basis to GAAP:				
Transfers from capital improvements bond fund are recorded as interest income for budgetary purposes				(69,834)
Changes assets and deferred inflows of resources:				
Net change in tax, intergovernmental and miscellaneous receivables				(214,668)
Net change in deferred inflows of resources				43,178
Total revenues as reported on the statement of revenues, expenditures, and changes in fund balances				<u>\$ 10,429,941</u>
<u>Uses/outflows of resources:</u>				
Actual amounts (budgetary basis) "total charges to appropriations" from the budgetary comparison schedule				\$ 9,421,952
Differences - budgetary basis to GAAP:				
Prior year encumbrances recorded as current year expenditures for GAAP basis				608,139
Current year encumbrances recorded as expenditures for budgetary purposes				(690,280)
Total expenditures as reported on the statement of revenues, expenditures, and changes in fund balances				<u>\$ 9,339,811</u>

The accompanying notes to budgetary comparison schedule are an integral part of this schedule.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Notes to Budgetary Comparison Schedule - General Fund
June 30, 2016

1. Stewardship, Compliance and Accountability

a. Budgetary Control

The Municipality's annual budget is prepared on the budgetary basis of accounting, which is not in accordance with GAAP, and represents departmental appropriations recommended by the Mayor and approved by the Municipal Legislature prior to the beginning of the fiscal year. Amendments to the budget require the approval of the Municipal Legislature. Transfer of certain appropriations within the budget, known as Mayor's Executive Orders, do not require the approval of the Municipal Legislature. The Municipality prepares its annual budget including the operations of the general fund.

For budgetary purposes, encumbrance accounting is used. The encumbrances (i.e., purchase orders, contracts) are considered expenditures when incurred. For GAAP reporting purposes, encumbrances outstanding at year end are disclosed in the notes of the financial statements as other significant commitments and do not constitute expenditures or liabilities because the commitments will be honored during the subsequent year. In addition, under budgetary basis of accounting, revenues are recorded when cash is received. The unencumbered balance of any appropriation at the end of the fiscal year will lapse at the end of such fiscal year.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Schedule of Expenditures of Federal Awards
June 30, 2016

U.S. Department of Housing and Urban Development	<u>Federal CFDA Number</u>	<u>Pass-through Grantor's Number</u>	<u>Expenditures</u>
Section 8 Housing Assistance Payment	14.195	RQ46R000013	\$579,600
Section 8 Housing Choice Voucher	14.871	RQ-059	\$285,219
Pass-through of the State-Office of the Municipal Affairs Commissioners – Community Development Block Grant/State's program	14.228	2016-004776	689,026
Pass-through of the State-Office of the Department of the Family – Emergency Solutions Grant Program	14.231	2016-000173	10,265
Continuum of Care (CoC) Program	14.267	HUD- PR0100B4N021100	<u>65,594</u>
Total U.S. Department of Housing and Urban Development			<u>1,629,704</u>
Total Federal Financial Assistance			<u>\$1,629,704</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Notes to Schedule of Expenditures of Federal Awards
June 30, 2016

1. Basis of Presentation

The accompanying Schedule of Expenditures of Federal Awards (Schedule) includes the federal grant activities of the Municipality of Aibonito of the Commonwealth of Puerto Rico under programs of the Federal government for the fiscal year ended June 30, 2016. The information in this schedule is presented in accordance with the requirements of Title 2 U. S. code of Federal Regulations Part 200, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal awards (Uniform Guidance). Because the Schedule presents only a selected portion of the operations of the Municipality of Aibonito, it is not intended to and does not present the financial position, changes in net position, or cash flows of the Municipality of Aibonito.

2. Summary of Significant Accounting Policies

Expenditures reported on the Schedule are reported on the accrual basis of accounting. Such expenditures are recognized following the cost principles contained in the Uniform Guidance, wherein certain types of expenditures are not allowed or are limited as to reimbursement.

The Municipality of Aibonito has elected not to use the 10 percent de minimis indirect cost rate allowed under the Uniform Guidance.

3. Relationship to the Basic Financial Statements

Revenues and expenditures of the federal awards are included in the Municipality's basic financial statements within the Capital Projects Fund, the Proprietary Fund and the Other Governmental Funds. The reconciliation between the expenditures in the basic financial statements and expenditures in the Schedule of Expenditures of Federal Awards is as follows:

Expenditures in the basic financial statements:

Capital Projects Fund	\$ 2,135,117
Other Governmental Funds	460,036
Proprietary Fund	<u>570,820</u>
	3,165,973
Less: Non-federal expenditures	<u>(1,536,269)</u>
 Total expenditures in the Schedule of Federal Awards	 <u><u>\$1,629,704</u></u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
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
June 30, 2016**

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

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States, the financial statements of the governmental activities, the business-type activities, each major fund, and aggregate remaining fund information of the Municipality of Aibonito of the Commonwealth of Puerto Rico as of and for the year ended June 30, 2016, and the related notes to the financial statements, which collectively comprise the Municipality's basic financial statements and have issued our report thereon dated February 28, 2017.

Internal Control Over Financial Reporting

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

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

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses and therefore, material weaknesses or significant deficiencies may exist that were not identified. We consider the deficiencies described in the accompanying schedule of findings and questioned costs to be material weaknesses as items 2016-01 and 2016-02.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Municipality of Aibonito of the Commonwealth of Puerto Rico financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statements 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.

Municipality of Aibonito of the Commonwealth of Puerto Rico Response to Findings

The Municipality of Aibonito of the Commonwealth of Puerto Rico response to the findings identified in our audit is described in the accompanying schedule of findings and questioned costs. Municipality's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

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

Toa Alta, Puerto Rico
February 28, 2017

Stamp No. O2729498
was affixed to the
original report.

A handwritten signature in black ink, appearing to be 'C. P. S.', is written over a large, faint circular stamp. To the right of the signature, the text 'CPA - PSC' is handwritten in black ink.

**Report on compliance for each major program and on
Internal Control over compliance required by the Uniform Guidance
June 30, 2016**

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

Report Compliance on Compliance for Each Major Federal Program

We have audited the Municipality of Aibonito of the Commonwealth of Puerto Rico (the Municipality) compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have direct and material effect on each of the Municipality of Aibonito of the Commonwealth of Puerto Rico major federal programs for the year ended June 30, 2016. Municipality's major federal programs are identified in the Summary of Auditor's Results Section of the accompanying Schedule of Findings and Questioned Costs.

Management's Responsibility

Management is responsible for compliance with federal statutes, regulations and terms and conditions of its federal awards applicable to its federal programs.

Auditors' Responsibility

Our responsibility is to express an opinion on compliance or each of the Municipality of Aibonito of the Commonwealth of Puerto Rico major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the audit requirements of Title 2 U.S. Code of Federal Regulations Part 200, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards (Uniform Guidance). Those standards and the Uniform Guidance require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Municipality's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

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

Basis for Qualified Opinion on Pass-through State Office of the Municipal Affairs Commissioner – Community Development Block Grant/State – Administered Small Cities

As described in the accompanying schedule of findings and questioned costs, the Municipality of Aibonito did not comply with requirements regarding CFDA 14.228 Community Development Block Grant/State – Administered Small Cities Program as described in finding number 2016-03 for Cash Management requirement. Compliance with such requirements is necessary, in our opinion, for the Municipality to comply with the requirements applicable to that program.

Qualified Opinion on Pass-through State Office of the Municipal Affairs Commissioner – Community Development Block Grant/State – Administered Small Cities

In our opinion, except for the noncompliance described in the Basis for Qualified Opinion paragraph, the Municipality of Aibonito complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on the Community Development Block Grant/State – Administered Small Cities Program for the year ended June 30, 2016.

Unmodified Opinion on the Other Major Federal Program

In our opinion, the Municipality of Aibonito of the Commonwealth of Puerto Rico, complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its other major federal programs identified in the summary of auditor's results section of the accompanying Schedule of Findings and Questioned Costs for the year ended June 30, 2016.

Other Matters

The results of our auditing procedures disclosed instances of noncompliance, which are required to be reported in accordance with the Uniform Guidance and which are described in the accompanying schedule of findings and questioned costs as items 2016-04. Our opinion on each major federal program is not modified with respect to these matter.

Report on Internal Control Over Compliance

Management of Municipality of Aibonito of the Commonwealth of Puerto Rico is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered Municipality's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over

compliance. Accordingly, we do not express an opinion on the effectiveness of the Municipality's internal control over compliance.

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

A *significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

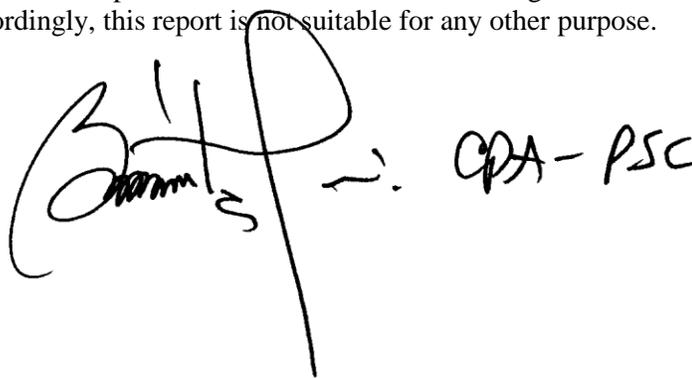
Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies and therefore material weaknesses or significant deficiencies may exist that were not identified. . However, we identified certain deficiencies in internal control over compliance, as described in the accompanying schedule of findings and questioned costs as items 2016-01, 2016-02, and 2016-03 that we consider to be a material weaknesses.

The Municipality's response to the internal control over compliance findings identified in our audit is described in the accompanying schedule of findings and questioned costs. Municipality's response was not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

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

Toa Alta, Puerto Rico
February 28, 2017

Stamp No. O2729499
was affixed to the
original report.

A handwritten signature in black ink, appearing to be 'B. H. P.', is written over a large, faint circular stamp. To the right of the signature, the initials 'CPA-PSC' are written in a similar hand.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
 Schedule of Findings and Questioned Costs
 June 30, 2016

Section I - Summary of Auditors' Results

Financial Statements

Type of auditor's report issued: Qualified
 Internal control over financial reporting:
 Material weakness (es) identified? yes no
 Significant deficiency (ies) identified
 not considered to be material weakness? yes none reported

 Noncompliance material to financial statements yes no
 noted?

Federal Awards

Internal Control over major programs:
 Material weakness (es) identified? yes no
 Significant deficiency (ies) identified
 not considered to be material weaknesses? yes none reported

 Type of auditor's report issued on compliance
 For major programs: Qualified

 Any audit findings disclosed that are required
 to be reported in accordance with
 Uniform Guidance? yes no

Identification of major programs:

<u>CFDA Numbers</u>	<u>Name of Federal Program or Cluster</u>
14.182	Section 8 Housing Assistance Payments
14.228	Community Development Block Grant/State – Administered Small Cities Program

Dollar threshold used to distinguish
 Between Type A and Type B programs: \$750,000

 Auditee qualified as low-risk auditee? yes no

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Schedule of Findings and Questioned Costs
June 30, 2016

Section II - Financial Statement Findings

The current year findings and questioned costs were discussed with the Municipality's management which generally concurred with our comments and recommendations. The Municipality of Aibonito will respond to the following findings through the issuance of a separate letter addressed to the Cognizant Agency.

2016-01 DEFICIENCIES IN THE UNIFORM ACCOUNTING SYSTEM AND OTHER ACCOUNTING RECORDS

The Uniform Accounting System (UAS) and the accounting records currently used by the Municipality do not have the necessary capabilities, procedures, internal controls and records to ensure accurate financial reporting and to prepare the Municipality's basic financial statements and federal programs' reports in conformity with Accounting Principles Generally Accepted in the United States of America for State and Local Governments (GAAP). The UAS is a system promulgated by the Office of the Commissioner of Municipal Affairs of Puerto Rico (OCAM, by its Spanish acronyms), a governmental entity created by law to provide technical assistance to the municipalities of Puerto Rico in several administrative and fiscal matters.

The Municipality's UAS mostly provides for the recording of revenue collections, disbursements and other limited transactions. In addition, the accounting records are not fully integrated, and a double entry system is not generally followed. Accounting records are maintained on the cash basis and budgetary accounting bases (two accounting bases that differ significantly from GAAP) and do not comply with Statement No. 34 of the Governmental Accounting Standards Board (GASB 34), as amended.

The following specific additional conditions were noted in relation to the UAS of the Municipality:

- Accounting transactions are currently accounted for simultaneously through manual and computerized accounting systems for which no reconciliation procedures are made among them, including the accounting records currently used by federal programs which are not reconciled with the UAS. The balance sheet accounts in the UAS are not reconciled and adjusted to conform them to the Municipality's audited basic financial statements.
- The UAS does not have the capabilities of: (1) recording and processing all types of capital asset transactions, principally the accounting of depreciation and amortization expense, (2) recording and processing all transactions related to revenues susceptible to accrual (accounts receivable) and, (3) recording and processing transactions related to long-term debt, including bonds and notes payable, obligations under capital leases, reserves for federal cost disallowances, legal claims and judgments, compensated absences, etc.
- No adequate year-end closing procedures are made to account for all transactions affecting all funds.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Schedule of Findings and Questioned Costs
June 30, 2016

- No adequate segregation is made between items representing actual accounts payable and those representing outstanding encumbrances. Accordingly, material amounts of unrecorded liabilities are generally recorded at fiscal year-end.
- The management of the federal programs administered by the Municipality maintains separate accounting records for each federal program, which are not reconciled with the UAS (the official accounting system of the Municipality).
- The audit adjustments resulting from Single Audits are not completely posted in the UAS.

The basic financial statements of the Municipality must be prepared using the financial information obtained from various municipal departments and accounting records outside of the official UAS, and from information obtained from regulators and independent third parties. In addition, the Department of Finance does not maintain accounting records and working papers supporting the balances and disclosures reported in the basic financial statements, principally those related to government-wide financial reporting.

The Department of Finance does not maintain accounting records supporting the following procedures performed as part of the preparation of the basic financial statements of the Municipality:

- The conversion of accounting records from the cash basis of accounting to the modified accrual basis of accounting used by governmental funds;
- The conversion of governmental funds from the modified accrual basis to the accrual basis of accounting used by government-wide financial statements; and
- Working papers and analyses of significant balances reported in the basic financial statements, such as capital assets, accounts receivable (municipal licenses, grants and contributions, etc.), deferred revenues, accounts payable, and long-term obligations (for which the general practice is to rely upon the notifications received from the Government Development Bank for Puerto Rico, the Puerto Rico Treasury Department, the Federal Government and the Municipal Revenue Collection Center for the balance of its outstanding debt and the withholding for its debt service).

A similar finding was included in the prior year's single audit report. Refer to finding 15-01.

CRITERIA:

Article 8.010(b) of Law No. 81 of August 30, 1991, known as the *Autonomous Municipalities Act of Puerto Rico* (Law No. 81), states that the Municipality must maintain its fund accounting in accordance with Accounting Principles Generally Accepted in the United States of America (GAAP), as promulgated by the Governmental Accounting Standards Board (GASB), the National Committee on Governmental Accounting (NCGA) and the Governmental Accounting, Auditing and Financial Reporting book (commonly known as Blue Book).

In addition, Article 8.010(c) of Law No. 81 states that uniform accounting system used by the Municipality must: (1) produce reliable reports and financial statements, (2) provide complete

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Schedule of Findings and Questioned Costs
June 30, 2016

information about the results of operations of the Municipality, and (3) include the necessary internal controls to account all funds, capital assets and other assets of the Municipality.

Due to the conditions referred to above, the preparation of the Municipality's basic financial statements as of and for the fiscal year ended June 30, 2016 was more difficult and less efficient than would have been in ordinary circumstances. A significant amount of adjusting entries had to be made to the financial data and reports processed through the UAS in order to properly account for unrecorded transactions and to correct transactions recorded in the wrong accounting period. Since the accounts and other accounting records of the UAS are not designed to provide all the information necessary to prepare the Municipality's basic financial statements, the Municipality had to obtain and process financial data from several sources outside the UAS. These conditions represent material weaknesses in the Municipality's internal controls over financial reporting.

CAUSE AND EFFECT:

These conditions occurred because the accounting system currently used by the Municipality has not been updated and, accordingly, the Municipality has not implemented an accounting system in compliance with the current accounting model established by GASB Statement No. 34, as amended. The continued failure to have an adequate accounting system does not allow the Municipality to have timely and accurate financial information for its decision making process. In addition, financial reports prepared may have errors or omissions that will affect future financial decisions.

RECOMMENDATION:

We recommend the Municipality to explore different alternatives for the implementation of a new accounting system in compliance with all applicable federal and local laws and regulations. This process should include only accounting systems that will enable the Municipality to prepare its basic financial statements in a timely manner and in conformity with GAAP. The systems to be evaluated must provide the necessary financial information that will serve as the basis for the effective control of revenues, disbursements, assets and liabilities, and the reporting of such items in the Municipality's financial statements, including:

- The implementation of a double entry accounting system, the integration of all subsidiary ledgers and the reconciliation with the records maintained for federal funds;
- The preparation of periodic financial reports to be submitted to the Director of Finance, the Mayor, the Municipal Legislature and the federal grantors; and
- Adequate training to all accounting personnel to improve the understanding of the system and to promote operational efficiency

The Department of Finance must establish and document new accounting policies and procedures addressed to correct the non-compliance situations referred to above. Accounting policies and procedures shall be promulgated by an appropriate level of management to emphasize their importance and authority. The documentation of such accounting policies and procedures shall be updated periodically according to a predetermined schedule.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Schedule of Findings and Questioned Costs
June 30, 2016

2016-02 LACK OF MONITORING AND FRAUD PREVENTION ACTIVITIES

As part of our evaluation of internal controls of the Municipality we noted that the Municipality have not designed, documented nor placed in operations specific internal controls and procedures designed to prevent fraud and certain types of misappropriation of assets, including certain situations that may lead to material inadequate financial reporting. In addition, does not keep verifiable records of the results of monitoring activities performed to avoid embezzlement and the identification and evaluation of the different types of fraud risk factors associated with the Municipality's core processes. The aforementioned conditions represent material weaknesses in the Municipality's internal controls over financial reporting.

A similar finding was included in the prior year's single audit report. Refer to finding 15-02.

CRITERIA:

Article 6.004 of Law No. 81 of August 30, 1991, known as the *Autonomous Municipalities Act of Puerto Rico* (Law No. 81), states the Municipality shall perform interventions, audits and monitoring activities over all municipal operations financed with public funds, including: (1) the acquisition, use and disposition of capital assets, (2) transactions and operations of all administrative units (municipal departments), and (3) all accounts, records, books, contracts, budgets and any other financial activities.

CAUSE AND EFFECT:

These conditions arose by the lack of effective controls and procedures for the evaluation of significant risk factors in all municipal areas, the lack of proper planning of continued monitoring activities, and the lack of proper allocation of human resources and time schedules to perform the activities required by law. These conditions, if not corrected, may increase the risk of instances of material unforeseen errors and irregularities that may not be detected in a timely manner by the current internal controls of the Municipality.

RECOMMENDATION:

We also recommend the Municipality to prepare a manual of policies and procedures specifically designed to prevent and detect fraud. The Municipality should also keep formal documentation of all fraud prevention and monitoring activities performed by management, including the identification and evaluation of all fraud risk factors. Fraud risk assessments should be reviewed periodically to consider changes in the operating policies of the Municipality and the control environment.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Schedule of Findings and Questioned Costs
June 30, 2016

Section III - Federal Award Findings and Questioned Costs

<u>Program</u>	<u>Findings/Noncompliance Recommendations</u>	<u>Questioned Cost</u>
CDBG CFDA No. 14.228	<p>2016-03 FEDERAL CASH MANAGEMENT SYSTEM</p> <p>Statement of Condition:</p> <p>The Municipality has not established effective cash management procedures. During our review of the drawdowns performed during the year, we noted the following deficiency:</p> <p>a. The Municipality performed 64 drawdown during the fiscal year 2015-2016 amounting to \$794,193. For 36 drawdowns amounting to \$530,851 or (56%) the disbursements related to the funds requested has a delay of 3 days or more between the funds receiving date and the disbursing date.</p> <p>A similar finding was included in the prior year's single audit report. Refer to finding 15-03.</p> <p>Criteria:</p> <p>Federal regulations require that Grantee shall conform to the standards applicable to advances from Federal agencies. Amounts requested should be limited to the Programs immediate cash needs.</p> <p>OCAM grant agreement requires that "the Municipality should maintained requested funds from OCAM for a period no longer than three (3) days".</p> <p>Cause and Effect:</p> <p>This condition arose because the Municipality has not implemented specific internal controls and procedures designed to minimize the time elapsed between the times when drawdowns are made and the subsequent time when disbursement of federal funds are carried out. This condition increases the risks of avoidable interest income and instances of idle cash balances in the program's bank accounts.</p>	NONE

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Schedule of Findings and Questioned Costs
June 30, 2016

<u>Program</u>	<u>Findings/Noncompliance Recommendations</u>	<u>Questioned Cost</u>
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Recommendation:

In accordance with Federal regulations, the Municipality should estimate drawdown's of Federal funds as closely as possible to the actual disbursements. Also, the Municipality should establish procedures to minimize the time elapsing between drawdowns and disbursements.

CDBG
CFDA No. 14.228

2016-04 FINANCIAL REPORTING

Statement of Condition:

Our review of the Program Income Quarterly Report submitted to Office of the Commissioner of Municipal Affairs (OCAM), disclosed that it was submitted after the required submission date, as detailed below.

NONE

<u>Quarter Ended</u>	<u>Due Date</u>	<u>Date Submitted</u>	<u>Past Due Days</u>
June 30, 2016	August 10, 2016	August 17, 2016	7 days

Criteria:

According to OCAM Circular Memorandum 2002-15 Program Income quarterly reports must be submitted to OCAM within the next 40 days after the end of the quarter period.

Cause and Effect:

This condition occurred because the Municipality has not adopted adequate internal controls and procedures designed to ensure the timely submission of program reports and the lack of adequate training and supervision of the municipal employees in charge of the preparation of the aforementioned reports.

This condition, if not corrected, may increase the risk of avoidable instances of material non-compliances with the laws and regulations applicable to the Program.

Recommendation:

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Schedule of Findings and Questioned Costs
June 30, 2016

<u>Program</u>	<u>Findings/Noncompliance Recommendations</u>	<u>Questioned Cost</u>
	<p>quarterly reports, in order to comply with Federal regulation. Also, the Municipality should consider implementing a reporting calendar to maintain all personnel aware of the reporting deadlines of each federal financial report. This will provide an additional tool to help the Municipality in complying with the federal regulation.</p>	
	Total Questioned Costs	<u>NONE</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
 Summary schedule of prior years audit findings
 Fiscal Year 2014-2015
 June 30, 2016

The following schedule contains the finding number and title of each of the findings included in the Report on Compliance and Internal Control Based on the Audit of the General Purpose Financial Statements for Performed in Accordance with Government Auditing Standards for the Fiscal Year ended June 30, 2015. Under the heading Corrective Action Taken there will be the following:

- FR - Fully resolved (indicating the corrective action plan was fully implemented).
- PR - Partially resolved (indicating the corrective action plan was partially implemented and the finding repeated in fiscal year 2015-2016).
- NR - Not resolved yet. Finding repeated in fiscal year 2015-2016.

<u>Finding Number</u>	<u>Title</u>	<u>Corrective Action Taken</u>
15-01	Deficiencies in the uniform accounting system and other accounting records	NR
15-02	Lack of monitoring and fraud prevention activities	NR

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
 Summary schedule of prior years audit findings
 Fiscal Year 2014-2015
 June 30, 2016

The following schedule contains the finding number and title of each of the findings included in the Report on Compliance with Requirements Applicable to Each Major Program and Internal Control over Compliance in accordance with OMB Circular A-133 for the Fiscal Year ended June 30, 2015. Under the heading Corrective Action Taken there will be the following:

- FR - Fully resolved (indicating the corrective action plan was fully implemented).
- PR - Partially resolved (indicating the corrective action plan was partially implemented and the finding repeated in fiscal year 2015-2016).
- NR - Not resolved yet. Finding repeated in fiscal year 2015-2016.

<u>Finding Number</u>	<u>Title</u>	<u>Corrective Action Taken</u>
15-03	Cash Management System	NR

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
 Summary schedule of prior years audit findings
 Fiscal Year 2013-2014
 June 30, 2016

The following schedule contains the finding number and title of each of the findings included in the Report on Compliance and Internal Control Based on the Audit of the General Purpose Financial Statements for Performed in Accordance with Government Auditing Standards for the Fiscal Year ended June 30, 2014. Under the heading Corrective Action Taken there will be the following:

FR - Fully resolved (indicating the corrective action plan was fully implemented).

PR - Partially resolved (indicating the corrective action plan was partially implemented and the finding repeated in fiscal year 2015-2016).

NR - Not resolved yet. Finding repeated in fiscal year 2015-2016.

<u>Finding Number</u>	<u>Title</u>	<u>Corrective Action Taken</u>
14-01	Deficiencies in the uniform accounting system and other accounting records	NR
14-02	Lack of monitoring and fraud prevention activities	NR

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
 Summary schedule of prior years audit findings
 Fiscal Year 2013-2014
 June 30, 2016

The following schedule contains the finding number and title of each of the findings included in the Report on Compliance with Requirements Applicable to Each Major Program and Internal Control over Compliance in accordance with OMB Circular A-133 for the Fiscal Year ended June 30, 2014. Under the heading Corrective Action Taken there will be the following:

- FR - Fully resolved (indicating the corrective action plan was fully implemented).
- PR - Partially resolved (indicating the corrective action plan was partially implemented and the finding repeated in fiscal year 2015-2016).
- NR - Not resolved yet. Finding repeated in fiscal year 2015-2016.

<u>Finding Number</u>	<u>Title</u>	<u>Corrective Action Taken</u>
14-03	Cash Management System	NR
14-04	Earmarking	FR
14-05	Inadequate Documentation of Participant Files	FR

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Corrective Action Plan – Financial Statement and Federal Awards Findings
Fiscal Year Ended June 30, 2016

Finding Control Number: 2016-01

DEFICIENCIES IN THE ACCOUNTING SYSTEM, CLOSING PROCEDURES AND OTHER ACCOUNTING RECORDS

CONDITION:

During the last two years, the Municipality acquired and implemented a new accounting and financial management system (NAFMS). However, the following specific conditions were noted during our audit that need to be addressed: The Municipality:

- Accounting transactions are currently accounted for simultaneously through manual and computerized accounting systems for which no reconciliation procedures are made among them, including the accounting records currently used by federal programs which are not reconciled with the NAFMS. The balance sheet accounts in the NAFMS are not reconciled and adjusted to conform them to the Municipality's audited basic financial statements.
- Does not reconcile periodically and agree amounts in the Municipality's general ledger with the corresponding subsidiary taxes receivable and accounts payable. Municipality makes significant year end efforts to identify all unrecorded liabilities.
- Does not account for long term debt balances in its accounting system on a timely basis nor its has a subsidiary ledger that provides a detail of all its long term obligations. The detail of long term debt is prepared as part of the year end closing process and kept in electronic worksheets. The long term debt presented in the government-wide basic financial statements is assembled from numerous external documents and resources.
- Does not close its accounting records to prepare financial reports in accordance with GAAP on a monthly basis for all of its operations. Current monthly procedures are carried on a modified budgetary basis and does not provide for an analysis of the overall financial position and results of operations of each of the Municipality's funds and accounts.
- Does not analyze and evaluate accounts balances and transactions on a monthly basis to ensure that these are free from errors and irregularities. The analysis of most account balances and transactions is performed once a year as part of the year end closing process.
- Does not have a formal periodical cut-off procedures to ensure that all transactions are recorded in the corresponding accounting period.
- Does not have an integrated financial reporting structure to allow for the effective and efficient preparation of the Municipality's basic financial statements including the conversion process for the government-wide financial statements. The 2015 basic financial statements and related conversion was completed after a significant gathering of formal and informal documents.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Corrective Action Plan – Financial Statement and Federal Awards Findings
Fiscal Year Ended June 30, 2016

CRITERIA:

Article 8.010(b) of Law No. 81 of August 30, 1991, known as the *Autonomous Municipalities Act of Puerto Rico* (Law No. 81), states that the Municipality must maintain its fund accounting in accordance with Accounting Principles Generally Accepted in the United States of America (GAAP), as promulgated by the Governmental Accounting Standards Board (GASB), the National Committee on Governmental Accounting (NCGA) and the Governmental Accounting, Auditing and Financial Reporting book (commonly known as Blue Book).

In addition, Article 8.010(c) of Law No. 81 states that uniform accounting system used by the Municipality must: (1) produce reliable reports and financial statements, (2) provide complete information about the results of operations of the Municipality, and (3) include the necessary internal controls to account all funds, capital assets and other assets of the Municipality.

Also, Article 7.001 (a) of the Autonomous Municipalities Law establishes that the Municipality shall close its accounting records at year end to allow for the accurate evaluation of the results of operations for the ensuing year.

Due to the conditions referred to above, the preparation of the Municipality's basic financial statements as of and for the fiscal year ended June 30, 2015 was more difficult and less efficient than would have been in ordinary circumstances. A significant amount of adjusting entries had to be made to the financial data and reports processed through the NAFMS in order to properly account for unrecorded transactions and to correct transactions recorded in the wrong accounting period. Since the accounts and other accounting records of the NAFMS are not designed to provide all the information necessary to prepare the Municipality's basic financial statements, the Municipality had to obtain and process financial data from several sources outside the NAFMS. These conditions represent material weaknesses in the Municipality's internal controls over financial reporting.

CAUSE AND EFFECT:

These conditions occurred because the Municipality's financial accounting and reporting structure is not designed to gather the necessary information efficiently and effectively to permit periodic analysis of transactions and balances and periodic reconciliation among trial balances and subsidiary ledgers. The failure to have an adequate accounting system does not allow the Municipality to have timely and accurate financial information for its decision making process.

RECOMMENDATION:

We recommend the Municipality to continue its efforts to review and revise its current accounting and financial reporting structure. This includes, among others, the evaluation of the current accounting and financial reporting software to ensure it meets the necessary standards, establishment or revision of policies and procedures, establishment of periodic reconciliation and analysis processes and procedures, additional training of all personnel related to accounting and financial reporting responsibilities and establishing a financial reporting unit. This financial reporting unit should be responsible for overseeing the overall deployment of the project to ensure that goals are met effectively.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Corrective Action Plan – Financial Statement and Federal Awards Findings
Fiscal Year Ended June 30, 2016

Response and Corrective Action by Department of Finance – Finding Control Number 2016-01:

We partially concur with this finding. The Department of Finance has adopted a new tailor-made financial (accounting) management system (Monet System) to ensure its financial statements comply with generally accepted accounting principles and even higher standards promulgated by the Government Finance Officers Association (GFOA). Consequently, from 2009 through 2014, the Municipality has been consecutively awarded with the *Certificate of Achievement for Excellence in Financial Reporting*, issued by GFOA.

The new accounting system implemented, Monet System, has many modern capabilities that the previous uniform financial system used by the Municipality in past years did not have. Among those capabilities are:

- All accounting transactions are currently accounted for in the computerized accounting system Monet which ensures proper cut-off of transactions and has eliminated the previous need of keeping manual accounting records, therefore, currently there is no need to reconcile manual and electronic records. The Department of Finance still keeps some minimal manual records but only for reference purpose and backup purposes (not as main accounting database).
- Monet System has complete interface among its different modules, therefore, there is no need to reconcile subsidiary records of receivables and payables with their corresponding general ledger accounts. This interface capability minimizes the need of performing manual accounts balance and transactions and transactions analysis on a monthly basis and minimizes the risk of undetected material errors and irregularities.
- All long-term debt maturities of principal and interests are accounted for in the corresponding governmental funds within Monet System.

In addition to the implementation of the Monet System referred to above, the Municipality has implemented many other internal control measures that compensate, to an acceptable level, all other minor or inconsequence deficiencies in the new current accounting system. Those controls reduce, to a relatively low level, the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. The principal of the abovementioned internal control measures adopted by the Municipality was the establishment of a *Financial Reporting Task Force* composed of the management team of the Department of Finance and outside fee accountants. Such team works together throughout the year to prepare the Municipality's financial statements, including all of the accounting records and reports needed to support the balances and disclosures reported in the financial statements as of and for the fiscal year ended June 30, 2016. These control measures minimized the risks of possible errors, omissions or deviations from generally accepted accounting principles in the Municipality's basic financial statements.

This is an ongoing process; additional improved procedures were established during the last two fiscal years to strengthen the accounting systems through the implementation of a new comprehensive financial management system which currently management is in the ongoing process of maximizing its use at full capacity, and the establishment and revision of additional accounting and administrative policies and procedures, the establishment of periodic reconciliation of tax subsidiary ledgers, and additional training to

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Corrective Action Plan – Financial Statement and Federal Awards Findings
Fiscal Year Ended June 30, 2016**

accounting personnel related to accounting and financial reporting matters including explanation of the year-end closing.

Furthermore, we should mention that the Municipality follows the accounting and administrative procedures established by the Administration Manual issued by the Office of the Commissioner of Municipal Affairs of Puerto Rico, which required strict control procedures in the accounting processes and procedures. At a result of the aforementioned facts, the Municipality has been able to shorten the complexity and the period of each annual audit, and the issuance of its Single Audit Report. We will continue on these efforts to strengthen controls over financial reporting and enforce procedures to provide timely information on accounting balances and transactions. As part of those procedures, the Department of Finance analyzes and evaluate accounts balances and transactions on a monthly basis to ensure that these are free from errors and irregularities and to ascertain they are in compliance with budgetary restrictions. This process includes a formal periodical cut-off procedure to ensure that all transactions are recorded in the corresponding accounting period and the corresponding budget.

Anticipated completion date:	Ongoing process expected to be completed by June 30, 2017
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Finding Control Number: 2016-02

LACK OF MONITORING AND FRAUD PREVENTION ACTIVITIES

As part of our evaluation of internal controls of the Municipality we noted that the Municipality have not designed, documented nor placed in operations specific internal controls and procedures designed to prevent fraud and certain types of misappropriation of assets, including certain situations that may lead to material inadequate financial reporting. In addition, does not keep verifiable records of the results of monitoring activities performed to avoid embezzlement and the identification and evaluation of the different types of fraud risk factors associated with the Municipality’s core processes. The aforementioned conditions represent material weaknesses in the Municipality’s internal controls over financial reporting. A similar finding was included in the prior year’s single audit report. Refer to finding 15-02.

CRITERIA:

Article 6.004 of Law No. 81 of August 30, 1991, known as the *Autonomous Municipalities Act of Puerto Rico* (Law No. 81), states the Municipality shall perform interventions, audits and monitoring activities over all municipal operations financed with public funds, including: (1) the acquisition, use and disposition of capital assets, (2) transactions and operations of all administrative units (municipal departments), and (3) all accounts, records, books, contracts, budgets and any other financial activities.

CAUSE AND EFFECT:

These conditions arose by the lack of effective controls and procedures for the evaluation of significant risk factors in all municipal areas, the lack of proper planning of continued monitoring activities, and the

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Corrective Action Plan – Financial Statement and Federal Awards Findings
Fiscal Year Ended June 30, 2016

lack of proper allocation of human resources and time schedules to perform the activities required by law. These conditions, if not corrected, may increase the risk of instances of material unforeseen errors and irregularities that may not be detected in a timely manner by the current internal controls of the Municipality.

RECOMMENDATION:

We also recommend the Municipality to prepare a manual of policies and procedures specifically designed to prevent and detect fraud. The Municipality should also keep formal documentation of all fraud prevention and monitoring activities performed by management, including the identification and evaluation of all fraud risk factors. Fraud risk assessments should be reviewed periodically to consider changes in the operating policies of the Municipality and the control environment.

Response and Corrective Action by Department of Finance – Finding Control Number 2016-02:

We do not concur with this finding. As in previous fiscal years, during the fiscal year ended June 30, 2016, the Municipality followed all the controls and procedures promulgated by the Office of the Commissioner of Municipal Affairs (OCAM, by its Spanish acronyms), a governmental entity created by law to establish uniform standard control procedures and internal controls for the Municipalities of Puerto Rico in compliance with the Autonomous Municipalities Act of the Commonwealth of Puerto Rico. The standards established by OCAM are extremely restrictive in nature, therefore, are designed to minimize the risks of fraud, errors and irregularities in the Municipality's revenues, collections, purchasing and disbursements and investing cycles, among others.

In addition, during the current fiscal year, the Municipality implemented the Monet System, a computerized system that, among other things, minimizes to an acceptable levels the risks of fraud and misappropriation of assets by having detailed subsidiary records of all assets susceptible to these risks, maintains adequate audit trail of authorization levels of all transactions and requires constant monitoring and reconciling of all assets, including cash and capital assets.

In addition, as of June 30, 2016 there was not neither a law nor regulation requiring an anti-fraud plan to the Municipality. However, the management of the Municipality is strongly committed with the prevention of fraud and the establishment of appropriate measures to reduce risks factors associated with errors, irregularities and fraud. Accordingly, during the last four fiscal years the Municipality has adopted several internal controls and procedures to minimize the risks of fraudulent financial reporting and the misappropriation of assets. Among such internal controls and procedures are the following.

In addition, a major goal of the Municipality's Department of Finance is to improve the quality of its current accounting, auditing, and financial reporting practices. During the last eleven fiscal years, the Department of Finance adopted several internal control measures to ensure its financial statements comply with generally accepted accounting principles. Such internal control measures compensate a majority of the deficiencies in the current accounting system used by the Municipality and reduce, to a relatively low level, the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Corrective Action Plan – Financial Statement and Federal Awards Findings
Fiscal Year Ended June 30, 2016**

The principal of the abovementioned internal control measures adopted by the Municipality was the establishment of a *Financial Reporting Task Force* composed of the management team of the Department of Finance and outside consultants. Such team works together throughout the year to prepare the Municipality’s financial statements, including all of the accounting records and reports needed to support the balances and disclosures reported in the financial statements as of and for the fiscal year ended June 30, 2016. These control measures minimized the risks of possible errors, omissions or deviations from generally accepted accounting principles in the Municipality’s basic financial statements (minimize the risk of fraudulent financial reporting). Also these measures minimize the risks of illegal acts and irregularities.

Furthermore, the Municipality has a strong control environment in which all applicable recommendations promulgated by the Office of the Comptroller of Puerto Rico and its independent auditors are implemented. The Municipality periodically is subject to extensive compliance and operational audits performed by the Office of the Comptroller of Puerto Rico. Also the Municipality is annually subject to a Single Audit under OMB Circular A-133. As part of such audits, the Municipality is extensively evaluated to determine the existence of possible frauds and irregularities. During the last twelve thirteen years, the audit reports issued by the independent auditors and the Office of the Comptroller of Puerto Rico have not disclosed any instances of fraud nor irregularities.

However, during the fiscal year ending June 30, 2017, the Municipality will prepare a manual of specific internal controls and procedures designed to prevent and detect fraud risks of the Municipality

Anticipated completion date:	Not applicable.
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Finding Control Number: 2016-03

FEDERAL CASH MANAGEMENT SYSTEM – CDBG PROGRAM

CONDITION:

The Municipality has not established effective cash management procedures. During our review of the drawdowns performed during the year, we noted the following deficiency: a. The Municipality performed 64 drawdown during the fiscal year 2015-2016 amounting to \$794,193. For 36 drawdowns amounting to \$530,851 or (56%) the disbursements related to the funds requested has a delay of 3 days or more between the funds receiving date and the disbursing date. A similar finding was included in the prior year’s single audit report. Refer to finding 15-03.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Corrective Action Plan – Financial Statement and Federal Awards Findings
Fiscal Year Ended June 30, 2016**

CRITERIA:

Program grant agreement established that “the Municipality minimize the time elapsing between the receipt and the disbursement of funds. Such period shall not exceed three (3) days”.

CAUSE AND EFFECT:

This condition arose because the Municipality has not implemented specific internal controls and procedures designed to minimize the time elapsed between the time when drawdowns are made and the subsequent time when disbursement of federal funds are carried out. This condition increases the risks of avoidable interest income and instances of idle cash balances in the program’s bank accounts.

RECOMMENDATION:

In accordance with federal regulations, the Municipality should estimate drawdown’s of Federal funds as closely as possible to the actual disbursements. The Municipality should established procedures to minimize the time elapsing between drawdowns and disbursements.

Response by Departments of Finance and Federal Programs – Finding Control Number 2016-03:

We concur with this finding. The Municipality established new written procedures over cash management requiring that once federal funds are received from the Office of Commissioner of Municipal Affairs (OCAM) as pass-through granting entity, the Department of Finance (in coordination with the Department of Federal Programs) sends the disbursement checks by mail after holding the check on the municipal premises for no more than three days for pick up by the supplier or contractor. The Municipality will adopt a three days cycle time special policy (actually all payments have to wait until next Thursday) as to disburse checks on Federal funds to suppliers. This will minimize the time elapsed between the drawdown and the payment of such funds.

Anticipated completion date:	June 30, 2017
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Finding Control Number: 2016-04

FINANCIAL REPORTING – CDBG PROGRAM

CONDITION:

Our review of the Program Income Quarterly Report submitted to Office of the Commissioner of Municipal Affairs (OCAM), disclosed that it was submitted after the required submission date, as detailed below.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF AIBONITO
Corrective Action Plan – Financial Statement and Federal Awards Findings
Fiscal Year Ended June 30, 2016**

Quarter Ended	Due Date	Date Submitted	Past Due Dates
June 30, 2016	August 10, 2016	August 17, 2016	7 days

CRITERIA:

According to OCAM Circular Memorandum 2002-15 Program Income quarterly reports must be submitted to OCAM within the next 40 days after the end of the quarter period.

CAUSE AND EFFECT:

This condition occurred because the Municipality has not adopted adequate internal controls and procedures designed to ensure the timely submission of program reports and the lack of adequate training and supervision of the municipal employees in charge of the preparation of the aforementioned reports.

This condition, if not corrected, may increase the risk of avoidable instances of material non-compliances with the laws and regulations applicable to the Program.

RECOMMENDATION:

The Municipality should improve existing procedures to ensure the timely submission of the Program Income quarterly reports, in order to comply with Federal regulation. Also, the Municipality should consider implementing a reporting calendar to maintain all personnel aware of the reporting deadlines of each federal financial report. This will provide an additional tool to help the Municipality in complying with the federal regulation.

Response by Department of Federal Programs – Finding Control Number 2016-04:

We concur with this finding. Since this is an isolated incident, non-recurrent and without any material impact, the Director of Federal Programs has provided specific guidance and instructions to program accountant about the statutory reporting deadlines set forth by OCAM.

Anticipated completion date:	June 30, 2017
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