

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF BARRANQUITAS**

**SINGLE AUDIT REPORT
Fiscal Year Ended
June 30, 2017**

**BASIC FINANCIAL STATEMENTS AND
SUPPLEMENTAL SCHEDULE**

With Independent Auditors' Report Thereon
June 30, 2017

Commonwealth of Puerto Rico
Municipality of Barranquitas
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Fiscal Year ended June 30, 2017

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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 Barranquitas
Barranquitas, Puerto Rico

Report on the Financial Statements

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the Municipality of Barranquitas of the Commonwealth of Puerto Rico (the "Municipality"), as of and for the fiscal year ended June 30, 2017, 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 auditors' 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 15 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* and with the Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date, an amendment of the GASB Statement No. 68*. Accordingly, 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, 2017 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 and 71, 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 and 71. 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, the financial statements referred to above present fairly, in all material respects, the financial position of the governmental activities of the Municipality of Barranquitas as of June 30, 2017 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 Funds Financial Statements

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 Barranquitas of the Commonwealth of Puerto Rico, as of June 30, 2017, 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.

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 Budgetary Comparison information on pages 5 through 21 and 84, respectively, 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 May 21, 2018, on our consideration of the Municipality of Barranquitas 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 Barranquitas of the Commonwealth of Puerto Rico internal control over financial reporting and compliance.

May 21, 2018
Toa Alta, Puerto Rico

A handwritten signature in black ink, appearing to be 'Barranquitas', followed by a vertical line and the initials 'CPA-PSC'.

Stamp No. O2752849
was affixed to the
original report.

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Management's Discussion and Analysis
June 30, 2017

As management of the Municipality of Barranquitas (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, 2017. 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 amounted to \$49,358,953 at June 30, 2017, of which \$27,807,153 consists of capital assets (net of accumulated depreciation of \$51,429,523), \$18,802,019 consist of cash and cash equivalents (\$13,594,353), and deposits with governmental bank (\$5,207,666), of which, \$8,528,475 are restricted for specific purposes, \$2,673,248 consist of accounts receivable, net of reserve for doubtful accounts, and \$76,533 of other assets (net of accumulated amortization of \$3,559).
- The Municipality's liabilities and deferred inflows of resources amounted to \$25,782,879 at June 30, 2017, of which \$7,889,700 consist of bonds payable, \$2,729,445 consist of accounts payable and accrued liabilities, \$2,190,214 consist of deferred inflows of resources, \$1,507,285 consist of accrued compensated absences, and \$11,466,235 consist of municipal waste landfill closure and post-closure care costs debt.
- The Municipality's assets exceeded its liabilities and deferred inflows of resources (net position) by \$23,576,074 at June 30, 2017.
- The Municipality's revenues amounted to \$14,426,683 for the fiscal year ended June 30, 2017, of which \$9,581,187 arose from taxes, \$4,120,045, arose from intergovernmental grants and contributions, \$463,749 arose from miscellaneous revenues and interest on deposits, and \$261,702 arose from charges for services.
- The Municipality's expenses amounted to \$13,701,796 for the fiscal year ended June 30, 2017, of which \$9,036,429 were incurred in providing direct services and benefits to citizens in relation to urban and economic development, health and sanitation, public safety, public housing and welfare, and culture, recreation and education. In addition, the Municipality incurred \$382,766 of its total expenses, in interests related to its long-term obligations, and \$4,282,601 in general government activities to support the Municipality's functions and programs. The Municipality's expenses include depreciation in the amount of \$2,089,776, for the fiscal year ended June 30, 2017.
- The Municipality's net position increased by \$724,887 during the fiscal year ended June 30, 2017.

Governmental Funds' Highlights:

- The total fund balances of governmental funds amounted to \$14,997,451 at June 30, 2016, which increased by \$947,699 during fiscal year ended June 30, 2017.

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- The total assets of governmental funds increased from \$21,930,860 at June 30, 2016 to \$21,958,243 at June 30, 2017, for an increase of \$27,383.
- The governmental fund's total liabilities decreased from \$4,140,137 at June 30, 2016 to \$3,820,121 at June 30, 2017, for a decrease of \$320,016 (8% decrease).
- The total revenues of governmental funds decreased from \$14,574,322 for the fiscal year ended June 30, 2016 to \$14,454,113 for the fiscal year ended June 30, 2017, for a decrease of \$120,209 (1% decrease).
- The governmental fund's total expenditures decreased from \$15,217,569 for the fiscal year ended June 30, 2016 to \$13,506,414 for the fiscal year ended June 30, 2017, for a decrease of \$1,711,155 (11% 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, 2017. Because this MD&A is designed to focus on the current year activities, resulting changes and currently known facts, we encourage readers to consider the information presented in this MD&A in conjunction with the additional information furnished in the accompanying basic financial statements.

The Municipality's basic financial statements include three components: (1) government-wide financial statements (GWFS), (2) governmental fund financial statements (GFFS), and (3) 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.

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

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to determine the economic condition at June 30, 2017. 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, 2017, 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 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 present all of the Municipality's governmental activities, which are supported mostly by taxes and intergovernmental revenues (such as federal and state grants and contributions).

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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 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 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

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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 five (5) 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 five (5) major governmental funds are: (1) general fund, (2) capital projects fund, (3) legislative joint resolutions fund, (4) debt service fund, and (5) community development block grant fund.

c) Notes to Basic Financial Statements

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

d) Other Supplementary Information

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

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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:

Comparative Statement of Net Position
Governmental Activities (condensed)
June 30, 2017 and 2016

Assets:	<u>2017</u>	<u>2016</u>
Current assets	\$ 21,518,854	\$ 21,060,732
Non-current assets:		
Capital assets, net	27,807,153	27,955,177
Other non-current assets	32,946	36,505
Total assets	<u>\$ 49,358,953</u>	<u>\$ 49,052,414</u>
 Liabilities:		
Current liabilities	\$ 2,729,445	\$ 2,655,813
Long-term obligations due within one year	1,487,260	1,420,274
Long-term obligations due after one year	19,375,960	19,362,056
Total liabilities	<u>23,592,665</u>	<u>23,438,143</u>
 Deferred inflows of resources	<u>2,190,214</u>	<u>2,763,084</u>
 Net position:		
Net investment in capital assets, as restated	22,977,495	22,859,033
Restricted for debt service	5,095,705	1,851,625
Unrestricted	(4,497,126)	(1,859,471)
	<u>\$ 23,576,074</u>	<u>\$ 22,851,187</u>

At June 30, 2017, the Municipality's current assets, amounting to \$21,518,854, are mainly composed of cash and cash equivalents (\$13,594,353), deposits with governmental bank (\$5,207,666), accounts receivable (\$2,673,248), net of reserve for doubtful accounts, and other (\$43,587).

The restricted cash represents resources 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 programs. Restricted cash also consists of unspent proceeds of bonds issued for acquisition, construction and improvement of major capital assets. Restricted property taxes receivable represent resources set aside to redeem the bonds of the Municipality in minimum annual or biannual principal and interest payments.

The Municipality's non-current assets, amounting to \$27,840,099 at June 30, 2017, are substantially composed of capital assets, with a carrying balance of \$27,807,153, net of accumulated depreciation.

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At June 30, 2017, the Municipality's current liabilities amounting to \$4,216,705 are mainly composed of accounts payable and accrued liabilities (\$2,729,445), and the current portions of long-term obligations (\$1,487,260). Deferred inflows of resources (\$2,190,214) consist principally of unearned revenues associated with municipal license taxes and intergovernmental grants and contributions.

The Municipality's non-current liabilities, amounting to \$19,375,960 at June 30, 2017, are mainly composed of portions due after one year of bonds payable (\$7,282,000), compensated absences (\$627,725), and municipal waste landfill closure and post-closure care costs debt (\$11,466,235).

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 \$23,576,074 at June 30, 2017. The most significant portion of net position (\$22,977,495) 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 the 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.

The total net position of the Municipality increased by \$724,887 for the fiscal year ended June 30, 2017. Such increase is due to the excess of total revenues (\$14,426,683) over expenditures (\$13,701,796) for the fiscal year ended June 30, 2017.

For a detailed analysis of the most significant fluctuations in assets, liabilities and deferred inflows of resources, refer to the financial analysis of each major governmental fund included in this management 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:

Governmental Activities (condensed)
Fiscal Years Ended June 30, 2017 and 2016

	2017	2016
Program revenues:		
Program-specific operating grants and contributions	\$ 1,687,441	\$ 2,082,384
Program-specific capital grants and contributions	896,731	852,990
Charges for services	261,702	332,042
Total program revenues	2,845,874	3,267,416
General revenues:		
Property taxes	8,122,931	8,177,914
Municipal license taxes	754,148	762,311
Construction excise taxes	109,635	228,437
Sales and usage tax	594,473	614,513
Unrestricted grants and contributions	1,535,873	863,817
Interests on deposits and miscellaneous revenues	463,749	628,670
Total general revenues	11,580,809	11,275,662
Total revenues	14,426,683	14,543,078
Program expenses:		
General government	4,282,601	6,136,137
Public housing and welfare	1,822,818	1,942,962
Health and sanitation	1,852,311	1,818,909
Urban and economic development	3,604,837	2,701,733
Public safety	979,726	1,026,505
Culture, recreation and education	776,737	872,254
Interest on bonds	382,766	379,246
Total expenses	13,701,796	14,877,746
Net increase (decrease) in net position	724,887	(334,668)
Net position at beginning of fiscal year	22,851,187	38,541,521
Prior period adjustments, net	-	(15,355,666)
Net position at beginning of fiscal year, as restated	22,851,187	23,185,855
Net position at end of fiscal year	\$ 23,576,074	\$ 22,851,187

As previously mentioned, the Municipality's net position increased by \$724,887 during the current fiscal year. Approximately 66% of the Municipality's total revenues for the current fiscal year came from property, municipal license, construction excise taxes and sales and use taxes (\$9,581,187). Grants, contributions and charges for services (program revenues), amounting to \$4,381,747, provided 30% of the total revenues for the current fiscal year. Miscellaneous revenues and interest on deposits, amounting to \$463,749, provided 4% of total revenues.

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The Municipality's expenses cover a wide range of services. The largest expenses of the Municipality for the fiscal year ended June 30, 2017 were related to: (1) general administrating and operating costs (\$4,282,601), which were classified as "general government", (2) health and sanitation (\$1,852,311), (3) public housing and welfare (\$1,822,818), (4) urban and economic development (\$3,604,837), (5) public safety (\$979,726), and (6) culture, recreation and education (\$776,737). These expenses include depreciation of capital assets in the amount of \$2,089,776 for the fiscal year ended June 30, 2017.

As previously mentioned, the Municipality's expenses decreased from \$14,877,746 for the fiscal year ended June 30, 2016 to \$13,701,796 for the fiscal year ended June 30, 2017, for a decrease of \$1,175,950. 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 \$1,853,536, and urban and economic development expenses which increased \$903,104 during current fiscal year.

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, 2017, the total assets of governmental funds amounted to \$21,958,243, which consisted principally of: (1) cash and cash equivalents of \$13,594,353, (2) deposits with governmental bank of \$5,207,666, (3) accounts receivable, \$2,673,248, net of reserve for doubtful accounts, and (4) inter-fund receivables of \$482,976. Such assets are restricted for debt service, capital projects, encumbrances, and other specific purposes.

At June 30, 2017, the total liabilities and deferred inflows of resources of governmental funds amounted to \$6,013,093, which consisted principally of: (1) accounts payable and accrued liabilities of \$2,729,445, (2) deferred inflows of resources of \$2,192,972, (3) inter-fund payables of \$482,976, and (4) matured bonds and interest due and payable of \$607,700.

The fund balance of governmental funds increased by \$947,699 during the fiscal year ended June 30, 2017.

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MUNICIPALITY OF BARRANQUITAS
Management's Discussion and Analysis
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Condensed Balance Sheet - Governmental Funds
June 30, 2017 and 2016

Assets:	<u>2017</u>	<u>2016</u>
Total assets - major governmental funds	\$ 19,760,727	\$ 19,729,831
Total assets - other governmental funds	<u>2,197,516</u>	<u>2,201,029</u>
Combined assets	<u>\$ 21,958,243</u>	<u>\$ 21,930,860</u>
Liabilities:		
Total liabilities - major governmental funds	\$ 3,216,734	\$ 3,518,250
Total liabilities - other governmental funds	<u>603,387</u>	<u>621,887</u>
Combined liabilities	<u>3,820,121</u>	<u>4,140,137</u>
Deferred inflows of resources	<u>2,192,972</u>	<u>2,793,272</u>
Fund balances:		
Non-spendable - general fund	-	88,675
Assigned - general fund	925,391	749,292
Restricted -other major governmental funds	4,164,386	3,918,296
Restricted - other governmental funds	931,319	295,666
Unassigned - general fund	<u>9,924,054</u>	<u>9,945,522</u>
Combined fund balances	<u>15,945,150</u>	<u>14,997,451</u>
Total liabilities, deferred inflows of resources and fund balances	<u>\$ 21,958,243</u>	<u>\$ 21,930,860</u>

Major Governmental Funds

General fund (GF) - The GF is the principal operating fund of the Municipality. The GF's total assets amounted to \$13,657,666 at June 30, 2017. Such assets consist principally of: (1) cash and cash equivalents (\$10,273,544), (2) deposits with governmental bank (\$297,753) (3) property tax, municipal license tax, construction excise tax, and intergovernmental grants and contributions receivable (\$2,603,393), and (4) short-term amounts due from other funds (\$482,976).

The GF's total liabilities and deferred inflows of resources amounted to \$2,276,089 at June 30, 2017. Such liabilities are composed mainly of: (1) intergovernmental payables (\$1,531,609), (2) deferred inflows of resources (\$464,313), and (3) accounts payable and accrued liabilities (\$280,167).

At the end of the current fiscal year, unassigned fund balance of the GF's amounted to \$10,158,433, while total fund balance reached \$11,381,577. 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

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represents 100 percent of the total GF's expenditures, while total fund balance represents 100 percent of that same amount.

Capital projects fund (CPF) - The CPF's total assets amounted to \$2,419,471 at June 30, 2017, which consist mainly of deposits with governmental bank (\$2,419,396), and accrued interest on deposits (\$75). The CPF's total liability amounted to \$43,728 at June 30, 2017. At the end of the current fiscal year, CPF's total restricted fund balance reached \$2,375,743.

Legislative joint resolutions fund (LJRF) - The LJRF is a major capital project 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 \$1,150,501 at June 30, 2017, which consists of restricted cash and cash equivalents amounting to \$1,150,501. The LJRF's total liabilities and deferred inflows of resources amounted to \$1,150,501 at June 30, 2017, which are composed principally of due to other funds (\$129,121), accounts payable and accrued liabilities (\$146,257), and deferred inflows of resources (\$875,123).

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 payable. The DSF's total assets amounted to \$2,495,292 at June 30, 2017, which consists mainly of (1) cash in commercial bank (\$935,109) and (2) deposits with governmental bank (\$1,559,198). The DSF's total liabilities amounted to \$1,048,055 at June 30, 2017, which is mainly composed of: (1) matured bonds due and payable (\$607,700), (2) accounts payable and accrued liabilities (\$194,689), and (3) due and advances to other funds (\$245,666).

Community development block grant fund (CDBGF) - The CDBGF's is a major capital project fund used to account for the financial resources arising from program-specific capital grants and contributions awarded by the U.S. Department of Housing and Urban Development through the Puerto Rico Office of the Commissioner of Municipal Affairs (sub-grantor), which are principally used in the acquisition or construction of major capital facilities, other assets and permanent improvements. The CDBGF's total assets amounted to \$37,797 at June 30, 2017, which consists principally of restricted cash and cash equivalents amounting to \$36,842 and grant awards receivable from the U.S. Department of Housing and Urban Development amounting to \$955. The CDBGF's total liabilities amounted to \$37,797 at June 30, 2017, which is composed of amounts due to other funds (\$37,797).

Other governmental funds (OGF) - The OGF's is a combination of non-major major capital project and special revenue funds principally used to account for the financial resources arising from program-specific capital and operating grants and contributions awarded by state and federal agencies. The OGF's total assets amounted to \$2,197,516 at June 30, 2017, which consist mainly of (1) restricted cash and cash equivalents (\$1,198,357), (2) short-term amounts due from other funds (\$931,319), and (3) intergovernmental grants and contributions receivable (\$67,840). The OGF's total liabilities and deferred inflows of resources amounted to \$1,456,923 at June 30, 2017, which are mainly composed of (1) accounts payable and accrued liabilities (\$532,995), (2) short-term and long-term amounts due to and advances from other funds (\$70,392) and deferred inflows of resources (\$853,536). At the end of the current fiscal year, OGF's total and restricted fund balance reached \$740,593.

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**Condensed Statement of Revenues, Expenditures and
Changes in Fund Balances -Governmental Funds (condensed)**
Fiscal Years Ended June 30, 2017 and 2016

Revenues:	<u>2017</u>	<u>2016</u>
Total revenues - major governmental funds	\$ 13,294,152	\$ 13,198,166
Total revenues - other governmental funds	1,159,961	1,376,156
Combined total revenues	<u>14,454,113</u>	<u>14,574,322</u>
 Expenditures:		
Total expenditures - major governmental funds	12,206,617	13,910,451
Total expenditures - other governmental funds	1,299,797	1,307,118
Combined total expenditures	<u>13,506,414</u>	<u>15,217,569</u>
 Excess (deficiency) of revenues over (under) expenditures:	<u>947,699</u>	<u>(643,247)</u>
 Other financing sources (uses), net:		
Proceeds from issuance of bonds	-	1,010,000
Other financing sources, net	1,544,818	366,087
Other financing uses, net	(1,544,818)	(366,087)
Combined other financing sources, net	<u>-</u>	<u>1,010,000</u>
 Net increase (decrease) in fund balances	<u>947,699</u>	<u>366,753</u>
Fund balances at beginning of fiscal year	<u>14,997,451</u>	<u>14,630,698</u>
Fund balances at end of fiscal year	<u>\$ 15,945,150</u>	<u>\$ 14,997,451</u>

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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, 2017:

General fund (GF) – The total fund balance of the GF increased by \$598,088 during current fiscal year. Approximately 81% (\$9,207,453) of the GF's total revenues for the current fiscal year came from property, municipal license, construction excise taxes, and sales and use taxes, 14% (\$1,563,303) resulted from intergovernmental grants and contributions, and 5% (\$543,875) resulted from interests, charges for services, and miscellaneous revenues.

The largest expenses of the GF for the fiscal year ended June 30, 2017 were related to: (1) general administrating and operating costs (\$3,773,551), (2) construction, rehabilitation and preservation of new or existing housing, (\$2,343,122), which were classified as "urban and economic development, (3) public housing and welfare (\$663,005), (4) health and sanitation (\$1,094,978), (4) public safety (\$881,432), (6) culture, recreation and education (\$539,831), and capital outlays (\$783,490).

Capital projects fund (CPF) – The most significant transaction of this fund for the current fiscal year is related to capital outlays (\$460,138). The total fund balance of the CIBF increased by \$13,406 during current fiscal year. Total revenues, expenditures, and other financing sources (net), amounted to \$168,457, \$460,138, and \$305,087, respectively, for the fiscal year ended June 30, 2017.

Legislative joint resolutions fund (LJRF) – The most significant transactions of this fund for the current fiscal year are related to capital outlays (\$146,257) and intergovernmental grants and contributions revenues from the Legislature of the Commonwealth of Puerto Rico (\$144,846). Total revenues and expenditures amounted to \$146,257 and \$146,257, respectively, for the fiscal year ended June 30, 2017.

Debt service fund (DSF) – The total fund balance of the DSF decreased by \$108,722 during current fiscal year. Total revenues, expenditures, and other financing uses (net), amounted to \$1,137,006, \$990,466, and (\$255,262), respectively, for the fiscal year ended June 30, 2017. Approximately 33 percent (\$373,734) of DSF's total revenues for the current fiscal year came from restricted property taxes. All expenditures of the debt service fund were related to principal and interest expenditures on bonds payable amounting to \$990,466 during the current fiscal year.

Community development block grant fund (CDBGF) – The CDBGF's most significant transactions for the current fiscal year are related to program-specific capital grant revenues provided by the U.S. Department of Housing and Urban Development and capital outlays related to the acquisition or construction of major capital facilities, other assets and permanent improvements, incurred to develop viable communities and a suitable living environment and expanding economic opportunities, principally for persons of low and moderate income.

All CDBGF's revenues for the current fiscal year amounting to \$527,801 came from intergovernmental grants and contributions revenues from the U.S. Department of Housing and Urban Development. Approximately 89 percent (\$472,182) of CDBGF's total expenditures for the current fiscal year came from capital outlays. The total revenues of the community block grant fund decreased \$178,688 in comparison with the prior fiscal year, due to the decrease in the capital grants and contributions received.

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Other governmental funds (OGF) – The total fund balance of the OGF increased by \$444,927 during current fiscal year. Total revenues, expenditures, and other financing sources (net), amounted to \$1,159,961 and \$1,299,797, and \$584,763, respectively, for the fiscal year ended June 30, 2017.

One hundred percent (\$1,159,641) of OGF's total revenues for the current fiscal year came from intergovernmental grants and contributions. Approximately 6 percent (\$79,685) of OGF's total expenditures for the current fiscal year came from capital outlay, 78 percent (\$1,009,595) came from public housing and welfare, while 16 percent (\$210,517) came from general government, and urban and economic development.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

The Municipality has invested \$79,236,676 in capital assets used in governmental activities, which have an accumulated depreciation of \$51,429,523 at June 30, 2017. Capital assets decreased \$148,024 during the current fiscal year due to the excess of depreciation expense (\$2,089,776) over current fiscal year's additions (\$1,941,752), for the fiscal year ended June 30, 2017. The principal additions to capital assets for the current fiscal year were related to construction in progress (\$1,045,230), and infrastructure (\$746,791). The capital additions to infrastructure were principally related to major improvements of streets and roads and the construction of recreational areas.

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 basic 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, 2017, the Municipality's total bonded debt amounted to \$7,889,700, consisting of bonds payable. Such debt is backed by the full faith and credit of the Municipality. The following is a summary of the principal debt and long-term obligations activity for the fiscal year ended June 30, 2017:

- The estimated liability for municipal solid waste landfill closure and post-closure care costs increased by \$686,082 due to the current year provision of such amount debited to health and sanitation expenses.

We encourage readers to consider the information presented here in conjunction with more detailed long-term debt information furnished in Note 13 to the accompanying notes to the basic financial statements.

Government Development Bank for Puerto Rico (GDB)

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

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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, 2017. Accordingly, the accompanying financial statements do not include any adjustments or reserves over these balances at June 30, 2017.

CURRENTLY KNOWN FACTS

Failure to Implement Requirements of New Accounting Standard for Pensions

As disclosed in Note 15 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*

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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.
- 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.

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THE PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT

As more fully described in note 16, 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

The Municipality's financial statements are designed to present users (citizens, taxpayers, customers, investors and creditors) with a general overview of the Municipality's finances and to demonstrate the Municipality's accounting. Questions concerning any of the information provided in this report or requests for additional information should be addressed to: Municipality of Barranquitas, Department of Finance and Budget, P.O.P. Box 250, Barranquitas, Puerto Rico, 00794.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF BARRANQUITAS
Statement of Net Position
June 30, 2017

Assets		<u>Governmental activities</u>
Current assets:		
Cash in commercial banks		\$ 10,273,544
Accounts receivable, net of allowance for doubtful accounts:		
Property taxes	\$ 1,182,084	
Municipal license taxes	1,527	
Construction excise taxes	3,010	
Intergovernmental grants and contributions	1,416,772	
Total accounts receivable		2,603,393
Inventories and other current assets		43,587
Restricted assets:		
Cash in commercial banks	\$ 3,320,809	
Deposits with governmental bank	5,207,666	
Accrued interests on deposits	1,060	
Intergovernmental grants and contributions receivable	68,795	
Total restricted assets		<u>8,598,330</u>
Total current assets		<u>21,518,854</u>
Non-current assets:		
Capital assets, at cost:		
Depreciable capital assets	\$ 72,702,991	
Non-depreciable capital assets	6,533,685	
Total capital assets, at cost	79,236,676	
Less: accumulated depreciation and amortization	(51,429,523)	
Total capital assets, net		27,807,153
Other assets		<u>32,946</u>
Total non-current assets		<u>27,840,099</u>
Total assets		<u>\$ 49,358,953</u>

(Continued)

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

COMMONWEALTH OF PUERTO RICO
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Statement of Net Position
June 30, 2017

Liabilities and net position

		<u>Governmental activities</u>
Current liabilities (due within one year):		
Accounts payable and accrued liabilities	\$ 280,167	
Intergovernmental payables	<u>2,064,604</u>	
Total accounts payable and accrued liabilities		\$ 2,344,771
Liabilities related to restricted assets -		
accounts payable and accrued liabilities		384,674
Current portion of long term obligations:		
Bonds payable		607,700
Compensated absences		<u>879,560</u>
Total current liabilities		<u>4,216,705</u>
Non-current liabilities, excluding current portion (due in more than one year):		
Non-current portion of liabilities related to		
restricted assets - bonds payable		7,282,000
Compensated absences		627,725
Estimated liability for municipal solid waste landfill		
closure and post-closure care costs		<u>11,466,235</u>
Total non-current liabilities		<u>19,375,960</u>
Total liabilities		<u>23,592,665</u>
Deferred inflows of resources		<u>2,190,214</u>
Net position:		
Net investment in capital assets		<u>22,977,495</u>
Restricted for:		
Debt service		\$ 5,095,705
Unrestricted		<u>(4,497,126)</u>
Total net position		<u>\$ 23,576,074</u>

(Concluded)

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF BARRANQUITAS
Statement of Activities
Fiscal Year Ended June 30, 2017

<u>Function / programs</u>	<u>Expenses, including depreciation expense of \$2,089,776</u>	<u>Program revenues</u>			<u>Net revenues (expenses) and changes in net position</u>
		<u>Charges for services</u>	<u>Program- specific operating grants and contributions</u>	<u>Program- specific capital grants and contributions</u>	
<i>Governmental activities:</i>					
General government	\$ 4,282,601	-	150,045	-	\$ (4,132,556)
Public housing and welfare	1,822,818	-	1,009,595	-	(813,223)
Health and sanitation	1,852,311	-	-	-	(1,852,311)
Urban and economic development	3,604,837	261,702	527,801	896,731	(1,918,603)
Public safety	979,726	-	-	-	(979,726)
Culture, recreation and education	776,737	-	-	-	(776,737)
Interests on bonds payable	382,766	-	-	-	(382,766)
Total governmental activities	<u>\$ 13,701,796</u>	<u>261,702</u>	<u>1,687,441</u>	<u>896,731</u>	<u>\$ (10,855,922)</u>
General revenues:					
Taxes:					
Property taxes					\$ 8,122,931
Municipal license taxes					754,148
Construction excise taxes					109,635
Sales and usage taxes					594,473
Total tax revenues					<u>9,581,187</u>
Intergovernmental grants and contributions, not restricted to specific programs					1,535,873
Interests on deposits					203,614
Miscellaneous revenues					260,135
Total general revenues					<u>11,580,809</u>
Net increase in net position					<u>724,887</u>
Net position at beginning of fiscal year					<u>22,851,187</u>
Net position at end of fiscal year					<u>\$ 23,576,074</u>

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF BARRANQUITAS
Balance Sheet – Governmental Funds
June 30, 2017

Assets	Major governmental funds						Total governmental funds
	General fund	Capital projects fund	Legislative joint resolutions fund	Debt service fund	Community development block grant fund	Other governmental funds	
Cash in commercial banks	\$ 10,273,544	-	-	-	-	-	\$ 10,273,544
Accounts receivable, net of allowance for doubtful accounts:							
Property taxes	1,182,084	-	-	-	-	-	1,182,084
Municipal license taxes	1,527	-	-	-	-	-	1,527
Construction excise taxes	3,010	-	-	-	-	-	3,010
Intergovernmental grants and contributions	1,416,772	-	-	-	-	-	1,416,772
Due and advances from other funds	482,976	-	-	-	-	-	482,976
Restricted assets:							
Cash in commercial banks	-	-	1,150,501	935,109	36,842	1,198,357	3,320,809
Deposits with governmental bank	297,753	2,419,396	-	1,559,198	-	931,319	5,207,666
Accrued interests on deposits	-	75	-	985	-	-	1,060
Intergovernmental grants and contributions receivable	-	-	-	-	955	67,840	68,795
Total assets	\$ 13,657,666	2,419,471	1,150,501	2,495,292	37,797	2,197,516	\$ 21,958,243
Liabilities							
Accounts payable and accrued liabilities	\$ 280,167	-	-	-	-	-	\$ 280,167
Intergovernmental payables	1,531,609	-	-	-	-	532,995	2,064,604
Liabilities related to restricted assets:							
Accounts payable and accrued liabilities	-	43,728	146,257	194,689	-	-	384,674
Due and advances to other funds	-	-	129,121	245,666	37,797	70,392	482,976
Matured bonds due and payable	-	-	-	607,700	-	-	607,700
Total liabilities	1,811,776	43,728	275,378	1,048,055	37,797	603,387	3,820,121
Deferred inflows of resources	464,313	-	875,123	-	-	853,536	2,192,972
Fund balances							
Spendable:							
Assigned	925,391	-	-	-	-	-	925,391
Restricted for debt service payments	297,753	2,419,396	-	1,447,237	-	931,319	5,095,705
Unassigned	10,158,433	(43,653)	-	-	-	(190,726)	9,924,054
Total fund balances	11,381,577	2,375,743	-	1,447,237	-	740,593	15,945,150
Total liabilities, deferred inflows of resources and fund balances	\$ 13,657,666	2,419,471	1,150,501	2,495,292	37,797	2,197,516	\$ 21,958,243

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF BARRANQUITAS
Reconciliation of the Balance Sheet – Governmental Funds to the Statement of Net Position
June 30, 2017

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	\$ 15,945,150
Add (Deduct):	
Capital assets used in governmental activities are not considered available financial resources at fiscal year-end, therefore, are not reported in the governmental funds. This is the carrying amount of capital assets, net of accumulated depreciation and amortization of \$51,429,523 at June 30, 2017, which is reported in statement of net position.	27,807,153
Inventories and other assets recorded in the statement of net position are not considered available financial resources at fiscal year-end, therefore, are not reported as assets in the governmental funds.	76,533
The following liabilities are not due (mature) in the current fiscal year, therefore, are not reported in the governmental funds at June 30, 2017:	
Bonds payable	(7,282,000)
Compensated absences	(1,507,285)
Estimated liability for municipal solid waste landfill closure and post-closure care costs	(11,466,235)
Deferred inflows of resources	2,758
Net position-governmental activities, as reported in the statement of net position	\$ 23,576,074

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF BARRANQUITAS
Statement of Revenues, Expenditures and
Changes in Fund Balances – Governmental Funds
Fiscal Year Ended June 30, 2017

	Major governmental funds						Total governmental funds
	General fund	Capital projects fund	Legislative joint resolutions fund	Debt service fund	Community development block grant fund	Other governmental funds	
Revenues:							
Taxes:							
Property taxes	\$ 7,749,197	-	-	373,734	-	-	\$ 8,122,931
Municipal license taxes	754,148	-	-	-	-	-	754,148
Construction excise taxes	109,635	-	-	-	-	-	109,635
Sales and usage taxes	594,473	-	-	-	-	-	594,473
Total tax revenues	9,207,453	-	-	373,734	-	-	9,581,187
Intergovernmental grants and contributions	1,563,303	-	144,846	751,885	527,801	1,159,640	4,147,475
Charges for services	261,702	-	-	-	-	-	261,702
Interests on deposits	22,038	168,457	1,411	11,387	-	321	203,614
Miscellaneous revenues	260,135	-	-	-	-	-	260,135
Total revenues	11,314,631	168,457	146,257	1,137,006	527,801	1,159,961	14,454,113
Expenditures:							
Current:							
General government	3,773,551	-	-	-	-	132,642	3,906,193
Public housing and welfare	663,005	-	-	-	58,165	1,009,595	1,730,765
Health and sanitation	1,094,978	-	-	-	-	-	1,094,978
Urban and economic development	2,343,122	-	-	-	-	77,875	2,420,997
Public safety	881,432	-	-	-	-	-	881,432
Culture, recreation and education	539,831	-	-	-	-	-	539,831
Debt service:							
Principal	-	-	-	607,700	-	-	607,700
Interests	-	-	-	382,766	-	-	382,766
Capital outlays	783,490	460,138	146,257	-	472,182	79,685	1,941,752
Total expenditures	10,079,409	460,138	146,257	990,466	530,347	1,299,797	13,506,414
Revenues over (under) expenditures	1,235,222	(291,681)	-	146,540	(2,546)	(139,836)	947,699
Other financing sources (uses):							
Transfers from other funds	393,676	473,595	-	58,988	2,546	616,013	1,544,818
Transfers to other funds	(1,030,810)	(168,508)	-	(314,250)	-	(31,250)	(1,544,818)
Total other financing sources (uses), net	(637,134)	305,087	-	(255,262)	2,546	584,763	-
Net increase (decrease) in fund balances	598,088	13,406	-	(108,722)	-	444,927	947,699
Fund balances at beginning of fiscal year	10,783,489	2,362,337	-	1,555,959	-	295,666	14,997,451
Fund balances at end of fiscal year	\$ 11,381,577	2,375,743	-	1,447,237	-	740,593	\$ 15,945,150

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF BARRANQUITAS
Reconciliation of the Statement of Revenues, Expenditures and
Changes in Fund Balances – Governmental Funds to the Statement of Activities
Fiscal Year Ended June 30, 2017

The amounts of governmental activities reported in the accompanying statement of activities and the statement of revenues, expenditures and changes in fund balances - governmental funds, are different for the following reasons:

Total net increase in fund balances reported in the accompanying statement of revenues, expenditures and changes in fund balances – governmental funds	\$ 947,699
Add (Deduct):	
Net change in deferred inflows of intergovernmental grants and contributions	(27,430)
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 and amortization expense. This is the amount by which depreciation and amortization expense (\$2,089,776) exceeded capital outlays expenditures (\$1,941,752) for the fiscal year ended June 30, 2017.	(148,024)
Repayment of principal of long-term liabilities is reported as an expenditure in the governmental funds, however, the repayment reduces bonds payable in the statement of net position.	607,700
The following changes in assets and liabilities 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:	
Other assets	(8,368)
Estimated liability for municipal solid waste landfill closure and post-closure care costs	(686,082)
Accrued compensated absences	<u>39,392</u>
Net decrease in net position, as reported in the accompanying statement of activities	<u>\$ 724,887</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF BARRANQUITAS
Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2017

1. Background Information and Summary of Significant Accounting Policies

The Municipality of Barranquitas (the Municipality) is a local municipal government constituted in 1970 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 public housing, welfare, public safety, health, sanitation, education, culture, recreation, education, urban development, economic development, and many other fiscal, general and administrative services.

a) Financial Reporting Model

The accompanying basic financial statements present the financial position and the results of operations of the Municipality as a whole, and its various governmental funds as of and for the fiscal year ended June 30, 2017, in conformity with accounting principles generally accepted in the United States of America (GAAP), as prescribed by the Governmental Accounting Standards Board (GASB).

According to the financial reporting model established by GASB Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments* (GASB No. 34), the required basic financial statement presentation applicable to the Municipality is composed of the following elements: (1) government-wide financial statements (GWFS), (2) governmental fund financial statements (GFFS), (3) notes to basic financial statements, and (4) required supplementary information (RSI).

RSI, consisting of a Management's Discussion and Analysis (MD&A), is information presented along with, but separate from, 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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF BARRANQUITAS
Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2017

ended June 30, 2017, 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, 2016, the Municipality adopted the provision of GASB Statement No. 77, *Tax Abatement Disclosures*. This Statement requires governments that enter into tax abatement agreements to disclose the tax being abated, the authority under which tax abatements are provided, eligibility criteria, the mechanism by which taxes are abated, provisions for recapturing abated taxes, and the types of commitments made by tax abatement recipients.

b) Financial Reporting Entity

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, as prescribed by Act No. 81.

The Municipality's management has considered all potential component units (whether governmental, not-for-profit, or profit-oriented) for which it may be financially accountable and other legally separate organizations for which the nature and significance of their relationship with the Municipality may be such that exclusion of their basic financial statements from those of the Municipality would cause the Municipality's basic financial statements to be misleading or incomplete.

GASB Statement No. 14, *The Financial Reporting Entity* (GASB No. 14), as amended, has set forth criteria to be considered in determining financial accountability for financial reporting purposes. These criteria include appointing a voting majority of an organization's governing body and: (1) the ability of the Municipality to impose its will on that organization or (2) the potential for the organization to provide specific financial benefits to, or impose specific financial burdens on, the Municipality.

On July 1, 2003, the Municipality adopted the provisions of GASB Statement No. 39, *Determining Whether Certain Organizations are Component Units – an Amendment of GASB Statement No. 14* (GASB No. 39). GASB No. 39 states that certain organizations for which a primary government is not financially accountable nevertheless warrant inclusion as part of the financial reporting entity because of the nature and significance of their relationship with the primary government, including their ongoing financial support of the primary government and its other component units.

According to GASB No. 39, a legally separate, tax-exempt organization should be reported as a discretely presented component unit of a reporting entity if all of the following criteria are met:

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF BARRANQUITAS
Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2017

- The economic resources received or held by the separate organization are entirely or almost entirely for the direct benefit of the primary government, its component units, or its constituents.
- The primary government, or its component units, is entitled to, or has the ability to otherwise access, a majority of the economic resources received or held by the separate organization.
- The economic resources received or held by an individual organization that the specific primary government, or its component units, is entitled to, or has the ability to otherwise access, are significant to that primary government.

In addition, GASB No. 39 states that other organizations should be evaluated as potential component units if they are closely related to, or financially integrated with, the primary government. Such types of entities may be presented as either blended or discretely presented component units, depending upon how they meet the criteria for each specified in GASB No. 14.

On July 1, 2011, the Municipality adopted the provisions of GASB Statement No. 61, *The Financial Reporting Entity: Omnibus-an amended of GASB Statement No. 14 and No. 34* (GASB No. 61). GASB No. 61 modified certain requirements for inclusion of component units in the financial reporting entity.

The Municipality's management has concluded that, based on the aforementioned criteria, there are no legally separate entities or organizations that should be reported as component units of the Municipality for the fiscal year ended June 30, 2017.

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 BARRANQUITAS
Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2017

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 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 items reported as "net position" (equity) and or net liabilities. 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, net of related debt** – This net position category consists of capital assets, net of accumulated depreciation and amortization, reduced by the outstanding balances of bonds payable and other debts that are attributed to the acquisition, construction or improvement of those assets (capital-related debt). For the purposes of determining the outstanding debt attributed to capital assets, the total long-term debt related to the acquisition, construction or improvement of capital assets has been reduced by any related unspent debt proceeds and any related unamortized debt issuance costs.

COMMONWEALTH OF PUERTO RICO
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Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2017

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.

- **Restricted net position** – This net position category consists of net resources 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. 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.

COMMONWEALTH OF PUERTO RICO
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Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2017

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 as of June 30, 2017:

Debt service – Represent net resources available to cover future debt service payments of bonds payable.

- **Unrestricted** – This category consists of the excess of assets over related liabilities and deferred inflows of resources that are neither externally nor legally restricted, neither invested in capital assets. At June 30, 2017, this category has a negative balance of \$4,497,126 because liabilities and deferred inflows of resources exceeded the related assets. 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, 2017, 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, 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:

General government:
Municipal legislature
Mayor's office

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Fiscal Year Ended June 30, 2017

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

Public safety:

Department of emergency management
Department of municipal police

Health and sanitation:

Department of recycling and environmental
control

Culture, recreation and education:

Department of recreation and sports
Department of culture and tourism

Public housing and welfare:

Department of elderly services
Department of service to citizens

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, 2017:

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MUNICIPALITY OF BARRANQUITAS
Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2017

- **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 interest on deposits, 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 activities (revenues, expenditures and other financing sources/uses among governmental 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.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF BARRANQUITAS
Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2017

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

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

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. 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 modified the interpretations of certain terms within the definition of the special revenue funds and the types of activities the Municipality may choose to report in those funds. GASB 54 also clarified the capital projects fund type definition

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF BARRANQUITAS
Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2017

for better alignment with the needs of preparers and users. Definitions of other governmental fund types also were also modified for clarity and consistency.

Pursuant to the provisions set forth by GASB 54, the Municipality reported the following governmental funds in the accompanying GFFS:

- **General fund** – The general fund is the Municipality’s main operating fund and a major governmental fund, as defined below, used to account for all financial resources and governmental activities, 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.

- **Debt service fund** – The debt service fund is a major governmental fund, as defined below, 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, 2017, 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 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.

- **Special revenue funds** – The special revenue funds are non-major governmental funds, as defined below, used by the Municipality to account for revenues derived from grants, contributions or other revenue sources that are either self-restricted by the Municipality or legally restricted by outside parties for use in specific purposes (except for revenues that are earmarked for expenditures in major capital projects which are accounted for in the capital projects fund). 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.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF BARRANQUITAS
Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2017

- ***Capital projects funds*** – Capital projects funds are major and non-major governmental funds, as defined below, used to account for the financial resources used for the acquisition, construction or improvement of major capital facilities and other 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 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, liabilities, revenues or expenditures of that individual governmental fund are at least ten percent (10%) of the corresponding element total (assets, liabilities, revenues or expenditures) for all governmental funds. For the purposes of applying the aforementioned major fund criteria, no eliminations of 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 these purposes mean all expenditures, including operating and non-operating expenditures, except for other financing uses.

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 and the community development block grant 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 debt service fund, (3) the capital projects fund, (4) the legislative joint resolutions fund, and (5) the community development block grant fund.

The capital projects fund is a major governmental fund in the GFFS used to account for the financial resources arising mainly from bond issuance proceeds used in the acquisition or

COMMONWEALTH OF PUERTO RICO
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Notes to Basic Financial Statements
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construction of major capital facilities, other assets and permanent improvements. The most significant transactions of this fund are related to capital outlays and proceeds from issuance of bonds.

The legislative joint resolutions fund is a major capital project 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 most significant transactions of this fund are related to capital outlays and intergovernmental grants and contributions revenues.

The community development block grant 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 U.S. Department of Housing and Urban Development, which are principally used in the acquisition or construction of major capital facilities, other assets and permanent improvements. The most significant transactions of this fund are related to grant revenues and capital outlays incurred to develop viable communities and a suitable living environment and expanding economic opportunities, principally for persons of low and moderate income.

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 improvement bond issues outstanding have been reported as a single major capital projects fund.
- Numerous less significant capital project and special revenue funds have been combined into single capital projects funds and special revenue funds, respectively.
- 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.

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e) Measurement focus and Basis of Accounting

Government-wide financial statements – The accompanying GWFS are prepared using the economic resources measurement focus and the accrual basis of accounting. Subject to the additional rules and limitations detailed below, revenues (including interest on deposits and investments) 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.

In the case of imposed non-exchange revenue transactions (such as property taxes and municipal license 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.

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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 to better identify the relationship between the GWFS and the GFFS.

Governmental funds 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, 2017, 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, 2017.

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The principal revenue sources considered susceptible to accrual include property taxes, intergovernmental grants and contributions, interest 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 tax receivables are also generally recorded in the fiscal year when an enforceable legal claim has arisen while property tax and municipal license tax revenues (net of amounts considered not collectible) are also generally recorded in the fiscal year when resources are required to be used or the first fiscal year that the use of the resources is permitted. Receivables and revenues from 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, 2017.

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

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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 payable are recorded when they mature (when payment is due), except for principal and interest of bonds due on July 1, 2017, which are recorded as governmental fund liabilities of the debt service fund at June 30, 2017 which is the date when resources were available in the debt service fund.
- Compensated absences, and the estimated liability for municipal solid waste landfill closure and post-closure care costs 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.

f) 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.

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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.

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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.

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, 2017. 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, 2017, 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 at P.O. Box 250, Barranquitas, Puerto Rico 00794.

g) Unrestricted and Restricted Deposits

The Municipality's deposits at June 30, 2017 are composed of: (1) demand deposits in commercial banks and (2) demand deposits in the Government Development Bank for Puerto Rico (GDB), governmental bank.

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Cash in commercial banks of \$10,273,544 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 to 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 in the debt service fund consists principally of property tax collections amounting to \$935,109 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 \$2,419,396 that are restricted for the acquisition, construction or improvements of major capital assets.

Restricted cash in commercial banks in the legislative joint resolutions fund consists of unspent program-specific grants and contributions amounting to \$1,150,501 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 \$1,198,357, represents the balance of non-interest bearing accounts restricted to finance the operations of various federal and state funded grant programs.

h) Unrestricted and Restricted Accounts and Notes Receivable

Receivables consist of all revenues earned but not collected at June 30, 2017. These accounts receivables are stated net of estimated allowances for uncollectible accounts, which are determined based upon past collection experience, historical trends, current economic conditions and the periodic aging of accounts receivable.

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

On July 1, 2007, the Municipality adopted the provisions of GASB Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future*

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Revenues (GASB No. 48). This Statement establishes standards for the measurement, recognition, and display of transactions where governments exchange an interest in their expected cash flows from collecting specific receivables or specific future revenues for immediate cash payments, generally, a single lump sum. GASB No. 48 provides technical guidance to determine whether this type of transaction should be regarded as a sale or as a collateralized borrowing resulting in a liability. This criteria is used to determine the extent to which a transferor government either retains or relinquishes control over the receivables or future revenues through its continuing involvement with those receivables or future revenues. Accordingly, GASB No. 48 establishes that 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 change statements. If it is determined that a transaction involving future revenues should be reported as a sale, the revenue should be deferred and amortized, except when specific criteria are met. This Statement also provides additional guidance for sales of receivables and future revenues within the same financial reporting entity.

GASB No. 48 also provides guidance to be used for recognizing other assets and liabilities arising from a sale of specific receivables or future revenues, including residual interests and recourse provisions. 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, 2017; therefore, the adoption of GASB No. 48 had no effect in the accompanying basic financial statements.

i) Inventories and Other Current Assets

Inventories consist principally of construction materials and inventories of office supplies, food and medicines, which are held for consumption. Other current assets consist of prepaid costs. Generally, inventories are capitalized and stated at cost using the first-in, first-out method (FIFO) in the GWFS. Inventories and prepaid expenses in the GFFS are generally recorded as expenditures (purchase method) when purchased (paid) rather than capitalized as an asset.

j) Capital Assets

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

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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, 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, 2002 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, 2002 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 and amortization expense is recorded only in the government-wide statement of activities. However, there is no depreciation or amortization recorded for land and construction in progress. Depreciable capital assets are generally depreciated or amortized over their estimated useful lives under the straight-line method, except for machinery and equipment held under capital leases which is depreciated over the shorter of its estimated useful life or the lease term. The estimated useful lives of major capital asset categories are:

	<u>Years</u>
Land improvements	20
Buildings, structures and building improvements	30 to 50
Infrastructure	20 to 50
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 and amortization expense of capital assets is recorded as a direct expense of the function/program specifically identified with the asset. Depreciation and amortization of

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infrastructure is not allocated to various functions/programs but reported as direct expenses of the urban and economic development function.

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, 2017 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.

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, 2017 and (2) is not 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.

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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 include the Municipality's bonds payable, notes payable, obligations under capital leases, accrued compensated absences, and estimated liabilities for municipal solid waste landfill closure and post-closure care costs.

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, 2017 are recorded as governmental fund liabilities in the GFFS (debt service fund) when resources are available in the debt service fund (June 30, 2017). In the GFFS, the face amount of debt issued (gross debt reported) is reported as other financing sources when issued.

n) Municipal Solid Waste Landfill Closure and Post-Closure Care Costs

Solid waste landfill closure and post-closure maintenance care costs are accounted for following the provisions of GASB Statement No. 18, *Accounting for Municipal Solid Waste Landfill Closure and Post-closure Care Costs* (GASB No. 18). Pursuant to the "Solid Waste Disposal Criteria", issued by the U.S. Environmental Agency on October 9, 1991, and according to GASB No. 18, the estimated liability for solid waste landfill closure and post-closure care costs (cost of equipment expected to be installed or constructed, the cost of the final cover (capping), and the costs of monitoring and maintenance) include an estimate of all costs to be incurred near or after the close of the Municipality's solid waste landfill under the accrual basis of accounting. In addition to operating expenses related to the current activities of the landfill, an expense provision and related liability are being recognized based on future closure and post-closure care costs that will be incurred during operation and will continue after the date the landfill no longer accepts waste.

In the accompanying government-wide statement of net position, this liability is recognized over the useful life of the landfill, even though such costs will only be incurred, by definition,

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near or after the close of the landfill. The estimates of closing and post-closing care costs are made using current costs (costs that would be incurred if the closing date of the landfill would have been June 30, 2017). The liability is adjusted annually to reflect the effects of inflation, advances in technology, changes in regulations or similar changes.

At the governmental funds' level, landfill closure and post-closure care costs are recorded in the statement of revenues, expenditures and changes in fund balances – governmental funds as expenditures in the accounting period in which the liability is incurred.

o) 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.

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.

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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, 2017. 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.

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.

Pursuant to the provisions of GASB 54, the accompanying GFFS report fund balance amounts that are considered non-spendable since are net resources that cannot be spent readily with cash or are legally or contractually required not to be spent. At June 30, 2017, such fund balances are related to long-term inter-fund loans receivable from the Public Assistance Program fund recorded in the general fund.

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

- a. 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

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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 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.
- b. 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 executive orders or budgetary encumbrances approved by the Mayor). The Municipal Legislature delegates the Mayor the authority to establish fund balance assignments.

At June 30, 2017 assigned fund balances in the general fund consist of fund balances reserved for encumbrances amounting to \$925,391.

- 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, 2017. 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.

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, 2017.

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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 governmental funds among general, debt service, special revenue and capital project 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, 2017 have not been affected for this change in accounting principle.

q) *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. 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

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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, 2017.

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, 2017, there were no transfers from Level 2 to other categories.

The following methods and assumptions were used to estimate the fair values of the most significant financial instruments at June 30, 2017. There have been no changes in valuation methods.

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- 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, 2017 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, 2017.

r) 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

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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.

s) ***Direct Charges***

Pursuant to and determined by an internal cost allocation plan, certain costs initially are charged to the general fund and then billed as direct charges to other funds. Revenues from these charges are accounted for in the government-wide statement of activities as general government and in the statement of revenues, expenditures and changes in fund balances as charges for services in the general fund. The corresponding expenses appear as function/program costs in the Statement of Activities.

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

Accounting Standards Issued But Not Yet Adopted

- a. 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.

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- b. 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.
- c. 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.
- d. GASB Statement No. 84, *Fiduciary Activities*, was issued in January 2017. The requirements of this Statement are effective for reporting periods beginning after December 15, 2018.
- e. GASB Statement No. 85, *Omnibus 2017*, was issued in March 2017. The requirements of this Statement are effective for reporting periods beginning after June 15, 2017.
- f. GASB Statement No. 86, *Certain Debt Extinguishment Issues*, was issued in May 2017. The requirements of this Statement are effective for reporting periods beginning after June 15, 2017.
- g. GASB Statement No. 87, *Leases*, was issued in June 2017. The requirements of this Statement are effective for reporting periods beginning after December 15, 2019.
- h. GASB Statement No. 88, *Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements*, was issued in April 2018. The requirements of this Statement are effective for reporting periods beginning after June 15, 2018.

2. Cash 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.

At June 30, 2017, the carrying amounts of the Municipality's deposits in commercial banks is as follows:

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	Major governmental funds						Total
	General fund	Capital projects fund	Legislative joint resolutions fund	Debt service fund	Community development block grant fund	Other governmental funds	
Unrestricted:							
Cash in commercial banks	\$ 10,273,544	-	-	-	-	-	\$ 10,273,544
Restricted:							
Cash in commercial banks	-	-	1,150,501	935,109	36,842	1,198,357	3,320,809
Total carrying amount of deposits in commercial banks	\$ 10,273,544	-	1,150,501	935,109	36,842	1,198,357	\$ 13,594,353

Unrestricted deposits of \$10,273,544 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 \$1,150,501 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 collections amounting to \$935,109 that are available for the debt service payments of bonds and certain general obligations notes.

Restricted cash in the community development block grant fund amounting \$36,842 consists of intergovernmental operating grants contributions received from the federal government of the United States of America that are available for the operations of several operating grant programs.

Restricted cash in other governmental funds amounting \$1,198,357 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. Restricted 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 originally created to aid the Government of Puerto Rico on its fiscal duties and more efficiently carry out its responsibility to develop the economy of Puerto Rico. Over decades, GDB evolved and its role expanded to include, among other services, acting as fiscal agent, paying agent, 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. GDB became a financing backstop for fiscal losses of the Government and the municipalities of Puerto Rico.

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GDB was also called upon to provide financial support during periods of financial distress, leveraging its strong credit rating, reputation, access to the capital markets and its constructive relationship with the investment community, to provide financial support to troubled public entities and assist them in regaining financial stability.

For a variety of reasons, several years ago GDB came to find itself immersed in a fiscal and viability crisis. In April 2016, the Governor of the Commonwealth imposed on GDB certain emergency operational restrictions, including restrictions on the withdrawal and transfer of deposits from GDB, 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, based on GDB's need for additional sources of liquidity.

In early 2017, the Puerto Rico Fiscal Agency and Financial Advisory Authority (AAFAF) was created to assume the roles of the fiscal agent, financial advisor and disclosure agent for the Government.

On May 15, 2017, AAFAF and GDB announced a *Restructuring Support Agreement (RSA)* with certain of GDB's financial creditors. On June 19, 2017, AAFAF and GDB announced that parties representing over fifty percent (50%) of GDB's Participating Bond Claims, as defined in the RSA, had signed the RSA.

On August 24, 2017, Act No. 109, known as *GDB Restructuring Act*, was enacted. to establish the legal framework for the transactions contemplated by, or in furtherance of, the Restructuring Support Agreement dated May 17, 2017 and certified by the Oversight Board as a Qualifying Modification under Section 601(g)(2)(A) of PROMESA, as the same may be amended from time to time in accordance with its terms.

On March 27, 2018, the GDB publically released the Fourth Amendment (the "Fourth Amendment") to the RSA, dated May 15, 2017, by and among GDB, AAFAF, and the Supporting Bondholders party thereto. The draft Fourth Amendment is said to be currently supported by the GDB, AAFAF, and a portion of the creditors to the RSA.

Under the Fourth Amendment, the principal amount of any bond, note and/or loan of any municipality of Puerto Rico held by GDB shall be automatically reduced by an amount equal to the balance of proceeds of such bond, note and/or loan that were not disbursed to such municipality and were held on deposit at GDB. Any remaining municipal deposits held at GDB shall be reduced on a dollar-for-dollar basis, from the outstanding principal amount of any corresponding bond, note and/or loan relative to the type of corresponding deposit. The remaining balances of the municipal loans shall be those certified by AAFAF, and all future payments of interest on such bonds, notes and/or loans shall be computed based on such balances.

GDB's operational wind down was completed on March 23, 2018, with all fundamental operations having ceased or transferred to other entities (i.e. AAFAF, EDB, etc.) and workforce restructuring completed with minimal "at will" staffing needed to conclude legal and operational matters through fiscal year 2019.

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At June 30, 2017, the carrying amounts of the Municipality’s uninsured and uncollateralized restricted deposits with GDB as follows:

	Carrying Amounts of Deposits				Total
	General fund	Debt service fund	Capital projects fund	Other governmental funds	
Restricted deposits in GDB:	\$ 297,753	\$ 1,559,198	\$ 2,419,396	\$ 931,319	\$ 5,207,666

Restricted deposits in the general fund include \$297,753 that were originally intended 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. Pursuant to the terms and conditions of the amended RSA referred to above, these formerly unrestricted deposits and all other restricted deposits described below became restricted for the payment of the outstanding balance of any bond, note and/or loan of the Municipality held at GDB as previously described.

Restricted deposits in the debt service fund consist of unspent property tax and sales and usage tax collections amounting to \$935,109 and \$1,559,198 , respectively, that are available for the debt service payments of bonds and certain general obligations notes.

Restricted deposits in the capital projects fund to \$2,419,396 consist of unspent bonds and notes proceeds that were previously restricted for the acquisition, construction or improvements of major capital assets financed with public debt.

Restricted deposits in other governmental funds of \$931,319 consist of intergovernmental capital and operating grants and contributions from the Commonwealth that were previously mainly restricted for general infrastructure projects.

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 Barranquitas. 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, 2017, 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

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(generally 5 business days after April 15), a 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 \$461,857 at June 30, 2017.

Municipal license tax revenues amounted to \$754,148 for the fiscal year ended June 30, 2017, which has been recorded in the general fund since is available for general operating purposes.

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 estimated market prices).

Personal property taxes is a derived tax 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, 2017 was 8.53 percent (of which taxpayers pay 8.33 percent and the remaining 0.20 percent is paid by the Commonwealth, as a subsidy).

Real property taxes are assessed every January 1 (lien; levy date) and are 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, 2017 was 10.53 percent (of which 10.33 percent is paid by taxpayers and the remaining 0.20 percent is also paid by the Commonwealth, 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 Commonwealth pays 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.

Included within the total personal and real property tax rates, there is a portion of the tax rate in the amount of 3.50 percent that is restricted for the Municipality's debt service requirements on bonds and certain notes. Such amounts are recorded in the Municipality's debt service fund.

The Municipal Revenue Collection Center (CRIM, by its Spanish acronym) is a governmental entity independent from the Municipality and other governmental entities in Puerto Rico that is responsible of administering the Puerto Rico Municipal Property Tax Law on behalf of the municipalities of Puerto Rico. CRIM has the responsibility of imposing and collecting property taxes on behalf of the Municipality CRIM is composed of a Board of Governors and a management team leader by an Executive Director. The Board of

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Governors is composed of nine (9) mayors representing the seventy-eight (78) municipal governments of Puerto Rico and the President of the Government Development Bank for Puerto Rico and the Commissioner of Municipal Affairs as representatives of the GDB.

On November 2, 2015, the Government Development Bank for Puerto Rico (GDB), in its capacity as fiscal agent for the municipalities, established an irrevocable trust with CRIM in which property tax collections shall be deposited in the name and for the benefit of all the municipalities of Puerto Rico pursuant to Article 4 of Public Act No. 80 of August 30, 1991, as amended.

The initial transfer to the trust consisted of property taxes collected by CRIM on behalf of all municipalities through November 2, 2015 amounting to approximately \$445 million, of which \$290 million were deposited in GDB and \$155 million were deposited in a commercial bank. Both banking institutions are co-authorized to render the fiduciary services, which include, among other things, the custody, management and investing of such municipal funds. In addition, both banks are bounded to keep those financial resources separated from any other deposits for the sole benefit of the municipalities.

The funds held in trust shall be invested in U.S. Treasury Bills, U.S. Treasury Notes, and certificates of deposits and other interest-bearing account of qualifying authorized banks pursuant to the Trust Investment Policy approved on October 29, 2015.

As more fully described in Note 20, on March 13, 2017, the Puerto Rico Fiscal Agency and Financial Advisory Authority (“AAFAF”) submitted the Fiscal Plan for Puerto Rico for the review and subsequent approval of the Puerto Rico Oversight Board (“PROB”) pursuant to the provisions of *The Puerto Rico Oversight, Management, and Economic Stability Act*, Pub. Law 114-187 (“PROMESA”).

On April 24, 2018, the Puerto Rico Oversight Board (PROB) delivered the compliance certification for the New Commonwealth Fiscal Plan pursuant to Section 201(e)(2) of PROMESA. The New Commonwealth Fiscal Plan states that to incentivize municipal operational changes, the Commonwealth must reduce the current level of municipal subsidies to all municipalities in Puerto Rico. In fiscal year 2018, the total municipal appropriation was reduced by \$175 million, bringing the new baseline appropriations to \$220 million per year. Going forward from this current baseline, there must be a reduction of 20% in each successive year, holding appropriations constant at 80% of current levels starting in fiscal year 2022 before ultimately phasing out all subsidies in fiscal year 2024. The estimated impact of this reduction of the appropriation in the Municipality for fiscal year 2018 amounts to approximately \$1 million.

At June 30, 2017, property taxes receivable recorded in the general fund amounted to \$1,182,084.

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

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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 from one point five percent (1.5%) to one point zero percent (1.0%) for all municipalities of Puerto Rico. Simultaneously, Act No.19 created the Municipal Finance Corporation (MFC), a subsidiary 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 that are payable from or backed by the municipal sales and use taxes effective July 1,2014.

In order to mitigate the effects of the reductions in the municipal sales and use tax rate referred to above, Act No. 18 established the mechanisms to protect the financial stability of the municipal governments of Puerto Rico by allowing the municipalities to continue receiving the economic benefits lost as a consequence of the reduction in the statutory municipal sales and use 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 use 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, commencing on July 1, 2014, the Commonwealth of Puerto Rico shall make advances from the collections arising from the zero point five percent (0.5%) of the state sales and usage taxes to the MAF of each municipality. The advances shall be made and distributed to the municipalities 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 shall be available to cover general operating expenses of the General Fund of each municipality.
- ii.* Forty percent (40%) of the of the amounts transferred shall be 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 shall be available and restricted in the capital improvements bond fund to finance the acquisition, construction and improvement of major capital assets.

Sales and usage tax revenues recorded in the general fund amounted to \$594,473 for the fiscal year ended June 30, 2017.

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.

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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. 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 revenue amounted to \$109,635 for the fiscal year ended June 30, 2017, which has been recorded in the general fund since is available for general operating purposes.

8. Intergovernmental Receivables

Intergovernmental receivables recorded in the accompanying GWFS and GFFS are as follows at June 30, 2017:

	<u>Major governmental funds</u>			Total
	General fund	Community development block grant fund	Other governmental funds	
<u>Intergovernmental receivables:</u>				
<i>Intergovernmental grants and contributions:</i>				
Puerto Rico Electric Power Authority - Contributions in lieu of municipal taxes	\$ 1,416,772	-	-	\$ 1,416,772
Puerto Rico Department of Education - Schools maintenance and capital improvements program	-	-	67,840	67,840
U.S. Department of Housing and Urban Development- SBGP Block Grant	-	955	-	955
Total intergovernmental receivables	<u>\$ 1,416,772</u>	<u>955</u>	<u>67,840</u>	<u>\$ 1,485,567</u>

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9. Inter-fund Transactions

The composition of inter-fund balances and transactions at June 30, 2017 and for the fiscal year then ended is as follows:

	Due/advances from other governmental funds- General fund
<i>Major governmental funds:</i>	
Legislative joint resolutions fund	129,121
Debt service fund	245,666
Community development block grant fund	37,797
<i>Other governmental funds</i>	
Total	\$ 482,976

Transfers from other governmental funds:

	General fund	Total governmental funds
<u>Transfers to other governmental funds:</u>		
General fund	\$ 1,030,810	\$ 1,030,810
Capital projects fund	168,508	168,508
Debt service fund	314,250	314,250
Other governmental funds	31,250	31,250
Total	\$ 1,544,818	\$ 1,544,818

Inter-fund receivables and payables represent the pending settlements of the aforementioned transfers, which are considered by management to be fully realizable at June 30, 2017.

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

- Recognize in the general fund the outstanding balance of \$482,976 of short-term and long-term loans granted to other governmental funds.
- Recognize the outstanding balance of short-term loans amounting to \$129,121 granted by the general fund to the legislative joint resolutions fund to temporarily finance the acquisition, construction and improvement of various major capital assets.
- Recognize the outstanding balance of short-term loans amounting to \$245,666 granted by the general fund to the debt service fund.

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- Recognize the outstanding balance of short-term loans amounting to \$70,392 granted by the general fund to other governmental funds to finance the operation of several state and federally-funded programs.
- Recognize the outstanding balance of short-term loans amounting to \$37,797 granted by the general fund to the community development block grant fund to temporarily finance the operation of several federally funded programs.

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

- Make a non-routine residual equity transfer amounting to \$31,250 from the public order code fund (reported within other governmental funds) to the general fund.
- Make a routine transfer of interest income amounting to \$168,508 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 \$314,250 from the debt service fund to the general fund.

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10. Capital Assets

Capital assets activity for the fiscal year ended June 30, 2017:

	Balance at beginning of fiscal year, as restated	Additions/ depreciation expense	Balance at end of fiscal year
<i>Governmental activities:</i>			
<i>Cost basis:</i>			
Capital assets, not being depreciated:			
Land	\$ 2,899,500	-	\$ 2,899,500
Construction in progress	2,588,955	1,045,230	3,634,185
Total capital assets not being depreciated/amortized	<u>5,488,455</u>	<u>1,045,230</u>	<u>6,533,685</u>
Capital assets, being depreciated:			
Land improvements	2,981,855	-	2,981,855
Buildings, structures, and improvements	50,474,033	-	50,474,033
Infrastructure	8,008,546	746,791	8,755,337
Machinery and equipment, and furniture and fixtures	4,285,018	149,731	4,434,749
Licensed vehicles	6,057,017	-	6,057,017
Total capital assets, being depreciated	<u>71,806,469</u>	<u>896,522</u>	<u>72,702,991</u>
Total cost basis of capital assets	<u>77,294,924</u>	<u>1,941,752</u>	<u>79,236,676</u>
<i>Accumulated depreciation and amortization:</i>			
Land improvements	2,981,855	64,298	3,046,153
Buildings, structures, and improvements	35,004,941	299,787	35,304,728
Infrastructure	3,361,931	1,178,056	4,539,987
Machinery and equipment, and furniture and fixtures	3,673,708	243,365	3,917,073
Licensed vehicles	4,317,312	304,270	4,621,582
Total accumulated depreciation and amortization	<u>49,339,747</u>	<u>2,089,776</u>	<u>51,429,523</u>
Net capital assets	<u>\$ 27,955,177</u>	<u>(148,024)</u>	<u>\$ 27,807,153</u>

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Depreciation and amortization expense was charged to functions in the accompanying government -wide statement of activities as follows for the fiscal year ended June 30, 2017:

General government	\$ 387,671
Public housing and welfare	93,173
Health and sanitation	75,347
Urban and economic development	1,186,698
Public safety	100,971
Culture, recreation and education	245,916
Total depreciation and amortization expense	\$ 2,089,776

11. INTERGOVERNMENTAL PAYABLES

Intergovernmental payables at year-end are as follows:

Puerto Rico Electric Power Authority	\$ 1,398,692
U. S. Department of Homeland Security	\$ 532,995
Puerto Rico Aqueduct and Sewer Authority	129,032
Puerto Rico General Services Administration	3,885
Total intergovernmental payables	\$ 2,064,604

Intergovernmental payables to the Puerto Rico Electric Power Authority (PREPA) of \$1,398,692 consist of unpaid energy consumption, to be applied to the contributions in lieu of taxes of \$1,432,308 million. Every fiscal year, PREPA shall distribute from its surplus a contribution in lieu of taxes (CILT) to all municipalities of Puerto Rico in exchange of full municipal tax exemption pursuant to the provisions of Act No. 57 of May 27, 2014, as amended.

The maximum amount or cap of the CILT has been established by computing the average energy consumption of municipalities, on an annual kilowatt-hour basis, for the three years of highest consumption since the change in the formula in 2004 up to 2014. Of this maximum amount or cap, the municipalities were required to reduce five percent (5%) annually during the fiscal years ended June 30, 2015 through 2017, until a reduction of at least fifteen percent (15%) of the maximum consumption amount or cap is achieved.

Any consumption in excess of the maximum amount or cap established as contribution by virtue of the CILT shall be billed to the municipality by PREPA for collection. PREPA also bills the Municipality for the energy consumption of all municipal revenue-generating properties, which are excluded from the annual CILT.

The maximum amount or cap of the CILT has been established by computing the average energy consumption of municipalities, on an annual kilowatt-hour basis, for the three years of highest consumption since the change in the formula in 2004 up to 2014. Of this maximum amount or cap, the

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municipalities were required to reduce five percent (5%) annually during the fiscal years ended June 30, 2015 through 2017, until a reduction of at least fifteen percent (15%) of the maximum consumption amount or cap is achieved.

Any consumption in excess of the maximum amount or cap established as contribution by virtue of the CILT shall be billed to the municipality by PREPA for collection. PREPA also bills the Municipality for the energy consumption of all municipal revenue-generating properties, which are excluded from the annual CILT.

Intergovernmental payables to the Puerto Rico Aqueduct and Sewer Authority of \$129,032 consist of the unpaid water and sewer utility consumption.

Intergovernmental payables to the U. S. Department of Homeland Security represents reimbursable grant funds to the Federal Emergency Management Agency under the Public Assistance Grant Program as a result of the Fourth Amendment to the RSA of GDB (Notes 3 and 19).

Intergovernmental payables to the Puerto Rico General Services Administration consist of unpaid billings of vehicles fuel and supplies.

12. Deferred Inflows of Resources

At June 30, 2017, 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>Legislative joint resolutions fund</u>	<u>Other governmental funds</u>	<u>Total governmental funds</u>	
<i>Unavailable revenues-</i> intergovernmental grants and contributions	\$ 2,456	-	-	2,456	\$ -
<i>Unearned revenues:</i>					
Municipal license taxes	461,857	-	-	461,857	461,857
Intergovernmental grants and contributions	-	875,123	853,536	1,728,659	1,728,357
Total unearned revenues	<u>461,857</u>	<u>875,123</u>	<u>853,536</u>	<u>2,190,516</u>	<u>2,190,214</u>
Total deferred inflows of resources	<u>\$ 464,313</u>	<u>875,123</u>	<u>853,536</u>	<u>2,192,972</u>	<u>\$2,190,214</u>

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13. Long-Term Obligations

The general long-obligations debt activity for the fiscal year ended June 30, 2017 is as follows:

	Balance at beginning of fiscal year	Borrowings or additions	Payments or deductions	Balance at end of fiscal year	Balance due within one year
Bonds payable	\$ 8,455,500	-	(565,800)	7,889,700	\$ 607,700
Compensated absences	1,546,677	25,086	(64,478)	1,507,285	879,560
Estimated liability for municipal solid waste landfill closure and post-closure care costs	10,780,153	686,082	-	11,466,235	-
Total long term obligations	\$20,782,330	711,168	(630,278)	20,863,220	\$ 1,487,260

Historically, the general fund has been used to liquidate 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

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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 5, the Municipality levies an annual additional special 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.

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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, 2017:

	<u>Outstanding amount</u>
1995 serial bonds for the acquisition of major capital assets, original amount of \$515,000, due in annual principal installments ranging from \$5,000 to \$45,000; plus interests due in semiannually installments at variable rates (8.21% at June 30, 2017) through July 1, 2019.	\$ 125,000
2004 serial bonds for the acquisition, construction and improvement of major capital assets, original amount of \$725,000, due in annual principal installments ranging from \$15,000 to \$75,000; plus interests due in semiannually installments at variable rates (4.66% at June 30, 2017) through July 1, 2024.	380,000
2002 serial bonds for the acquisition, construction and improvement of major capital assets, original amount of \$910,000, due in annual principal installments ranging from \$5,000 to \$80,000; plus interests due in semiannually installments at variable rates (5.01% at June 30, 2017) through July 1, 2026.	585,000
1999 serial bonds for the acquisition, construction and improvement of major capital assets, original amount of \$1,525,000 due in annual principal installments ranging from \$30,000 to \$140,000 plus interests due in semiannually installments at variable rates (5.01% at June 30, 2017) through July 1, 2019.	390,000
2004 serial bonds for the acquisition, construction and improvement of major capital assets, original amount of \$235,000, due in annual principal installments ranging from \$5,000 to \$20,000; plus interests due in semiannually installments at variable rates (4.66% at June 30, 2017) through July 1, 2029.	160,000
2008 serial bonds for the acquisition of major capital assets, original amount of \$2,905,000, due in annual principal installments ranging from \$20,000 to \$225,000; plus interests due in semiannually installments at variable rates (2.11% at June 30, 2017) through July 1, 2032.	2,440,000
2010 serial bonds for the acquisition of major capital assets, original amount of \$170,000, due in annual principal installments ranging from \$20,000 to \$35,000; plus interests due in semiannually installments at variable rates (6.00% at June 30, 2017) through July 1, 2017.	30,000

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	<u>Outstanding amount</u>
2010 serial bonds for the acquisition of major capital assets, original amount of \$255,000, due in annual principal installments ranging from \$5,000 to \$20,000; plus interests due in semiannually installments at variable rates (6.00% at June 30, 2017) through July 1, 2035.	\$ 225,000
2010 serial bonds for the acquisition of major capital assets, original amount of \$188,000, due in annual principal installments ranging from \$20,000 to \$33,000; plus interests due in semiannually installments at variable rates (6.00% at June 30, 2016) through July 1, 2017.	33,000
2010 serial bonds for the acquisition of major capital assets, original amount of \$1,110,000, due in annual principal installments ranging from \$15,000 to \$95,000; plus interests due in semiannually installments at variable rates (6.00% at June 30, 2017) through July 1, 2035.	990,000
2011 serial bonds for the acquisition of major capital assets, original amount of \$325,000, due in annual principal installments ranging from \$5,000 to \$30,000; plus interests due in semiannually installments at variable rates (6.00% at June 30, 2017) through July 1, 2036.	300,000
2012 serial bonds for the acquisition of major capital assets, original amount of \$403,000, due in annual principal installments ranging from \$45,900 to \$70,800; plus interests due in semiannually installments at variable rates (6.00% at June 30, 2017) through July 1, 2018.	136,600
2012 serial bonds for the acquisition of major capital assets, original amount of \$405,000, due in annual principal installments ranging from \$45,000 to \$75,000; plus interests due in semiannually installments at variable rates (6.00% at June 30, 2017) through July 1, 2018.	140,000
2013 serial bonds for the acquisition of major capital assets, original amount of \$198,000, due in annual principal installments ranging from \$2,800 to \$16,500; plus interests due in semiannually installments at variable rates (6.00% at June 30, 2017) through July 1, 2037.	185,100

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	Outstanding amount
2014 serial bonds for the acquisition of major capital assets, original amount of \$810,000, due in annual principal installments ranging from \$15,000 to \$75,000; plus interests due in semiannually installments at variable rates (6.00% at June 30, 2017) through July 1, 2034.	\$ 775,000
2015 serial bonds for the acquisition of major capital assets, original amount of \$1,010,000, due in annual principal installments ranging from \$15,000 to \$90,000; plus interests due in semiannually installments at variable rates (7.00% at June 30, 2017) through July 1, 2040.	995,000
Total general obligation and public improvements bonds	\$ 7,889,700

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 Commonwealth's Industrial Incentives Acts and, which qualify for benefits provided by the former Section 936 of the U.S. Internal Revenue Code.

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

Fiscal year ending June 30,	Principal	Interest	Total
2018	607,700	534,508	1,142,208
2019	585,000	498,754	1,083,754
2020	469,500	466,040	935,540
2021	304,800	443,597	748,397
2022	371,040	368,662	739,702
2023-2027	1,484,160	1,474,646	2,958,806
2028-2032	1,958,400	1,181,244	3,139,644
2033-2037	1,667,200	440,501	2,107,701
2038-2040	441,900	84,359	526,259
Totals	\$ 7,889,700	5,492,311	\$ 13,382,011

At June 30, 2017, accrued interest payable on bonds amounted to \$194,689. Interest expense on bonds amounted to \$382,766 for the fiscal year ended June 30, 2017.

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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, 2017, 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.

14. Municipal Solid Waste Landfill Closure and Post-closure Care Costs

The Municipality is legally responsible for closure and post-closure care costs associated with its municipal solid-waste landfill. State and federal laws and regulations require the Municipality to place a final cover on the Municipality's solid waste landfill site when it stops accepting waste, and to perform certain maintenance and monitoring functions at the site for 30 years after closure.

The Municipality has performed a study of the activities that need to be implemented at the Municipality's landfill to guarantee the maximum yield of available space and to comply with applicable state and federal regulations. Based on this study, the Municipality has recognized an estimated liability of \$11,466,235 in the accompanying government-wide financial statements using current costs allocated based on the actual landfill capacity at June 30, 2017. The portion of the estimated current costs to be incurred in future years is approximately \$2.1 million, which has not been recognized yet in the accompanying government-wide financial statements. The net change in the liability for the fiscal year ended June 30, 2017 was recorded in the accompanying government-wide financial statements with a debit to health and sanitation expenses of \$686,082 in the statement of activities. The current costs of landfill closure and post-closure at June 30, 2019 is \$12.8 million.

Actual costs may be different due to inflation, changes in technology, or changes in laws and regulations. At June 30, 2017, the Municipality's landfill is still operating and its remaining estimate useful life is approximately two (2) years. Approximately eighty (89) percent of the Municipality's total capacity has been used at June 30, 2017. However, the Municipality is currently evaluating alternatives for the expansion of its solid waste landfill. The expansion would extend the useful life through June 30, 2019.

15. Employees' Retirement Systems

As discussed in Note 22, on August 23, 2017, Act No. 106, known as the "*Law to Guarantee Payment to Our Pensioners*" (Act No. 106) was approved to establish a mechanism by which the general fund of the Government of the Commonwealth of Puerto Rico, through a "pay-as-you-go system", would assume the pension obligations that the Retirement System of the Employees of the Government of Puerto Rico (in which the employees of the Municipality participate), the Teachers' Retirement System and the Judiciary Retirement System can not fulfill.

Act No. 106 provides that the three retirement systems shall contribute its net assets to the general fund of the Government of the Commonwealth of Puerto Rico and establishes a new defined contributions plan.

Under the new pension system, the payments of the accumulated pensions will be disbursed starting July 1, 2017 from the funds deposited in a trust account under the control of the Secretary of the Treasury of the Commonwealth of Puerto Rico but separated from the assets of the Government of the Commonwealth of Puerto Rico. The trust account will include the net proceeds of the liquidations of the net assets of the three

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retirement systems, and a “Pay-Go” charge imposed to the covered sponsoring employers. The disbursement of the benefits of all the pensioners will be guaranteed by the general fund of the Government of the Commonwealth of Puerto Rico.

The following discussion provides information about ERS before its curtailment as a result of the facts discussed in the previous three paragraphs.

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 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.

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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, 2016 and 2017 basic financial statements, nor has it provided the Municipality with the required information to implement the requirements of GASB 68 as of June 30, 2015, 2016 and 2017. 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, 2016 and June 30, 2017, 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.

On November 30, 2015, Puerto Rico Treasury Department issued an unaudited report of the preliminary estimate of the Municipality's net pension liability amounting to \$1.3 billion as of June 30, 2014 (latest estimate available). However, an updated unaudited estimate of the net pension liability was not available as of June 30, 2017 and for the fiscal year then ended. Accordingly, it is not practical for the management

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of the Municipality to determine the financial impact of the implementation of GASB 68 in future financial statements of the Municipality.

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.

During the fiscal years ended June 30, 2017, 2016 and 2015, the Municipality and the participating employees contributed substantially all of the required contributions to ERS and System 2000. The combined actual contributions made by the Municipality and its participating employees to ERS and System 2000 amounted to \$712,534, \$678,060, and \$640,972, for the fiscal years ended June 30, 2017, 2016 and 2015, respectively.

16. Commitments and Contingencies

The Municipality is defendant in various legal proceedings pertaining to matters incidental to the performance of routine governmental operations. Under Public Act No. 104 of June 25, 1955, as amended, persons are authorized to sue the Municipality only for causes of actions set forth in said Act to a maximum amount of \$75,000 or \$150,000 if it involves actions for damages to more than one person or where a single injured party is entitled to several causes of action. Under certain circumstances, as provided in Public Act No. 9 of November 26, 1975, as amended, the Municipality may provide its officers and employees with legal representation as well as assume the payment of any judgment that may be entered against them. There is no limitation on the payment of such judgments.

With respect to pending and threatened litigation, the Municipality has not reported liabilities for awarded or anticipated unfavorable judgments as of June 30, 2017. Management believes that any unfavorable outcome in relation to pending or threatened litigation would be covered by the Municipality's insurance coverage and any exposure would not be material to the basic financial statements taken as a whole, if any.

The Municipality has reported outstanding encumbrances amounting to \$925,391 in the general fund at June 30, 2017. 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.

As of June 30, 2017, the Municipality has several outstanding or planned non-cancelable construction projects of which \$3.6 million have been already incurred and paid as of June 30, 2017. These projects are evidenced by contractual commitments with contractors and are accounted for in the capital improvements bond fund and other non-major capital project funds.

The Municipality receives financial assistance from the federal Governments of the United States of America and the Commonwealth in the form of grants and entitlements. Receipt of grants is generally conditioned upon compliance with terms and conditions of the grant agreements and applicable federal laws and regulations, including the expenditure of resources for eligible purposes. Accordingly, expenditures financed by these programs are subject to financial and compliance audits by the appropriate grantor. Disallowance as a result of these audits may become liabilities of the Municipality. The *"Reports on Compliance and Internal Control in Accordance with Government Auditing Standards and the Requirements of the Uniform Guidance"* for the fiscal year ended June 30, 2017, disclosed various instances of

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MUNICIPALITY OF BARRANQUITAS
Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2017

noncompliance with applicable laws and regulations and with internal accounting and administrative controls. If expenditures are disallowed due to noncompliance with grant programs regulations, the Municipality may be required to reimburse the grantor the disallowed amounts. Management believes that the Municipality will be able to comply with the terms of corrective action plans that may be requested by the federal grantors, if any.

17. Fund Balances

As of June 30 2017, fund balance is comprised of the following:

	<u>General fund</u>	<u>Capital projects fund</u>	<u>Debt service fund</u>	<u>Other governmental funds</u>	<u>Total</u>
<i>Assigned for:</i>					
Budgetary encumbrances - general government	\$ 925,391	-	-	-	\$ 925,391
<i>Restricted for:</i>					
Debt service of bonds payable	297,753	2,419,396	1,447,237	931,319	5,095,705
<i>Unassigned</i>	10,158,433	(43,653)	-	(190,726)	9,924,054
Total fund balances	<u>\$ 11,381,577</u>	<u>2,375,743</u>	<u>1,447,237</u>	<u>740,593</u>	<u>\$ 15,945,150</u>

18. TAX ABATEMENTS

Pursuant to the provisions of GASB Statement No. 77, *Tax Abatement Disclosures*, a tax abatement is a reduction in tax revenues that results from an agreement between one or more governments and an individual or entity in which (a) one or more governments promise to forgo tax revenues to which they are otherwise entitled and (b) the individual or entity promises to take a specific action after the agreement has been entered into that contributes to economic development or otherwise benefits the Municipality or its citizens.

Pursuant to various tax exemption laws, during the fiscal year ended June 30, 2017 the Government of the Commonwealth Puerto Rico granted several exemptions to businesses operating in the telecommunications industry, which forgone municipal taxes of Barranquitas amounting to approximately \$20,172.

The Program provides for forty percent (40%) to one hundred percent (100%) tax exemption on property taxes, municipal license taxes and construction excise taxes. The tax exemptions referred to above are applied against the taxpayer's annual tax liabilities related to property taxes, municipal license taxes and construction excise taxes.

19. LIQUIDITY CONSIDERATIONS

a. Government Development Bank for Puerto Rico

During the fiscal year ended June 30, 2017 GDB faced significant insolvency problems, failed to meet its obligations with the municipalities of Puerto Rico, and was not able to obtain additional funding or other arrangements with its creditors.

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Fiscal Year Ended June 30, 2017

As a consequence of this situation, during the current fiscal year GDB did not transfer to the general fund in a timely manner its excess restricted property tax deposits (CAE, by its Spanish acronym) amounting to \$245,666 for the fiscal year ended June 30, 2017, a financial resource of the Municipality's general. GDB's failure to meet its obligations materially affects the financial position, results of operations and cash flows of the general fund and the Municipality as a whole as of and for the fiscal year ended June 30, 2017. This amount was transferred by GDB subsequently in August 2017.

b. Puerto Rico Electric Power Authority

The Municipality's contribution in lieu of taxes (CILT) received from PREPA was significantly reduced to \$1,365,076 and new additional consumption charges amounting to \$33,616 were imposed by PREPA during the current fiscal year on certain municipal properties used on profit and non-profit activities that were excluded by PREPA from the annual CILT. This enacted legislation also adversely affected the financial position, results of operations and cash flows of the general fund and the Municipality as a whole as of and for the fiscal year ended June 30, 2017.

The Municipality is currently evaluating different alternatives to improve its financial condition, results of operations and cash flows. Those measures include, among other things, the implementation of further cost reduction initiatives, the maximization of revenue collections and the evaluation of any available financing opportunities.

20. SUBSEQUENT EVENTS

The Municipality evaluated subsequent events through May 21, 2018, the date on which the basic financial statements were available to be issued. There are no material subsequent events that would require adjustments to or disclosures in the accompanying basic financial statements as of and for the year ended June 30, 2017.

a. Hurricanes Irma and María

On September 6, 2017 and September 20, 2017, Hurricanes Irma and Maria devastated the Municipality of Barranquitas and Puerto Rico, respectively. The Hurricanes caused unprecedented economic and infrastructure-related damages disrupting the daily lives of substantially all residents of Puerto Rico.

Hurricane María is the worst storm to hit Puerto Rico in over 80 years and arrived only two weeks after Hurricane Irma passed just north of the island and left the 3.4 million population (1.4 million electric power customers) without service and with little hope of a quick recovery. As a result of the lack of power, the water system also collapsed leaving 55% of the population without access to potable water. The effect on Puerto Rican families and the island's infrastructure will take many years to heal.

Hurricane María caused massive flooding, affecting both residents and businesses in Puerto Rico and the U.S. Virgin Islands. Thousands of people, homes, and businesses have been impacted

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Fiscal Year Ended June 30, 2017

across multiple islands and island municipalities per reports from the Federal Emergency Management Agency (FEMA) and news agencies.

Accordingly, a day after Hurricane María impacted Puerto Rico, there was zero percent of electricity generated in Barranquitas, while 95% of mobile telecommunications were interrupted leaving people with no communication and extremely limited food and beverage supplies. Furthermore, over 60% of all gas stations across the island were closed in Puerto Rico while only 7% of all ATM machines were operating in the island.

Heavy rains and flash floods brought on by the storm exacerbated widespread devastation, turning streets into rivers full of debris. In some areas, floodwaters were waist-high more than 30 inches deep and often sewage-ridden.

The Government of the Municipality of Barranquitas also shut down operations and limited its activities to the life-saving activities and immediate recovery efforts for the benefits of its residents.

The initial review made by the management of the Municipality of Barranquitas shows that the local municipal government suffered severe damages to its public facilities citywide, including buildings, parks, public facilities and other structures.

The Municipality is currently evaluating and determining the estimated monetary loss of other local general infrastructure assets composed of roads, lighting systems, signals and other general infrastructure assets that also suffered significant damages.

The President of the United States of America, Hon. Donald J. Trump, issued a presidential declaration of major disaster for Puerto Rico on September 20, 2017 as a result of the damage caused by the Hurricane Maria, making the Municipality and the residents of Barranquitas eligible to receive public and individual assistance, respectively, from the Federal Emergency Management Agency (FEMA).

Since September 20, 2017, the Municipality has suffered a substantial loss of more than five percent (5%) in its income corresponding to the general fund (operating budgetary fund) and other governmental funds, whose effect may adversely extend to the future income for at least the next three (3) fiscal years as a direct result of the effects of Hurricane Maria.

As a result of these devastating effects of Hurricane María, on April 13, 2018, FEMA approved federal financial assistance to the Municipality amounting to \$5 million under the *Community Disaster Loans Program* (CDL), which provides loans with favorable terms and conditions to any eligible governmental applicant who demonstrate, among other things, that: (1) suffered a substantial loss of at least five percent (5%) of its tax revenues as a direct result of a major disaster and (2) has a need for financial assistance to compensate for the substantial revenue losses that currently, or in the near future, could limit the capability and power to continue performing its governmental functions in a normal way while the recovery efforts continue.

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Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2017

The term of the loan will be five (5) years and could be extended to ten (10) years at the request of the Municipality of Barranquitas, subject to the approval of FEMA. The interest rate on the loan has been determined by the Secretary of the Treasury of the United States of America on the date of the signing of the promissory note. This interest rate is similar to that used in other obligations of the Treasury of the United States of America, adjusted to the nearest 1/8 percent. The Municipality issued a promissory note to FEMA and the United States Treasury and provided an adequate collateral to guarantee the repayment of the loan to be determined by FEMA.

The loan proceeds shall only be used by the Municipality to carry out its existing governmental operational functions or to expand its essential functions aimed at meeting disaster-related needs.

Federal law (44 CFR, part 206) prohibits any state law of the Government of Puerto Rico that limits or prohibits the Municipality of Barranquitas from issuing public debt from the CDL program promoted by FEMA. The aforementioned legislation allowed the Municipality to accept the loan proceeds and anticipate them in support of its operational budgets.

The service of principal and interests on the loan might be forgiven by FEMA, totally or partially, under certain extraordinary circumstances. Any portion of the principal and interests of the loan not waived shall be paid at a time when the economic recovery has broadened the revenue base in support of the budget of the Municipality, in accordance with the terms and conditions of the CDL program agreed with FEMA.

The Municipality is currently negotiating a business interruption claim to its insurance company.

b. Government Development Bank for Puerto Rico

As noted above, on March 27, 2018, the GDB publically released the Fourth Amendment to the RSA, which is said to be currently supported by the GDB, AAFAF, and a portion of the creditors to the RSA.

Pursuant to the Fourth Amendment, the principal amount of any bond, note and/or loan of any municipality of Puerto Rico held by GDB shall be automatically reduced by operation of law, without the need for any further action, by an amount equal to the balance of proceeds of such bond, note and/or loan that were not disbursed to such municipality and were held on deposit at GDB pursuant to the Municipal Financing Act, Act 64-1996, as amended. Such application shall be effected by reducing any remaining installments of principal in inverse order of maturity and shall not otherwise affect the repayment schedule of the corresponding bond, note or loan.

Any remaining municipal deposits held at GDB shall be reduced on a dollar-for-dollar basis, from the outstanding principal amount of any corresponding bond, note and/or loan (excluding the loans that are collateral for the Secured Deposit Account), relative to the type of corresponding deposit (restricted property tax deposits (CAE, by its Spanish acronyms) against CAE guaranteed loans), restricted sales and usage tax deposits (IVU, by its Spanish acronyms against IVU guaranteed loans, and all undesignated deposits against outstanding principal balance of other loans in the following order: operational loans, revenue loans, IVU loans, then CAE loans). Such application will be effected in ascending order of outstanding loan balances. In cases where deposits are not

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Fiscal Year Ended June 30, 2017

enough to pay a loan in full, the application shall be effected by reducing installments of principal in inverse order of maturity without affecting the repayment schedule of the bond, note or loan. The remaining balances of the municipal loans shall be those certified by AAFAF, and all future payments of interest on such bonds, notes and/or loans shall be computed based on such balances.

If a municipality that has excess CAE deposits in GDB executes a settlement agreement with GDB providing a release against GDB and the issuer and agreeing not to challenge or otherwise take any action that is inconsistent with, or that would reasonably be expected to prevent, interfere with, delay or impede the consummation of, the Restructuring, then, promptly upon the effective date of such settlement agreement, if so provided pursuant to an amendment to the GDB Restructuring Act, GDB shall pay, in cash, to such municipality an amount equal to fifty-five percent (55%) of the undisbursed Excess CAE corresponding to such municipality.

In the case of such municipalities that have excess CAE but which do not execute a settlement agreement with GDB prior to the closing date, pursuant to Article 502 of the GDB Restructuring Act, as in effect on August 24, 2017, GDB shall pay to such municipality on the closing date, in cash, an amount equal to 55% of the undisbursed Excess CAE corresponding to such municipality.

Upon the effective date of a settlement agreement entered into by a municipality as described above or, in the case of municipalities that do not execute such a settlement agreement, upon the closing date, the remaining portion of such municipality's undisbursed excess CAE shall be discharged, and such municipality shall have no further rights or claims thereto, and GDB shall have no further liability or obligation to such municipality in respect of the excess CAE.

GDB, as a legally responsible entity is anticipated to resolve (i) outstanding legal matters and claims that exist or may be asserted by or against GDB and (ii) certain public entity loans that will remain at GDB and for which GDB shall have a contractual duty to the Recovery Authority to use commercially reasonable best efforts to maximize proceeds and transfer such proceeds, if any, to the Recovery Authority.

On April 20, 2018, the Puerto Rico Fiscal Oversight Board certified the GDB's new fiscal plan that includes the amended RSA referred to above.

c. New Commonwealth Fiscal Plan

At the Oversight Board's twelfth public meeting, held on April 19, 2018, the Oversight Board voted to certify, pursuant to 201(e)(2) of PROMESA, the fiscal plan for the Commonwealth of Puerto Rico as developed by the Oversight Board, pursuant to Section 201(d)(2) of PROMESA (the "New Commonwealth Fiscal Plan"). On letter dated April 24, 2018, the Oversight Board delivered the compliance certification for the New Commonwealth Fiscal Plan pursuant to Section 201(e)(2) of PROMESA. The New Commonwealth Fiscal Plan states that to incentivize municipal operational changes, the Commonwealth must reduce the current level of municipal appropriations. In fiscal year 2018, the total municipal appropriation was reduced by \$175 million, bringing the new baseline appropriations to \$220 million per year. Going forward from this current baseline, there must be a reduction of 20% in each successive year, holding appropriations constant at 80% of current levels starting in FY2022 before ultimately phasing out all subsidies in

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Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2017

fiscal year 2024. The slow ramp in reductions is intended to allow the remaining funds to be used to fund shared service consolidations across multiple municipalities. Two levers in particular are expected to enable municipalities to become solvent: municipal service consolidations and institution of a property tax reform. The estimated impact of this reduction of the appropriation in the Municipality for fiscal year 2018 amounts to approximately \$1 million.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF BARRANQUITAS
 Budgetary Comparison Schedule - General Fund
 June 30, 2017

	Budgeted amounts		Actual amounts (budgetary basis-Note 1)	Variance with final budget-over (under)
	Original	Final		
REVENUES:				
Property taxes	\$ 7,880,534	7,880,534	7,880,534	\$ -
Municipal license taxes	505,000	742,246	754,148	11,902
Sales and use taxes	300,000	496,451	594,473	98,022
Construction excise taxes	100,000	90,597	109,635	19,038
Intergovernmental grants and contributions	945,884	1,051,255	1,009,739	(41,516)
Interests on deposits	50,000	9,974	190,495	180,521
Charges for services	144,000	211,436	261,702	50,266
Miscellaneous revenues	152,000	225,547	260,136	34,589
Total revenues	10,077,418	10,708,040	11,060,862	352,822
EXPENDITURES:				
Current:				
General government	4,880,060	5,536,679	4,093,132	(1,443,547)
Urban and economic development	379,621	1,690,732	2,590,889	900,157
Health and sanitation	1,115,933	1,119,417	1,140,667	21,250
Public safety	1,008,384	1,008,384	889,438	(118,946)
Public housing and welfare	778,521	870,621	728,777	(141,844)
Culture, recreation and education	528,778	612,116	559,323	(52,793)
Capital outlays	1,386,121	1,310,091	783,490	(526,601)
Total expenditures	10,077,418	12,148,040	10,785,716	(1,362,324)
REVENUES OVER (UNDER) EXPENDITURES	-	(1,440,000)	275,146	1,715,146
Other financing sources - prior year's budgetary cash surplus readjustment	-	1,440,000	-	-
REVENUES AND OTHER FINANCING SOURCES OVER EXPENDITURES AND OTHER FINANCING USES	\$ -	-	275,146	\$ 1,715,146
Explanation of differences:				
<i>Sources/inflows of resources:</i>				
Actual amounts (budgetary basis) "available for appropriations" from the budgetary comparison schedule			\$	11,060,862
Differences - budgetary basis to GAAP:				
Transfers from capital improvements bond fund are recorded as interest income for budgetary purposes				(168,457)
Changes in assets and deferred inflows of resources:				
Net change in tax, intergovernmental and miscellaneous receivables				395,712
Net change in deferred inflows of resources				26,514
Total revenues as reported on the statement of revenues, expenditures, and changes in fund balances			\$	11,314,631
<i>Uses/outflows of resources:</i>				
Actual amounts (budgetary basis) "total charges to appropriations" from the budgetary comparison schedule			\$	10,785,716
Differences - budgetary basis to GAAP:				
Prior year encumbrances recorded as current year expenditures for GAAP basis				1,304,369
Current year encumbrances recorded as expenditures for budgetary purposes				(2,010,676)
Total expenditures as reported on the statement of revenues, expenditures, and changes in fund balances			\$	10,079,409

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

1. STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY

- a) **Budgetary Control** – The Municipality prepares its annual budget for all of its operations and activities. Such legally adopted budget is based on expected expenditures by the 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.

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 10 business days, but not later than 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 6 days. The Mayor may decrease or eliminate any line item but may not increase or insert any new line item in the budgets. The Mayor may also veto the budgets in their entirety and return it to the Municipal Legislature with his objections. If the Mayor rejects the Project, the Municipal Legislature will have up to 8 days to adopt or reject the recommendations or objections of the Mayor. The approved Project is sent again to the Mayor, which then would have 3 days to sign and approve it.

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

The annual budget 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 the Office of Management and Budget have 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 and among funds. The Municipal Legislature may transfer amounts among programs within and among funds.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF BARRANQUITAS
Notes to Budgetary Comparison Schedule - General Fund
June 30, 2017

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

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

b) Budgetary Accounting

The Municipality's annual budget is prepared using the budgetary (statutory) basis of accounting, which is not in accordance with GAAP. According to the budgetary basis of accounting, revenue is generally recorded when cash is received, except in the case of municipal license taxes collected prior to June 30 but pertaining to the next fiscal year are recorded as revenue in the following budget year. 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 supplemental budgetary comparison schedule - general fund provides information about the general fund's original budget, its amendments, and the actual results of operations of the general fund under the budgetary basis of accounting for the ensuing fiscal year.

At June 30, 2017, the Municipality has outstanding encumbrances in the general fund amounting to \$925,391.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF BARRANQUITAS
Schedule of Expenditures of Federal Awards
June 30, 2017

	<u>Federal CFDA Number</u>	<u>Pass-through Grantor's Number</u>	<u>Expenditures</u>
U.S. Department of Housing and Urban Development			
Section 8 – Housing Choice Voucher	14.871	RQ-060-VO	\$ 857,677
Pass-through of the State-Office of the Department of the Family – Emergency Solutions Grant Program	14.231	2016-000177	77,875
Pass-through of the State-Office of the Municipal Affairs Commissioners – Community Development Block Grant/State – Administer Small Cities	14.228	2017-00734	<u>530,347</u>
Total U.S. Department of Housing and Urban Development			<u>1,465,899</u>
U.S. Department of Homeland Security			
Disaster Grant – Public Assistance (Presidentially Declared Disasters)	97.036	FEMA 4017 FEMA 1919	<u>79,685</u>
Total U.S. Department of Homeland Security			<u>79,685</u>
U.S. Department of Agriculture			
Pass-through of the Puerto Rico Elderly Commission – Food Distribution-Child and Adult Care Food Program	10.558	N/A	<u>151,918</u>
Total U.S. Department of Agriculture			<u>151,918</u>
Total Federal Financial Assistance			<u>\$ 1,697,502</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF BARRANQUITAS
Notes to Schedule of Expenditures of Federal Awards
June 30, 2017

1. Basis of Presentation

The accompanying Schedule of Expenditures of Federal Awards (Schedule) includes the federal grant activities of the Municipality of Barranquitas of the Commonwealth of Puerto Rico under programs of the Federal government for the fiscal year ended June 30, 2017. 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 Barranquitas, it is not intended to and does not present the financial position, changes in net position, or cash flows of the Municipality of Barranquitas.

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. Negative amounts shown on the Schedule represent adjustments or credits made in the normal course of business to amounts reported as expenditures in prior years. The Municipality of Barranquitas has elected not to use the 10 percent de minimis indirect cost rate allowed under the Uniform Guidance.

3. Relationship to Basic Financial Statements

Expenditures of the federal awards as reported in the Statement of Revenues, Expenditures and Changes in Fund Balances-Governmental Funds, are included within the Major Governmental Funds and Nonmajor 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

Major governmental funds	\$12,206,617
Nonmajor governmental funds	<u>1,299,797</u>
	13,506,414
Less: Non-federal expenditures	<u>(11,808,912)</u>
 Total expenditures in the Schedule of Federal Awards	 <u>\$1,697,502</u>

**Independent Auditors' 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, 2017**

To the Honorable Mayor
and the Municipal Legislature
Municipality of Barranquitas
Barranquitas, 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, each major fund, and the aggregate remaining fund information of the Municipality of Barranquitas of the Commonwealth of Puerto Rico as of and for the year ended June 30, 2017, and the related notes to the financial statements, which collectively comprise the Municipality's basic financial statements and have issued our report thereon dated May 21, 2018.

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 Barranquitas 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 was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses and therefore, material weaknesses or significant may exist that have not been identified. We consider the deficiencies described in the accompanying schedule of findings and questioned costs to be material weaknesses as item 2017-001.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Municipality of Barranquitas 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 Barranquitas of the Commonwealth of Puerto Rico Response to Findings

The Municipality of Barranquitas 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
May 21, 2018

A handwritten signature in black ink, appearing to be 'Barranquitas', is written over a large, stylized circular mark. To the right of the signature, the text 'CPA-PSC' is written in a similar handwritten style.

Stamp No. O2752850
was affixed to the
original report.

**Independent Auditors' Report on compliance for each major program and on
Internal Control over compliance required by the Uniform Guidance
June 30, 2017**

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

Report on Compliance for Each Major Federal Program

We have audited the Municipality of Barranquitas 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 Barranquitas of the Commonwealth of Puerto Rico major federal programs for the year ended June 30, 2017. Municipality's major federal programs are identified in the Summary of Auditors' Results Section of the accompanying Schedule of Findings and Questioned Costs.

Management's Responsibility

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

Auditors' Responsibility

Our responsibility is to express an opinion on compliance for each of the Municipality of Barranquitas 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; 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 qualified and unmodified opinions on compliance for major federal programs. 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 Barranquitas did not comply with requirements regarding CFDA 14.228 Community Development Block Grant/State – Administered Small Cities Program as described in finding number 2017-002 for the 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 Barranquitas 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, 2017.

Unmodified Opinion on Each of the Other Major Federal Programs

In our opinion, the Municipality of Barranquitas 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 auditors' results section of the accompanying schedule of findings and questioned costs for the year ended June 30, 2017.

Report on Internal Control Over Compliance

Management of Municipality of Barranquitas 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 the 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.

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 have not been identified. We did not identify any deficiencies in internal control over compliance that we consider to be material weakness. However, material weaknesses may exist that have not been identified.

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.

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
May 21, 2018

Stamp No. O2752851
was affixed to the
original report.

A handwritten signature in black ink, appearing to be 'B. Williams', is written over a large, stylized circular mark. To the right of the signature, the text 'CPA-PSC' is written in a similar handwritten style.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF BARRANQUITAS
Schedule of Findings and Questioned Costs
June 30, 2017

Financial Statements

Type of auditors' report issued:		Qualified
Internal control over financial reporting:		
Material weakness (es) identified?	<u> X </u> yes	<u> </u> no
Significant deficiency (ies) identified not considered to be material weakness?	<u> </u> yes	<u> X </u> none reported
Noncompliance material to financial statements noted?	<u> </u> yes	<u> X </u> no

Federal Awards

Internal Control over major programs:		
Material weakness (es) identified?	<u> X </u> yes	<u> </u> no
Significant deficiency (ies) identified not considered to be material weaknesses?	<u> </u> yes	<u> X </u> none reported
Type of auditors' report issued on compliance For major programs:		Qualified
Any audit findings disclosed that are required to be reported in accordance with Uniform Guidance?	<u> X </u> yes	<u> </u> no

Identification of major programs:

<u>CFDA Number(s)</u>	<u>Name of Federal Program or Cluster</u>
14.228	Community Development Block Grants/State's Program
14.871	Section 8 Housing Choice Voucher

Dollar threshold used to distinguish Between Type A and Type B programs:	<u> \$750,000 </u>	
Auditee qualified as low-risk auditee?	<u> </u> yes	<u> X </u> no

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF BARRANQUITAS
Schedule of Findings and Questioned Costs
June 30, 2017

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 Barranquitas of the Commonwealth of Puerto Rico will respond to the following findings through the issuance of a separate letter addressed to the Cognizant Agency.

2017-001 DEFICIENCIES IN THE ACCOUNTING SYSTEM, CLOSING PROCEDURES AND OTHER ACCOUNTING RECORDS

CONDITION:

During the last three 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:

- 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 cash 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 under the modified accrual basis of accounting.
- 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 under the accrual basis of accounting. The 2017 basic financial statements and related conversion was completed after a significant gathering of formal and informal documents.

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF BARRANQUITAS
Schedule of Findings and Questioned Costs
June 30, 2017

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, 2017 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 BARRANQUITAS
 Schedule of Findings and Questioned Costs
 June 30, 2017

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>2017-002 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 request of funds performed during the year, we noted the following deficiency:</p> <p>a. From 54 request of funds received during the 2016-2017 fiscal year amounting to \$920,835, 17 (31%) disbursements amounting to \$87,362, maintained a delay of 3 days or more between the funds receipt date and the disbursement date.</p> <p>Criteria:</p> <p>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”.</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 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.</p> <p>Recommendation:</p> <p>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.</p>	<p>NONE</p>
Total questioned costs		<u>\$ -</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF BARRANQUITAS
 Summary schedule of prior years audit findings
 Fiscal Year 2015-2016
 June 30, 2017

The following schedule contains the finding number and title of each of the findings included in the Report on Compliance and on Internal Control Based on an Audit of General Purpose Financial Statements Performed in Accordance with Government Auditing Standards for the Fiscal Year ended June 30, 2016. 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 2016-2017).
- NR - Not resolved yet. Finding repeated in fiscal year 2016-2017.

<u>Finding Number</u>	<u>Title</u>	<u>Corrective Action Taken</u>
2016-01	Deficiencies in the accounting system, closing procedures and other accounting records.	NR

COMMONWEALTH OF PUERTO RICO
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Summary schedule of prior years audit findings
Fiscal Year 2015-2016
June 30, 2017

The following schedule contains the finding number and title of each of the findings included in the Report on Compliance with the Requirements Applicable to Each Major Program and Internal Control over Compliance in accordance with the Uniform Guidance for the Fiscal Year ended June 30, 2016. 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 2016-2017).
- NR - Not resolved yet. Finding repeated in fiscal year 2016-2017.

<u>Finding Number</u>	<u>Title</u>	<u>Corrective Action Taken</u>
2016-02	Federal cash management system	NR

The following schedule contains the finding number and title of each of the findings included in the Report on Compliance and on Internal Control Based on an Audit of General Purpose Financial Statements 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 2016-2017).
- NR - Not resolved yet. Finding repeated in fiscal year 2016-2017.

<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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF BARRANQUITAS
 Summary schedule of prior years audit findings
 Fiscal Year 2014-2015
 June 30, 2017

The following schedule contains the finding number and title of each of the findings included in the Report on Compliance with the 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 2016-2017).
- NR - Not resolved yet. Finding repeated in fiscal year 2016-2017.

<u>Finding Number</u>	<u>Title</u>	<u>Corrective Action Taken</u>
15-02	Federal cash management system	NR

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF BARRANQUITAS
Corrective Action Plan – Financial Statement and Federal Awards Findings
Fiscal Year Ended June 30, 2017**

Finding Control Number: 2017-001

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

Response and Corrective Action by Department of Finance – Finding Control Number 2017-001:

We concur with this finding. However, in addition to Monet System referred to above, the Municipality has 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, 2017. These control measures minimized the risks of possible errors, omissions or deviations from generally accepted accounting principles in the Municipality’s basic financial statements.

Furthermore, we should mention that the Municipality follows the accounting and administrative procedures established by the Administration Manual issued by the Office of Management and Budget 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, 2018
Contact person:	Ms. Yamilet Guzmán Director of Finance Telephone: (787) 857-2065 Email: yguzman@barranquitas.pr.gov

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF BARRANQUITAS
Corrective Action Plan – Financial Statement and Federal Awards Findings
Fiscal Year Ended June 30, 2017

Finding Control Number: 2017-002

FEDERAL CASH MANAGEMENT SYSTEM – CDBG PROGRAM

Response by Departments of Finance and Federal Programs – Finding Control Number 2017-002:

We concur with this finding. The Municipality established new written procedures over cash management in accordance with CFR 200 requiring the following among other procedures:

- The Municipality has a three-day cycle time special policy as to disburse checks on federal funds to suppliers in order to minimize the time elapsed between the drawdown and the payment of such funds. Once the check to the supplier is issued, the payment officer calls the supplier to either come to pick immediately the check or be send immediately by mail.
- Cash flow statements by program are prepared periodically to determine essential cash flow needs. Responsibility reports are generated periodically and reviewed by the Director of Finance and the Director of Federal Programs for a consistent level of service and timely requests for reimbursement of expenditures.
- The Municipality periodically monitors the cash balances of federal programs for the possible identification, investigation and resolution of unused funds.
- The Municipality does not make any request of federal funds until such time as all statements presented for payment are thoroughly verified so as to confirm all the documents required by state and federal regulations. Through this new policy the Municipality will minimize the time elapsing between the receipt and the disbursement of federal funds and will ascertain it does not exceed three days.
- When applicable, the Municipality shall use existing resources available within a program before requesting additional advances. Such resources may include program income (including repayments to a revolving fund), rebates, refunds, contract settlements, audit recoveries, and interest earned on such funds.
- The Municipality recognizes the importance of cash management to insure there are sufficient funds to pay for the expenses of operating the Municipality's housing programs. The Director of Finance shall be responsible for monitoring the daily cash flow and balances of all cash funds. On a monthly basis, the Director of Finance shall provide a report that shows the cash position from all sources that are accounted for in the cash accounts, along with bank statements.
- Any cost allocable to a particular Federal award may not be charged to other Federal awards to overcome fund deficiencies, to avoid restrictions imposed by Federal statutes, regulations, or terms and conditions of the Federal awards, or for other reasons. For example, the Municipality shall not

COMMONWEALTH OF PUERTO RICO
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Corrective Action Plan – Financial Statement and Federal Awards Findings
Fiscal Year Ended June 30, 2017

divert funds between programs and/or activities, even when such programs/activities are each assisted by HUD.

- Accounting system Monet is capable of scheduling payments for accounts payable and requests for funds from the federal grantors and subgrantors (U.S.Treasury Department, HUD, OCAM, PROMB, etc.) to avoid time lapse between draw down of funds and actual disbursements of funds. The Municipality operates generally on strictly a reimbursement basis and accordingly there is no time lapse between draw down and disbursements.
- Appropriate level of supervisory review of cash management activities. The Director of Finance approves the reimbursement requests and the Director of Federal Programs reviews bills for payment and monthly financial statements.

Anticipated completion date:	June 30, 2018
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Contact persons:	Ms. Yamilet Guzmán Director of Finance Telephone: (787) 857-2065 Email: yguzman@barranquitas.pr.gov
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