COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NARANJITO
Basic Financial Statements and
Supplemental Schedules
Year Ended June 30, 2017

TABLE OF CONTENTS

Gil Alberto Ortiz Cabrera

Certified Public Accountant & Professional Consultant

Member of: The American Institute of Certified Public Accountants (AICPA)
Puerto Rico Board of Certified Public Accountants

INDEPENDENT AUDITOR'S REPORT

Hon.Orlando Ortiz Chevres and
Members of the Municipal Legislature of the
Commonwealth of Puerto Rico
Municipality of Naranjito
Naranjito, Puerto Rico

I have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the Municipality of Naranjito (the Municipality), 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 as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, I 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.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinions.

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

As discussed in Note K to the basic financial statements, the Municipality has not implemented the requirements of Statement No. 68 of the Governmental Accounting Standards Board, Accounting and Financial Reporting for Pensions, an amendment of GASB Statement No. 27. Accordingly,

1. The Municipality has not been able to determine and account for its proportionate share of net pension obligation, deferred inflow of resources and deferred outflow of resources, related to pension costs and,

2. The Municipality has not recognized the effect of current period changes in net pension obligation, deferred outflow of resources and deferred inflow of resources as these relate to pension costs.

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 recognize in accordance with parameters established by Statement No. 68, as well as the effect of current period changes of the aforementioned amounts that must be recognized in pension expense during the current period. Recognition of these amounts would increase liabilities, increase deferred outflow of resources, increase the deficit, 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, deficit, and expenses of the governmental activities has not been determined.

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

Qualified Opinion

In my opinion, except for the effects of the matter described in the "Basis for Qualified Opinion on Governmental Activities and Note Disclosure Regarding Pensions" paragraph, the financial statements referred to above present fairly, in all material respects, the financial position of the Governmental Activities of the Municipality, as of June 30, 2017, and the 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

In my 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, as of June 30, 2017, and the respective changes in financial position for the year then ended in accordance 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 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. My opinion on the basic financial statements is not affected by the information omitted.

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 4 - 9 and 38-39 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.

I 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 my inquiries, the basic financial statements, and other knowledge I obtained during my audit of the basic financial statements. I 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 Matters

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise **the Municipality's** financial statements as a whole. 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 (CFR) 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 of federal awards is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the 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 July 13, 2018, on our consideration of the Municipality's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Municipality of Naranjito's internal control over financial reporting and compliance.

CPA GIL A. ORTIZ CABRERA
San Juan, Puerto Rico
License 1332, in force
July 13, 2018
The stamp number 02759061
was affixed to the original report.

MANAGEMENT'S DISCUSSION AND ANALYSIS

The Municipality of Naranjito (the "Municipality") discussion and analysis has been designed with the followings goals:

a) Assist the reader in focusing on significant financial issues,
b) Provide an overview of the Municipality's financial activity,
c) Identify changes in the Municipality's financial position (its ability to address the next and subsequent year challenges),
d) Identify any material deviations from the financial plan (the approved budget), and;
e) Identify individual fund issues or concerns.

Since the Management's Discussion and Analysis (MD&A) is designed to focus on the current year activities, resulting changes and currently known facts, please read it in conjunction with the Municipality's financial statements.

FINANCIAL HIGHLIGHTS

- The Municipality net position decreased by $559,198.
- Net position amounts to $67,546,969.
- Capital assets increased by $108,015.
- Capital expenditures amounted to $1,601,073.
- General fund balance decreased by $1,263,279.

USING THIS ANNUAL REPORT

This annual report consists of a series of new financial statements with a change in the focus from previous financial statements. The new focus is on both the Municipality as a whole (government-wide) and the major individual funds. Both perspectives (government-wide and major fund) allow the user to address relevant questions, broaden a basis for comparison (year to year or government to government) and enhance the Municipality's accountability.

Government-Wide Financial Statements

The Government-Wide Financial Statements are designed to provide users of the financial statements with a broad overview of the Municipality's finances in a manner similar to private-sector companies.

The Statement of Net Position presents information on all of the Municipality's assets and liabilities, with the difference between both reported as net position. Over time, increases or decreases in net position may serve as a useful indicator of whether the financial position of the Municipality is improving or deteriorating.

The Statement of Activities presents information showing how the Municipality's net assets changed during the most recent fiscal year. All changes in net position are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the related cash flows. Thus, revenues and expenses are reported in the Statement of Activities that will only result in cash flows in future fiscal periods. The Statement of Activities is focused on both the gross and net cost of various activities, which are provided by the government's general tax and other revenues. This is intended to summarize and simplify the user's analysis of cost of various governmental services.

Fund Financial Statements

The Fund Financial Statements provide detailed information about the Municipality's most significant funds, not the Municipality as a whole. The Municipality has only one kind of fund which is the governmental fund.

Governmental funds are used to account for essentially the same functions reported as governmental activities in the Government Wide Financial Statements. However, unlike the Government Wide Financial Statements, Government Fund Financial Statements focus on near term inflows and outflows of spendable resources, as well as on balances of spendable resources available at the end of the fiscal year. Such information is useful in evaluating the Municipality's near term financial requirements.

Because the focus of governmental funds is narrower than that of the government wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government wide financial statements. By doing so, users of the basic financial statements may better understand the long-term impact of the Municipality's near term financial decisions. Both of the Governmental Fund Balance Sheet and the Governmental Fund Statement of Revenues, Expenditures and Changes in Fund Balances provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

Infrastructure Assets

Historically, a government's largest group of assets (infrastructure – roads, bridges, traffic signals, underground pipes [unless associated with a utility], etc.) have not been reported nor depreciated in government financial statements. GASB 34 requires that these assets be valued and reported within the governmental column of the Government-Wide Statements. Additionally, the government must elect to either (a) depreciate these assets over their estimated useful life or (b) develop a system of asset management designed to maintain the service delivery potential to near perpetuity. If the government develops the asset management system (the modified approach) which periodically (at least every third year), by category, measures and demonstrates its maintenance of locally established levels of service standards, the government may record its cost of maintenance in lieu of depreciation. The information about the condition and maintenance of condition of the government infrastructure assets should assist financial statement users in evaluating a local government and its performance over time. The Municipality has elected to depreciate infrastructure assets instead of using the modified approach.

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE

Net Position

As noted earlier, net position may serve over time as a useful indicator of a government's financial position. The Municipality's net position totaled $67.5 and $68.1 million at the end of 2017 and 2016, respectively.

The largest portion of the Municipality's net assets consists of the investment made throughout the years in capital assets such as land, buildings, equipment and infrastructure. The Municipality uses these capital assets to provide services to its citizens; consequently, these assets are not available for future spending. Although, the Municipality's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from the Debt Service Fund, since the capital assets themselves cannot be used to liquidate these liabilities. The amounts restricted for debt service represents another portion of the net assets, and these are resources subject to external restrictions for the purposes explained above.

Condensed Statement of Net Position
June 30, 2017 and 2016

	2017	2016
Current assets	$ 7,837,357	$ 9,361,581
Capital assets	81,340,970	81,232,955
Total assets	89,178,327	90,594,536
Currrent liabilities	2,140,647	2,693,523
Deferred inflows of resources	691,754	722,876
Noncurrent liabilities	18,798,957	19,071,970
Total liabilities	21,631,358	22,488,369
Invested in capital assets, net of related debt	66,526,970	65,751,955
Restricted	4,331,185	4,141,465
Unrestricted	(3,311,186)	(1,787,253)
Total net position	$ 67,546,969	$ 68,106,167

Changes in Net Position

The Municipality’s net position decreased by $559,198. Approximately 55 percent of the Municipality's total revenue came from grants and contributions, including federal aid, while 26 percent resulted from taxes. The Municipality's expenses cover a range of services. The largest expenses were for general government, public works and public housing and welfare.

Condensed Statement of Activities
June 30, 2017 and 2016

	2017	2016
Program revenues		
Charges for services	$ 297,143	$ 189,566
Operating grants and contributions	1,821,276	2,238,626
General revenues		
Property taxes	3,497,225	2,132,090
Municipal license tax	1,131,943	1,117,855
Sales and use taxes	1,038,088	1,490,501
Grants and contributions not restricted to specific programs	8,123,620	8,755,824
Interest and investment earnings	63,854	94,770
Miscellaneous	2,169,570	855,628
Total revenues	18,142,719	16,874,860
Expenses		
General government	10,874,630	9,267,472
Public safety	863,606	748,497
Health and welfare	2,514,363	2,763,374
Public works	935,252	3,740,726
Culture and recreation	886,021	885,855
Community development	613,438	511,915
Economic Development	139,332	139,793
Education	102,839	86,266
Interest on long-term debt	1,772,436	250,078
Total expenses	18,701,917	18,393,976
Change in net position	(559,198)	(1,519,116)
Net position, beginning of year	68,106,167	69,625,283
Net position, end of year	$ 67,546,969	$ 68,106,167

FINANCIAL ANALYSIS OF THE MUNICIPALITY'S INDIVIDUAL FUNDS

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

Governmental Funds

The focus of the Municipality’s governmental funds is to provide information on near-term inflows, outflows, and balances of spendable resources. Such information is useful in assessing the Municipality’s financing requirements. In particular, unreserved fund balance may serve as a useful measure of a government’s net resources available for spending at the end of the fiscal year.

As of the end of the current fiscal year, the Municipality’s governmental funds reported a combined fund balance of $5.3 million compared to a fund balance of $6.3 million in the prior year.

The general fund is included within the governmental funds; it is the chief operating fund of the Municipality. As of June 30, 2017, the general fund has a fund balance of $.9 million. The fund balance decreased by $1.3 million during fiscal year 2017.

GENERAL FUND BUDGETARY HIGHLIGHTS

Over the course of the year, the Municipality Council revised the Municipality's budget to reclassify certain expenditures among the different governmental functions. Such reclassifications were necessary to provide for the developments that affected the Municipality's finances.

Actual revenues and expenditures were mostly on line with budgeted amounts.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

The Municipality's investment in capital assets as of June 30, 2017, amounts to $102.0 million, net of accumulated depreciation of $20.7 million, leaving a net book value of $81.3 million. This investment in capital assets includes land, buildings, improvements, equipment, intangibles, infrastructure and construction in progress. Infrastructure assets are items that are normally immovable and of value only to the state, such as roads, bridges, streets and sidewalks, drainage systems, lighting systems, and similar items.

The total increase in the Municipality's investment in capital assets for the current fiscal year was about .13% in terms of net book value. Actual expenditures to purchase or construct capital assets were $1.6 million for the year. Depreciation charges for the year totaled $1.5 million.

The Municipality finances a significant portion of its construction activities through bond issuances. 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. As of June 30, 2017, the Municipality has approximately $1.7 million of unexpended proceeds from grants and bonds that are committed to future construction activities.

Debt Administration

The Puerto Rico Legislature has established a limitation for the issuance of general obligation municipal bonds and notes for the payment of which the good faith, credit and taxing power of each municipality may be pledged.

The applicable law also requires that in order for a municipality to be able to issue additional general obligation bonds and notes such municipality must have sufficient "payment capacity." Act No. 64 provides that a municipality has sufficient "payment capacity" to incur additional general obligation debt if the deposits in such municipality's Redemption Fund and the annual amounts collected with respect to such municipality's Special Additional Tax (as defined below), as projected by GDB, will be sufficient to service to maturity the municipality's outstanding general obligation debt and the additional proposed general obligation debt ("Payment Capacity").

The Municipality is required under applicable law to levy the Special Additional Tax in such amounts as shall be required for the payment of its general obligation municipal bonds and notes. In addition, principal of and interest on all general obligation municipal bonds and notes and on all municipal notes issued in anticipation of the issuance of general obligation bonds issued by the Municipality constitute a first lien on the Municipality's Basic Tax revenues. Accordingly, the Municipality's Basic Tax revenues would be available to make debt service payments on general obligation municipal bonds and notes to the extent that the Special Additional Tax levied by the Municipality, together with moneys on deposit in the Municipality's Redemption Fund, are not sufficient to cover such debt service. It has never been necessary to apply Basic Taxes to pay debt service on general obligation debt of the Municipality.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

The Municipality relies primarily on property and municipal taxes as well as federal grants to carry out the governmental activities. Historically, property and municipal taxes have been very predictable with increases of approximately five percent. Federal grant revenues may vary if new grants are available but the revenue also is very predictable.

Those factors were considered when preparing the Municipality's budget for the 2017-2018 fiscal year.

FINANCIAL CONTACT

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 accountability. If you have questions about the report or need additional financial information, contact the Municipality's Chief Financial Officer at P.O. Box 53 Naranjito, Puerto Rico 00719-0053.

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

ASSETS		
Cash		4,123,629
Cash with fiscal agent		3,107,026
Accounts receivable:		
Sales Taxes		11,696
Intergovernmental		198,302
Federal Grants		396,704
Capital assets		81,340,970
Total assets	$	89,178,327
LIABILITIES		
Accounts payable and accrued liabilities		1,079,367
Due to other governmental agencies		794,613
Claims and assessments		266,667
Noncurrent liabilities:		
Due within one year		684,667
Due in more than one year		18,114,290
Total liabilities	$	20,939,604
DEFERRED INFLOWS OF RESOURCES		
Deferred revenues:		
Municipal license tax	$	555,045
Federal grant revenues		136,709
Total deferred inflows of resources	$	691,754
NET POSITION		
Invested in capital assets, net of related debt		66,526,970
Restricted:		
Capital projects		1,371,561
Debt service		1,960,027
Federal and state grant funds		999,597
Deficit		(3,311,186)
Total net position	$	67,546,969

See notes to basic financial statements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NARANJITO

Statement of Activities

For the year ended June 30, 2017

		Program Revenues			Net (expense)
Functions/programs	Expenses	Charges for Services	Operating grants and contributions	Capital grants and contributions	revenue and changes in net assets
General government	$ 10,874,630	$ 297,143			$ (10,577,487)
Public safety	863,606				(863,606)
Health and welfare	2,514,363		1,821,276		(693,087)
Public works	935,252				(935,252)
Culture and recreation	886,021				(886,021)
Community development	613,438				(613,438)
Economic Development	139,332				(139,332)
Education	102,839				(102,839)
Interest on long-term debt	1,772,436				(1,772,436)
Total	$ 18,701,917	$ 297,143	$ 1,821,276	$ -	$ (16,583,498)

General revenues:	
Property taxes	$ 3,497,225
Municipal license tax	1,131,943
Sales tax	1,038,088
Grants and contributions not restricted to specific programs	8,123,620
Interest, fines and penalties	63,854
Miscellaneous	2,169,570
Total general revenues	16,024,300
Change in net position	(559,198)
Net position at beginning of year	68,106,167
Net position at end of year	$ 67,546,969

See notes to basic financial statements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NARANJITO

Balance Sheet

June 30, 2017

	General Fund	Special Revenue State and Federal Grants	Capital Projects	Debt Service	Total
ASSETS					
Cash and cash equivalents	$ 706,641	$ 2,578,520	$ 838,468	$ -	$ 4,123,629
Cash with fiscal agent	-	-	1,175,982	1,931,044	3,107,026
Accounts receivable:					
Sales Taxes	11,696	-	-	-	11,696
Intergovernmental	109,391	59,928	-	28,983	198,302
Federal Grants	-	396,704	-	-	396,704
Due from other funds	2,125,887	-	-	-	2,125,887
Total assets	$ 2,953,615	$ 3,035,152	$ 2,014,450	$ 1,960,027	$ 9,963,244
LIABILITIES, DEFERRED INFLOWS OF RESOURCES AND FUND BALANCES					
LIABILITIES					
Accounts payable and accrued liabilities	$ 663,519	$ 282,853	$ 132,995	$ -	$ 1,079,367
Due to other governmental units	794,613	-	-	-	794,613
Due to other funds	-	1,615,993	509,894	-	2,125,887
Total liabilities	1,458,132	1,898,846	642,889	-	3,999,867
DEFERRED INFLOWS OF RESOURCES					
Unearned revenues:					
Municipal license tax	555,045	-	-	-	555,045
Federal grant revenues	-	136,709	-	-	136,709
Total deferred inflows of resources	555,045	136,709	-	-	691,754
FUND BALANCES					
Restricted	-	999,597	1,371,561	1,960,027	4,331,185
Unassigned	940,438	-	-	-	940,438
Total fund balances	940,438	999,597	1,371,561	1,960,027	5,271,623
Total liabilities, deferred inflows of resources and fund balances	$ 2,953,615	$ 3,035,152	$ 2,014,450	$ 1,960,027	$ 9,963,244
Fund Balance Governmental Funds					5,271,623
Capital assets used in governmental activities are not financial resources and therefore not reported in the governmental funds.					81,340,970
Claims and assessments not due and payable in the current period					(266,667)
Long-term liabilities, including bonds payable, are not due and payable in the current period and therefore not reported in the governmental funds.					(18,798,957)
Net position					$ 67,546,969

See notes to basic financial statements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NARANJITO
Statement of Revenues, Expenditures and Changes in Fund Balances
For the year ended June 30, 2017

	General Fund	Special Revenue State and Federal Grants	Capital Projects	Debt Service	Total
REVENUES:					
Property taxes	$ 2,681,921	$ -	$ -	$ 815,304	$ 3,497,225
Municipal license tax	1,131,943	-	-	-	1,131,943
Sales tax	1,037,568	-	-	520	1,038,088
Licenses, permits and other local taxes	85,846	-	-	-	85,846
Charges for services	297,143	-	-	-	297,143
Interest, fines and penalties	63,854	-	-	-	63,854
Intergovernmental:					
Federal	-	2,287,466	-	-	2,287,466
Local	7,144,461	288,805	138,318	-	7,571,584
Other	245,975	1,021,107	902,488	-	2,169,570
Total revenues	12,688,711	3,597,378	1,040,806	815,824	18,142,719
EXPENDITURES:					
Current:					
General government	9,588,091	138,623	-	-	9,726,714
Public safety	605,202	228,505	-	-	833,707
Health and welfare	811,606	1,664,187	-	-	2,475,793
Public works	734,918	1,120	-	-	736,038
Culture and recreation	527,447	-	-	-	527,447
Community development	-	613,438	-	-	613,438
Urban development	139,332	-	-	-	139,332
Education	100,633	-	-	-	100,633
Capital outlays	1,422,094	-	178,979	-	1,601,073
Debt service:					
Principal	22,667	-	-	667,000	689,667
Interest	-	-	-	1,772,436	1,772,436
Total expenditures	13,951,990	2,645,873	178,979	2,439,436	19,216,278
EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES	(1,263,279)	951,505	861,827	(1,623,612)	(1,073,559)
FUND BALANCES, at beginning of year	2,203,717	48,092	509,734	3,583,639	6,345,182
FUND BALANCES, at end of year	$ 940,438	$ 999,597	$ 1,371,561	$ 1,960,027	$ 5,271,623

Net change in fund balance governmental funds	$ (1,073,559)
Amounts reported for governmental activities in the statement of activities are different because:	
Governmental funds report capital outlays as expenditures. However, in the statement of activities the cost of these assets is depreciated over their estimated useful lives and reported as depreciation expense. This is the amount by which capital outlays exceeded depreciation in the current period.	108,015
Claims and assessments previously reported in the statement of activities that are being reported as expenditures in the governmental funds	133,333
The issuance of long-term debt (e.g., bonds, leases) provides current financial resources to governmental funds, while the repayment of the principal of long-term debt consumes the current financial resources of governmental funds. Neither transaction, however, has any effect on net assets. Also, governmental funds report the effect of issuance costs, premiums, discounts, and similar items when debt is first issued, whereas these amounts are deferred and amortized in the statement of activities. This amount is the net effect of these differences in the treatment of long-term debt and related items.	273,013
Change in net position	$ (559,198)

See notes to basic financial statements.

1. Reporting Entity

The **Municipality of Naranjito** (the Municipality) of the Commonwealth of Puerto Rico is a local government constituted in 1824 with full legislative, fiscal and administrative powers to operate as a 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 full or shared 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.

2. Basis of Presentation and Summary of Significant Accounting Policies

The accounting and reporting policies of the Municipality conform to accounting principles generally accepted in the United States of America (U.S. GAAP), as applicable to governmental entities. The Municipality follows Governmental Accounting Standards Board (GASB) pronouncements under the hierarchy established by GASB Statement No. 55, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*, in the preparation of its financial statements.

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses/expenditures during the reported period. Actual results could differ from those estimates.

Government-Wide and Fund Financial Statements

Government-Wide Financial Statements — The statement of Net position and the statement of activities report information on all activities of the Municipality. The effect of inter-fund balances has been removed from the government-wide statement of Net position (deficiency), except for the residual amounts due between governmental and business-type activities. Inter-fund charges for services among functions of the government-wide statement of activities have not been eliminated. The Municipality's activities are distinguished between governmental and business-type activities. Governmental activities generally are financed through taxes, intergovernmental revenues, and other non-exchange revenues. Business-type activities are financed in whole or in part by fees charged to external parties for goods or services or interest earned on investment securities. Following is a description of the Municipality's government-wide financial statements.

The statement of net position presents the Municipality's assets and liabilities, with the difference reported as Net position. Net position is reported in three categories:

- Invested in capital assets, net of related debt, consist of capital assets, net of accumulated depreciation and amortization, and reduced by outstanding balances of bonds, notes, and other debt that are attributed to the acquisition, construction, or improvement of those assets, if any.
- Restricted net position result when constraints placed on Net position use are either externally imposed by creditors, grantors, contributors, and the like, or imposed by law through constitutional provisions or enabling legislation.
- Unrestricted net position consists of Net position that does not meet the definition of the two preceding categories. Unrestricted Net position often is designated, in order to indicate that management does not consider them to be available for general operations. Unrestricted Net position often has constraints on use that are imposed by management, but such constraints may be removed or modified.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment is offset by program revenues. Direct expenses are those that are clearly identifiable within a specific function. Program revenues include (1) interest income on loans and investments, changes in the fair value of investments, and fees and charges to customers for services rendered or for privileges provided and (2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function. Other items not meeting the definition of program revenues are reported as general revenues.

Fund Financial Statements — Fund accounting is designed to demonstrate legal compliance and to aid financial management by segregating transactions related to certain government functions or activities. A fund is a separate accounting entity with a self-balancing set of accounts. The financial activities of the Municipality that are reported in the accompanying basic financial statements have been classified into governmental and enterprise funds.

Separate financial statements are provided for governmental funds and enterprise funds. Major individual governmental and enterprise funds are reported as separate columns in the fund financial statements, with non-major funds being combined into a single column.

Fund balances for each governmental fund are displayed in the following classifications depicting the relative strength of the spending constraints placed on the purposes for which resources can be used:

- Nonexpendable — amounts that cannot be spent because they are not in a spendable form (such as inventories and prepaid amounts) or are legally or contractually required to be maintained intact.
- Restricted — amounts that can be spent only for specific purposes because of constraints imposed by external providers (such as grantors, bondholders, and higher levels of government), or imposed by constitutional provisions or enabling legislation.
- Committed — amounts that can be spent only for specific purposes determined by a formal action of the government's highest level of decision-making Municipality.
- Assigned — amounts the government intends to use for specific purposes that do not meet the criteria to be classified as restricted or committed.
- Unassigned — amounts that are available for any purpose.

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

Measurement Focus, Basis of Accounting, and Financial Statements Presentation

Government-Wide Financial Statements **—** The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenues as soon as all eligibility requirements imposed by the provider have been met.

Governmental Funds Financial Statements — The governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the Municipality considers revenues to be available if they are collected within 120 days after the end of the fiscal year. Principal revenue sources considered susceptible to accrual include federal and Commonwealth funds to be received. Other revenues are considered to be measurable and available only when cash is received. Expenditures generally are recorded when a liability is incurred, as under accrual accounting.

Modifications to the accrual basis of accounting include:

- Interest on general long-term obligations is generally recognized when paid.
- Debt service principal expenditures and claims and judgments are recorded only when payment is due.

For financial reporting purposes, the Municipality classifies its governmenta1 funds within the following categories:

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

Special revenue funds - Special revenue funds are 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 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.

Capital projects funds - Capital projects funds are governmental funds, 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 in the capital projects funds.

The use of the capital projects funds 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 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 10 percent of the corresponding element total (assets, liabilities, revenues or expenditures) for all governmental funds. For the purposes of applying the aforementioned major fund criteria, no eliminations of interfund balances have been made. Total revenues for these purposes means all revenues, including operating and 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.

Based on the aforementioned criteria, the Municipality's major governmental funds reported in the accompanying GFFS are: (1) the general fund, (2) the special revenue state and federal grants fund, and (3) the capital projects fund.

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.

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.

Budgetary Control

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.

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 preliminary 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 30.

The Municipal Legislature has 10 business days, up to the immediately preceding June 30, 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 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 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 within the general and debt service funds, respectively.

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

Budgetary Accounting

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

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 unspent balance from the prior year be carried forward and made available for current spending.

The accompanying statement of revenues and expenditures - budget and actual - budgetary basis - 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.

Deposits and Investments

Under Puerto Rico statutes, public funds deposited in commercial banks must be fully collateralized for the amount deposited in excess of federal depository insurance. All securities pledged as collateral are held by the Secretary of the Treasury of Puerto Rico. In addition, the Municipality maintains deposits with the Government Development Bank for Puerto Rico (GDB).

The Municipality's bank balances in commercial banks of $3,340,555 in the general fund, special revenue state and federal grants fund and capital projects fund were fully collateralized at June 30, 2017.

The deposits at GDB of $1,748,448, restricted for capital projects, joint resolutions, other governmental funds, and for debt service, are unsecured and uncollateralized, as no collateral is required to be carried by governmental bank.

Accounts 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”

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.

Inter-fund Activities

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

Inter-fund loans – Represent amounts provided with a requirement for repayment, which are recorded as “due from” in the lender governmental fund and “due to” in the borrower governmental fund. Inter-fund receivables, which are not considered to be currently available financial resources, are reported as advances. For amounts not expected to be collected within a reasonable period of time, inter-fund receivables/payables are reduced to the estimated realizable value and the amount that is not expected to be repaid is reported as an operating transfer from the governmental fund that made the loan.

Inter-fund transfers – Represent flows of assets (permanent reallocation of financial resources among governmental funds) without equivalent flows of assets in return and without a requirement for repayment.

Operating transfers are reported as other financing sources in the governmental fund making transfers and as other financing sources in the governmental fund receiving transfers.

Inter-fund reimbursements — Represent repayments from the governmental fund responsible for particular expenditures or expenses to the governmental fund that initially paid for them.

Capital Assets

Capital assets used in governmental activities include land and land improvements, buildings, structures and building improvements, machinery and equipment, furniture and fixtures, vehicles, construction in progress, and infrastructure. These assets are capitalized and reported in the accompanying statement of net position. Infrastructure assets are generally stationary in nature and include roads, bridges, streets and sidewalks, drainage systems and other similar assets.

For financial reporting purposes, the Municipality defines capital assets as assets with an individual cost of $5,000 or more at the date of acquisition, construction or improvement, and with useful lives extending beyond one year. All assets with individual costs under $5,000 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.

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

Depreciation and amortization expense is recorded only in the government-wide statement of activities. However, there is no depreciation or amortization recorded for land and construction in progress. Depreciable capital assets are generally depreciated or amortized over their estimated useful lives under the straight-line method. The estimated useful lives of major capital asset categories are:

Description	**Years**
Buildings	50
Infrastructure	10
Building and site improvements	25
Vehicles	10
Machinery and equipment	7

Impaired capital assets that will no longer be used by the Municipality, if any, are reported at the lower of carrying value or fair value. Impairment losses on capital assets with physical damages that will continue to be used by the Municipality are measured using the restoration cost approach. Impairments of capital assets that are subject to a change in the manner or duration of use, or assets affected by enactment or approval of laws or regulations or other changes in environmental factors or assets that are subject to technological changes or obsolescence, if any, are measured using the service units approach.

Unearned Revenues

In the GFFS, unearned revenue arises when one of the following situations occur:

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

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

Compensated Absences

Compensated absences are accounted for under the provisions of Statement No. I6, *Accounting for Compensated Absence,* 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, 2013 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. .

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.

Long-term Debt

The long term liabilities reported in the accompanying statements of net position include the Municipality's bonds payable, notes payable, accrued compensated absences, and accrued legal claims and judgments if any.

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.

Accounting for Pension Costs and Post-Employment Benefits

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

The government of the Commonwealth of Puerto Rico is considered to be the sponsor of the Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS) and System 2000, a multi-employer cost-sharing defined benefit pension plan and a hybrid defined contribution plan, respectively, in which the employees of the Municipality participate.

The Municipality is considered a participant, and not a sponsor, of these retirement systems since the majority of the participants in the aforementioned pension trust funds are employees of the Commonwealth of Puerto Rico and the basic financial statements of such retirement systems are part of the financial reporting entity of the Commonwealth of Puerto Rico.

Risk Management

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.

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.

Future Adoption of Accounting Pronouncements — The GASB has issued the following statements:

- GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions,* which is effective for periods beginning after June 15, 2017.
- GASB Statement No. 81, *Irrevocable Split-Interest Agreements,* which is effective for periods beginning after December 15, 2017.
- GASB Statement No. 83, *Certain Asset Retirement Obligations,* which is effective for periods beginning after June 15, 2018.
- GASB Statement No. 84, *Fiduciary Activities,* which is effective for periods beginning after December 15, 2018.
- GASB Statement No. 85, *Omnibus 2017,* which is effective for periods beginning after June 15, 2017.
- GASB Statement No. 86, *Certain Debt Extinguishment Issues*, which is effective for periods beginning after June 15, 2017.
- GASB Statement No. 87, *Leases,* which is effective for periods beginning after December 15, 2019.
- GASB Statement No. 88, *Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements,* which is effective for periods beginning after June 15, 2018.

Management is evaluating the impact that these statements will have on the Municipality's basic financial statements.

2. Credit Risk

The following is essential information about credit risk, interest rate risk, custodial credit risk, and foreign exchange exposure of deposits and investments of the Municipality at June 30, 2017:

Credit risk – This is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. In compliance with the laws and regulations of the Commonwealth of Puerto Rico, the Municipality has adopted, as its custodial credit risk policy, the *Statement of Uniform Investment Guidelines for the Municipalities of the Commonwealth of Puerto Rico, issued by the Government Development Bank for Puerto Rico*. Accordingly, the Municipality is only allowed to invest in obligations of the Commonwealth of Puerto Rico, obligations of the United States of America, certificates of deposit, commercial paper, bankers' acceptances or in pools of obligations of the Municipalities of Puerto Rico, which are managed by GDB. According to the aforementioned investment guidelines, the Municipality is not allowed to invest in marketable securities or any other type of investments (debt securities) for which credit risk exposure may be significant. Consequently, at June 30, 2017 and for the fiscal year then ended, the Municipality invested only in certificates of deposit in commercial banks, which are insured by the Federal Deposit Insurance Corporation (FDIC), generally up to a maximum of $250,000 per depositor. No investments in debt of equity securities were made during the fiscal year ended June 30, 2017. Therefore, the Municipality's management has concluded that the credit risk related to any possible loss related to defaults by commercial banks on the Municipality's deposits is considered low at June 30, 2017.

Interest rate risk - This is the risk that changes in interest rates of debt investments will adversely affect the fair value of an investment. The Municipality manages its exposure to declines in fair values by: (1) not including debt or equity investments in its investments portfolio at June 30, 2017, (2) limiting the weighted average maturity of its investments in certificates of deposit to periods of three months or less and (3) keeping most of its banks deposits and certificates of deposit in interest bearing accounts generating interest at prevailing market rates as required by the *Statement of Uniform Investment Guidelines for the Municipalities of the Commonwealth of Puerto Rico, issued by the Government Development Bank for Puerto Rico* (the adopted policy of the Municipality). At June 30, 2017, the interest rate risk associated with the Municipality's cash and cash equivalent is considered low since the investment portfolio of the Municipality consists of certificates of deposit and do not include debt securities or any type of investments that could be affected by changes in interest rates.

Custodial credit risk — In the case of deposits, this is the risk that in the event of a bank failure, the Municipality's deposits may not be recovered. Pursuant to the *Statement of Investment Guidelines for the Government of the Commonwealth of Puerto Rico,* the balances deposited in commercial banks by the Municipality are insured by the Federal Deposit Insurance Corporation (FDIC), generally up to a maximum of $250,000 per depositor. In addition, public funds deposited in commercial banks by the Municipality are fully collatera1ized for the amounts deposited in excess of the federal depository insurance. All securities pledged as collateral are held in the Municipality's name by the agents of the Commonwealth's Secretary of Treasury. Deposits of GDB, are uninsured and uncollateralized. However, no losses related to defaults by GDB on deposit transactions have been incurred by the Municipality through June 30, 2017. It is management's policy to only maintain deposits in banks affiliated to FDIC to minimize the custodial credit risk, except for GDB.

Therefore, the Municipality's management has concluded that at June 30, 2017, the custodial credit risk associated with the Municipality's cash and cash equivalents is considered low.

<u>Foreign exchange risk</u> – This is the risk that changes in exchange rates will adversely affect the value of an investment or a deposit. According to the aforementioned investment guidelines, adopted by the Municipality, the Municipality is prevented from investing in foreign securities or any other types of investments for which foreign exchange risk exposure may be significant. Accordingly, management has concluded that the foreign exchange risk related to the Municipality's deposits is considered low at June 30, 2017.

3. Property Taxes

The personal property tax is self-assessed by the taxpayer on a return which is to be filed by May 15 of each year with the CRIM, a governmental entity created by the government of Puerto Rico as part of the Municipal Governmental Autonomy Laws of August 1991. Real property tax is assessed by the CRIM on each piece of real estate and on each building.

The assessment is made as of January 1 of each year and is based on current values for personal property and on estimated values as of 1957 for real property tax. The tax on personal property must be paid in full together with the return by May 15. The tax on real property may be paid in two installments by July I and January 1. The CRIM is responsible for the billing and collections of real and personal property taxes on behalf of all the municipalities of Puerto Rico. Prior to the beginning of each fiscal year, the CRIM informs the Municipality of the estimated amount of property tax expected to be collected for the ensuing fiscal year. Throughout the year, the CRIM advances funds to the Municipality based on the initial estimated collections. The CRIM is required by law to prepare a settlement statement on a fiscal year basis, whereby a comparison is made between the amounts advanced to the Municipality and amounts actually collected from taxpayers. This settlement has to be completed on a preliminary basis not later than three months after fiscal year-end, and a final settlement made not later than six months after year-end. If the CRIM remits to the Municipality property tax advances, which are less than the tax actually collected, a receivable from the CRIM is recorded at June 30. However, if advances exceed the amount actually collected by the CRIM, deferred revenue is recorded at June 30.

On January 26, 2000, Public Law No. 42 was enacted authorized the CRIM to obtain a loan up to $200,000,000, and for a term not to exceeding 10 years, to allow for the financing of the debt that the Municipalities of Puerto Rico have with the CRIM arising from final settlements of property tax advances versus actual collections through fiscal year ended June 30, 2000. The amounts that the Municipalities will collect from additional property taxes resulting from increases in the subsidy from the Commonwealth of Puerto Rico to the Municipalities are assigned through this law to repay such loan. The increase in this subsidy was the result of the Public Law No. 238, enacted on August 15, 1999. On October 11, 2001, Public Law No. 146 was enacted to amend Public Law No. 42, to extend the loan amortization period up to 30 years.

Also, on October 11, 2002, Public Law No. 172 was enacted, to provide as an option for the Municipalities to include the debt that the Municipalities of Puerto Rico have with the CRIM arising from final settlements of property tax advances versus actual collections for the fiscal year ended June 30, 2001 with the loan authorized through Public Law No. 42 enacted on January 26, 2000.

On June 26 1997, Public Law No. 21 was enacted authorizing the CRIM, among other things, to sell the property tax receivables related to taxpayers who owed property taxes from 1974 to 1996. Such property tax receivables were purchased by the Public Financing Corporation, a subsidiary of the Government Development Bank of Puerto Rico (GDB) using the proceeds of a bond issuance executed for such purposes. Said Law imposed the CRIM the obligation to replace uncollectible property tax receivables with any valid property tax receivable or equivalent in money. Subsequent to the approval of the Law and to the sale transaction, it was detected that a substantial percentage of the receivables sold were uncollectible. In order to protect the economic damage to the financial structure of municipalities caused by the substitution of uncollectible tax receivables with sound collectible receivables, on October 11, 2001, Public Law No. 146 was approved and enacted. Through this Law, the CRIM was authorized to obtain a loan from any qualified financial institution and pay in advance the outstanding balance of the bonds issued and any related cost incurred for the purchase by the Public Financing Corporation (a GDB subsidiary) of the tax receivables.

Residential real property occupied by its owner is exempt by law from the payment of property taxes on the first $15,000 of the assessed value. For such exempted amounts, the Puerto Rico Treasury Department assumes payment of the basic tax to the Municipalities, except for property assessed at less than $3,500 for which no payment is made. As part of the Municipal Autonomous Law of 1991, the exempt amount to be paid by the Puerto Rico Treasury Department to the Municipalities was frozen as of January 1, 1992. In addition, the law grants a tax exemption from the payment of personal property taxes of up to $50,000 of the assessed value to retailers having annual net sales of less than $150,000.

The annual tax rate for fiscal year 2015-2017 is 7.83% for real property and 5.83% for personal property of which 1.03% of both tax rates are for the redemption of public debt issued by the Commonwealth of Puerto Rico. The remaining percentage is distributed as follows: (a) 6.80% and 4.80%, respectively, represents the Municipality’s basic property tax rate which is appropriated for basics and accounted for in the general fund. A portion of such amount is deposited in an equalization fund together with a percentage of the net revenues of the Puerto Rico electronic lottery and a subsidy from the Commonwealth of Puerto Rico. From such fund, a distribution is made to all municipalities; (b) 1.00% represents the ad valorem tax restricted for debt service. The Commonwealth also contributes an annual tax rate of 0.2% of the Property tax collected and such amount is accounted for similar to item (a) above.

Property tax revenues in the general and debt service funds amounted to $2,681,921 and $815,304, respectively, for the fiscal year ended June 30, 2017.

4. Municipal License Taxes

The Municipality is authorized to impose and collect municipal license taxes to any natural or legal person having trade or business activities within the territory of NARANJITO. 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.

Each taxpayer must assess the corresponding municipal license tax by declaring the volume of business through a tax return to be filed every April 15, based on the actual volume of business (revenues) generated in the preceding calendar year. Taxpayers with a sales volume of $3 million or more must include audited financial statements with their tax return filings. The tax can be paid by the taxpayer in two equal installments due on July 15 and January 15, subsequent to the filing of the declaration on April 15. The first installment of the tax covers the six-month period ended December 31, subsequent to the filing date of the declaration, while the second installment of the tax covers the six-month period ended June 30 of the subsequent calendar year. If a taxpayer elects to pay the tax in full on the filing date of the declaration (generally April 15), a 5 percent discount is granted automatically on the total tax amount due. Municipal license tax revenues for the fiscal year ended June 30, 2017 amounted to $1,131,943 in the accompanying financial statements.

Any municipal license taxes collected in advance (that is, pertaining to a future fiscal year) are recorded as unearned revenues. Unearned municipal license tax revenues recorded in the accompanying GWFS and GFFS amounted to $555,045 at June 30, 2017. This amount represents the municipal license taxes corresponding to fiscal year ending June 30, 2017 that were collected in advance during the last quarter of the current fiscal year, as required by law.

5. Sales and Use Taxes

The Municipality imposes a sales and use tax pursuant to the provisions of the Puerto Rico Internal Revenue Code, as amended. The tax consists of one percent (1.0%) on the sales price of taxable items or on the purchase prices of all usage, storage, or consumption of taxable items, excluding wholesales. The sales and use tax is a self-assessed tax collected by the Municipality through monthly tax returns due on the twentieth day of the immediate following month. The tax returns are filed by the respective businesses that are required by law to withhold the tax from consumers on each taxable product or service. Sales and use tax revenues amounted to $1,037,568 for the fiscal year ended June 30, 2017.

The commonwealth of Puerto Rico imposes a separate state sales and use tax of 0.5%, which is imposed and collected by the Puerto Rico Treasury Department through monthly tax return due on the twentieth day of the immediate following month. This 0.5% tax is administered by the Government Development Bank of Puerto Rico for the following purposes: (1) 0.2% is deposited in the new “Municipal Debt Service Fund”, strictly for granting loans to the municipalities of Puerto Rico; (2) 0.2% for the creation of the “Municipal Development Fund” percentage, which will be distributed among all municipalities pursuant to a statutory formula; and (3) 0.1%, for the creation of the “Permanent Improvements Fund”, to be distributed by the Legislature of the Commonwealth of Puerto Rico to carry out public works and permanent improvement projects in the municipalities of Puerto Rico.

6. Intergovernmental Receivables and Payables

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

Program Description	Amount	
CRIM	$	138,374
AUXILIARES EN EL HOGAR		40,000
ESG		5,820
FTA		14,108
Total	$	198,302

Federal grants receivable in special revenue state and federal grants and Capital Projects Fund represents expenditures incurred not yet reimbursed by the pass-through grantor. Following is a detail of the federal grants receivable:

Program Description	Amount	
Community Development Block Grant - State Program	$	244,540
Child Care		79,711
CADEN		72,453
Total	$	396,704

7. Inter-fund Transactions

Inter- fund – receivables and payables at June 30, 2017 are summarized as follows:

Fund	Receivable Fund		Payable Fund	
General Fund	$	2,125,887		
Special Revenue State and Federal Fund			$	-
Capital Projects Fund				2,125,887
	$	2,125,887	$	2,125,887

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.

8. Unearned Revenues

Unearned revenues of $555,045 in the general fund is related to municipal license tax collected in fiscal year 2016-2017 that will be earned in fiscal year 2017-2018.

9. Long-Term Obligations

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

	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Bonds payable	$ 15,481,000	$ -	$ (667,000)	$ 14,814,000	$ 662,000
CRIM - Law 42	573,757	-	(19,534)	554,223	19,534
CRIM - Law 146	50,135	-	(3,133)	47,002	3,133
ASES	746,040	-	-	746,040	-
AAA	366,032	-	-	366,032	-
Compensated absences	1,855,006	947,383	(1,089,114)	1,713,275	-
	$ 19,071,970	$ 947,383	$ (1,778,781)	$ 18,240,572	$ 684,667

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

b) Bonds Payable

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

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

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:

1999 General obligation bond for infrastructure's construction with an original amount of $56,000 due in installments of $2,000 to $4,000 through July 1, 2024, with interest of 4.50%	23,000
2000 General obligation bond for infrastructure construction with an original amount of $38,000 due in installments of $1,000 to $3,000 through July 1, 2025, with interest rate of 4.50%	17,000
2007 General obligation bond for infrastructure's construction with an original amount of $3,195,000 due in installments of $40,000 to $265,000 through July 1, 2032, with interest ranging from 1.53% to 7.00%	2,530,000
2008 Special obligation note for infrastructure's construction with an original amount $2,685,000 due in installments of $40,000 to $225,000 through July 1, 2032 with interest ranging from 1.53% to 7.25%	2,235,000
2009 Special obligation bond for infrastructure's construction with an original amount of $350,000 due in installments of $5,000 to $35,000 through July 1, 2034, with interest ranging from 5.00% to 7.00%	310,000
2009 General obligation bond for infrastructure's construction with an original amount of $335,000 due in installments of $5,000 to $30,000 through July 1, 2034, with interest ranging from 5.00% to 7.00%	295,000
2009 General obligation bond for infrastructure's construction with an original amount of $3,620,000 due in installments of $55,000 to $305,000 through July 1, 2034, with interest ranging from 4.75% to 7.00%	3,160,000
2009 Special obligation bond for infrastructure's construction with an original amount of $225,000 due in installments of $5,000 to $20,000 through July 1, 2034, with interest ranging from 5.00% to 7.50%	190,000
2010 Special obligation bond for infrastructure's construction with an original amount of $1,010,000 due in installments of $10,000 to $85,000 through July 1, 2035, with interest ranging from 5.00% to 7.50%	915,000
2011 Special obligation bond to compensate obligations related with the Municipal Revenue Collection Center (CRIM) with an original amount of $1,490,000 due in installments of $20,000 to $130,000 through July 1, 2035, with interest ranging from 6.00% to 7.50%	1,335,000
2012 General obligation bond for infrastructure's construction or improvements with an original amount of $645,000 due in installments of $15,000 to $65,000 through July 1, 2031, with interest ranging from 5.00% to 7.50%	550,000
2012 Special obligation note for infrastructure's construction or improvements with an original amount of $1,410,000 due in installments of $20,000 to $125,000 through July 1, 2036, with interest ranging from 6.00% to 7.50%	1,290,000
2013 General obligation bond for infrastructure's construction or improvements with an original amount of $405,000 due in installments of $45,000 to $75,000 through July 1, 2019, with interest ranging from 6.00% to 7.50%	200,000
2012 General obligation bond for infrastructure's construction or improvements with an original amount of $575,000 due in installments of $10,000 to $50,000 through July 1, 2037, with interest ranging from 6.00% to 7.50%	535,000
2012 Special obligation note for infrastructure's construction or improvements with an original amount of $560,000 due in installments of $5,000 to $45,000 through July 1, 2037, with interest ranging from 6.00% to 7.50%	530,000
2014 Special obligation note for equipment acquisition with an original amount of $763,000 due in installments of $97,000 to $121,000 through January 1, 2021, with interest rate of 3.50%	459,000
2014 Special obligation note for equipment acquisition with an original amount of $407,000 due in installments of $54,000 to $62,000 through January 1, 2021, with interest rate of 2.125%	240,000
	$ 14,814,000

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.

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

Year ending June 30,	Principal	Interest
2018	662,000	1,008,709
2019	692,000	967,455
2020	737,000	923,696
2021	703,000	879,909
2022	560,000	838,931
2023-2027	3,485,000	3,595,708
2028-2032	4,910,000	2,085,462
2033-2037	2,970,000	468,569
2038	95,000	3,563
	$ 14,814,000	$ 10,772,002

c. Advances from- CRIM-.This amount represents the balance owed to CRIM at June 30, 2017 which will be repaid through a financing obtained by the CRIM with GDB, as explained in Note 3.

d. Compensated absences – The government-wide statement of net position includes $1,713,275 of accrued sick leave benefits and accrued vacation benefits and related employer payroll cost, representing the Municipality's commitment to fund such costs from future operations.

NOTE 10. CAPITAL ASSETS

Capital assets; those with an estimated useful live of five years or more from the time of acquisition by the Municipality and a cost of $5,000 or more, are primarily funded through the issuance of long-term bonds and loans. A summary of capital assets and changes occurring in current year, including those changes for infrastructure and construction in-progress pursuant to the implementation of GASB Statement No. 34, follows. Land and construction in progress are not subject to depreciation:

Governmental Activities:	Balance July 1, 2016	Additions	Retirements	Balance June 30, 2017
Capital asset, not being depreciated:				
Land	$ 23,117,239	$	$ -	$ 23,117,239
Construction in progress	24,928,484			24,928,484
Total capital assets not being depreciated	48,045,723			48,045,723
Capital assets, being depreciated:				
Buildings and building improvements	7,652,019	-	-	7,652,019
Site improvements	15,592,168	207,763	-	15,799,932
Infrastructure	20,525,565	1,137,470	-	21,663,035
Furniture and fixtures	2,938,023	0	-	2,938,023
Works of Art	9,885	0	-	9,885
Vehicles	5,672,675	255,840	-	5,928,515
Total capital assets being depreciated	52,390,335	1,601,073		53,991,408
Less accumulated depreciation for:				
Buildings and building improvements	(3,316,099)	(191,300)	-	(3,507,399)
Site improvements	(1,913,589)	(394,998)	-	(2,308,587)
Equipment	(2,864,799)	(52,368)	-	(2,917,167)
Infraestructure	(6,234,645)	(494,410)	-	(6,729,055)
Works of Art	(4,853)	(928)	-	(5,781)
Vehicles	(4,869,118)	(359,053)	-	(5,228,172)
Total accumulated depreciation	(19,203,103)	(1,493,058)	-	(20,696,161)
Total capital assets being depreciated, net	$ 33,187,232	$ 108,015	-	$ 33,295,247
Governmental activities capital assets, net	$ 81,232,955	$ 108,015	-	$ 81,340,970

11. Employees' Retirement Systems

Defined Benefit Pension Plan — The Employees' Retirement System of the Government of the Commonwealth of Puerto Rico (the "Retirement System"), created pursuant to Act No. 447 of May 15, 1951, as amended, is a cost-sharing, multiple-employer defined benefit pension plan sponsored by and reported as a component unit of the Commonwealth. All regular employees of the Municipality hired before January 1, 2000, and less than 55 years of age at the date of employment became members of the Retirement System as a condition to their employment. No benefits are payable if the participant receives a refund of accumulated contributions.

The Retirement System provides retirement, death, and disability benefits pursuant to legislation enacted by the Commonwealth's Legislature. Retirement benefits depend upon age at retirement and the number of years of creditable service. Benefits vest after 10 years of plan participation. Disability benefits are available to members for occupational and non-occupational disabilities. However, a member must have at least 10 years of service to receive non-occupational disability benefits.

Members who have attained at least 55 years of age and have completed at least 25 years of creditable service, or members who have attained 58 years of age and have completed 10 years of creditable service, are entitled to an annual benefit payable monthly for life. The amount of the annuity shall be 1.5% of the average compensation, as defined, multiplied by the number of years of creditable service up to 20 years, plus 2% of the average compensation, as defined, multiplied by the number of years of creditable service in excess of 20 years. In no case will the annuity be less than $200 per month.

Participants who have completed at least 30 years of creditable service are entitled to receive the merit annuity. Participants who have not attained 55 years of age will receive 65% of the average compensation, as defined; otherwise, they will receive 75% of the average compensation, as defined.

Commonwealth legislation requires employees to contribute 5.775% for the first $550 of their monthly gross salary and 8.275% for the excess over $550 of monthly gross salary. The Municipality is required to contribute 10.275% of the participant's gross salary. On April 4, 2013 the Legislature enacted Act No. 3 which amended Act No. 447 to establish a new retirement program.

Defined Contribution Plan — The Legislature of the Commonwealth enacted Act No. 305 on September 24, 1999, which amended Act No. 447 to establish, among other things, a defined contribution savings plan program (the "Program") to be administered by the Retirement System. All regular employees hired for the first time on or after January 1, 2000, and former employees who participated in the defined benefit pension plan, received a refund of their contributions, and were rehired on or after January 1, 2000, become members of the Program as a condition to their employment. In addition, employees who at December 31, 1999, were participants of the defined benefit pension plan had the option, up to March 31, 2000, to irrevocably transfer their contributions to the defined benefit pension plan, plus interest thereon to the Program.

Act No. 305 requires employees to contribute 8.275% of their monthly gross salary to the Program. Employees may elect to increase their contribution up to 10% of their monthly gross salary. Employee contributions are credited to individual accounts established under the Program. Participants have three options to invest their contributions to the Program. Investment income is credited to the participant's account semiannually.

The Municipality is required by Act No. 305 to contribute 10.275% of the participant's gross salary. The Retirement System will use these contributions to increase its asset level and reduce the unfunded status of the defined benefit pension plan. On April 4, 2013 the Legislature enacted Act No. 3 which amended Act No. 305 to establish a new retirement program.

Upon retirement, the balance in the participant's account will be used to purchase an annuity contract, which will provide for a monthly benefit during the participant's life and 50% of such benefit to the participant's spouse in case of the participant's death. Participants with a balance of $10,000 or less at retirement will receive a lump-sum payment. In case of death, the balance in the participant's account will be paid in a lump sum to any beneficiaries. Participants have the option of a lump-sum payment or purchase of an annuity contract in case of permanent disability.

Defined Contribution Hybrid Program – On April 4, 2013 the Legislature enacted Act No. 3 which amended Act No. 447 and Act. No. 305 to establish, among other things, a defined contribution hybrid program (the "Hybrid Program") to be administered by the Retirement System. All regular employees hired for the first time on or after July 1, 2013, and former employees who participated in the defined benefit pension plan and the defined contribution plan, and were rehired on or after July 1, 2013, become members of the Hybrid Program as a condition to their employment. In addition, employees who at June 30, 2013 were participants of previous plans will become part of the Defined Contribution Hybrid Program.

Participants in the defined benefit pension plan who as of June 3, 2013, were entitled to retire and receive some type of pension, may retire on any later date and will receive the annuity corresponding to their retirement plan, as well as the annuity accrued under the Hybrid Program. Participants who as of June 30, 2013, have not reach the age of 58 and completed 10 years of service or have not reach the age of 55 and completed 25 years of service can retire depending on the new age limits defined by the Hybrid Program and will receive the annuity corresponding to their retirement plan, as well as the annuity accrued under the Hybrid Program.

Participants in the defined contribution plan who as of June 30, 2013, were entitled to retire because they were 60 years of age may retire on any later date and will receive the annuity corresponding their retirement plan, as well as the annuity accrued under the Hybrid Program. Participants in the Program who as of June 30, 2013, have not reach the age of 60 can retire depending on the new age limits defined by the Hybrid Program and will receive the annuity corresponding to their retirement plan, as well as the annuity accrued under the Hybrid Program.

Act. No. 3 requires employees to contribute ten percent (10%) of their monthly gross salary to the Hybrid Program. Employee contributions are credited to individual accounts established under the Hybrid Program. In addition a mandatory contribution equal to or less than point twenty five percent (.25%) is required for the purchase of disability insurance.

The Municipality is required to contribute 12.275% of each participant's gross salary. The Retirement System will use these contributions to increase its level of assets and to reduce the actuarial deficit. Beginning on July 1, 2013, and up until June 30, 2017, the employer's contribution rate shall be annually increased by one percent (1%). Beginning July 1, 2017, and up until June 30, 2021, the employer's contribution rate that is in effect on June 30 of every year shall be annually increased on every successive July 1st by one point twenty-five percent (1.25%).

Upon retirement, the balance in each participant's account will be used to purchase an annuity contract, which will provide for a monthly benefit during the participant's life. In case of the pensioner's death the designated beneficiaries will continue receiving the monthly benefit until the contributions of the participant are completely consumed. In case of the participants in active service a death benefit will be paid in one lump sum in cash to the participant's beneficiaries. Participants with a balance of less than $10,000 or less than five years of computed services at retirement will receive a lump-sum payment. In case of permanent disability the participants have the option of receiving a lump sum or purchasing an annuity contract

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 provided the Municipality with the required information to implement the requirements of GASB 68. Therefore, the accompanying 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 position as of July 1, 2015 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, 2017. Also, additional disclosures required by GASB 68 as well as required supplementary information have been omitted from these basic financial statements.

Additional information on the Retirement System is provided on its standalone financial statements for the year ended June 30, 2011, a copy of which can be obtained from the Employees' Retirement System of the Commonwealth of Puerto Rico, P.O. Box 42004, San Juan PR 00940-2004.

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

On July 15, 2015, the Municipality entered into an agreement with a supplier for the payment of $600,000 as settlement of an ongoing litigation for services that were performed between 2005 and 2008. The $600,000 will be paid in four installments, the first one being in July 15, 2015 for the amount of $200,000 and three equal installments of $133,333 every year thereafter. The amount outstanding at June 30, 2017 is $266,667.

The Municipality has reported committed fund balance, for the outstanding encumbrances amounting to $167,137 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.

The Municipality has reserved and committed funds for outstanding construction projects amounting to approximately $1.7 million at June 30, 2017.

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.

13. Deposits in Governmental Development Bank for Puerto Rico

The Governmental Development Bank for Puerto Rico ("Bank" or "GDB") has traditionally served as interim lender to the Commonwealth and its public corporations (also referred to herein as instrumentalities) and municipalities in anticipation of the issuance of long term bonds and notes by such entities in the municipal bond market. The Bank has also 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. As a result of this lending function, the Bank traditionally served as the principal source of short term liquidity for the Commonwealth, its public corporations and municipalities. Refer to Note 14 for current status of GDB.

Municipality's Deposits in GDB

As of June 30, 2017, the Municipality had the following cash and certificates of deposits in GDB:

Fund	Amount
Capital Projects	$ 1,748,448
Debt Service	1,365,424
	$ 3,113,872

Certificates of deposits in GDB are carried at cost based on the requirements of Statement No. 31 of the Governmental Accounting Standards Board (GASB 31) "Accounting and Financial Reporting for Certain Investments and for External Investment Pools". Management of the Municipality believes the cost basis remains the appropriate basis of accounting for such deposits based on the fact that the provisions of GASB 31 imply but do not mandate the recognition of the unrealized loss. Management of the Municipality has also evaluated if a contingency exist in the Deposits in GDB based on the requirements of Statement No. 62 of the Governmental Accounting Standards Board (GASB 62) "Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements" paragraphs 96 to 110.

Management believes, based on the information provided in Note 14, that the existence of the contingency is reasonably possible but not probable at this time and that there is no sufficient information to reasonably estimate such contingency, if any. Accordingly, Management of the Municipality has concluded that no contingency needs to be recorded as of June 30, 2017.

14. Subsequent events

On July 14, 2017, the Financial Oversight and Management Board for Puerto Rico (Oversight Board) created by Congress authorized the Government Development Bank for Puerto Rico (GDB) to pursue the restructuring of its debts under Title VI of PROMESA and conditionally certified GDB's Restructuring Support Agreement (RSA) under the relevant provisions of Title VI.

The Oversight Board's decision was in response to a Fiscal Agency and Financial Advisory Authority (FAFAA) request, dated June 30, 2017, in which the agency noted that the proposed restructuring, along with certain related settlements contemplated by the RSA, will result in an efficient wind down of GDB's operations and a comprehensive financial restructuring of GDB's obligations. FAFAA noted further that by proceeding under Title VI of PROMESA with the requisite creditor support, GDB believes that it will realize its objective of maximizing value for its stakeholders, while avoiding the delay, expense and uncertainty associated with litigation.

The RSA provides for the organized and consensual restructuring of a substantial portion of GDB's liabilities, including GDB public bonds, deposit claims by municipalities and certain non-public entities and claims under certain GDB-issued letters of credit and guarantees (Participating Bond Claims). In exchange for releasing GDB from liability relating to these claims, the claim-holders will receive new bonds to be issued by a new entity (the Issuer).

Due to the effects of the hurricanes, loss of communication, impairment to municipal revenues and liquidity, and the impact to GDB real estate owned assets, FAFAA, GDB and the RSA Requisite Bondholders agreed on revising certain milestones. They agreed on certain amendments to the RSA structure (Amended RSA) resulting in:

- Simplified structure (one security offered to Participating Bond Claims instead of original three).

- All municipal deposits will be applied against corresponding municipal loans to provide cash flow relief to municipalities to mitigate near-term impact of hurricanes.

The RSA Summary are as follow:

- RSA is consistent with the previously certified GDB Fiscal Plan, as it contemplates the conclusion of the orderly wind-down of GDB and a Title VI Qualifying Modification for the restructuring of GDB's Participating Bond Claims. RSA contemplates dividing GDB's assets into (i) the Recovery Authority for the benefit of bondholders, municipal depositors, and non-government entity depositors, and (ii) the Public Entity Trust (PET) for the benefit of other Government Entity Depositors.

- GDB will continue to exist as a legal entity for the purpose of resolving (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.

- GDB and the PET will be pre-funded at the time of closing of the Restructuring (as defined in the RSA) and will not require further financial assistance from the Recovery Authority, the PET or the Government.

- Prior to the closing of the Restructuring, the Amended RSA will simplify the GDB restructuring transaction while simultaneously providing additional relief to municipalities as they recover from the severe damage and devastation caused to Puerto Rico and its municipalities in the wake of Hurricanes Irma and María. The amendment to the RSA provides that, upon consummation of the transaction, each municipality will be authorized to apply the full amount of deposits held at GDB against the balance of any loan owed by such municipality to GDB. Additionally, to provide municipalities with immediate liquidity, the amendment to the RSA gives each municipality the opportunity to receive immediate payment, before consummation of the transaction, of 55% of such municipality's undisbursed certified Excess CAE held at GDB in exchange for releases. The other 45% should be apply against the balance of any loan owed by such municipality to GDB.

- The amendment also results in a simplified structure whereby GDB's financial creditors will exchange their claims for only one tranche of new bonds at an upfront exchange ratio of 55%. The RSA amendment is available on the Electronic Municipal Market Access website.

Management and Trust Structure Summary

- On or prior to the closing of the transaction, pursuant to the terms of the RSA and the GDB Restructuring Act, each as amended, available cash will be distributed as follows: Approximately (i) $21 million for payment to certain municipalities of the Excess CAE Settlement; (ii) $27.2 million for estimated operating cash and contingency requirements of GDB; (iii) transaction cost (including legal and professional fees and contemplated settlements); $1.5 million for estimated operating cash requirements of the PET; and (v) distributable cash to the Recovery Authority (~$324 million). All amount subject to change.

- Upon closing of the Restructuring, GDB will transfer the servicing of the Recovery Authority assets (or the New Bond Collateral) to a third-party servicer approved by GDB.

Also, the Oversight Board require a New Fiscal Plan that was approved on April 20, 2018.

- The Plan is based on the projected performance of GDB's existing loan asset portfolio, based on recent historical results.

- Based on the assessment of GDB's loan portfolio and the information available post-Hurricanes Irma and María, the Plan assumes currently performing municipal loans (after the corresponding application of municipal deposits against municipal loans), certain public-sector loans, and the sale of real estate owned assets are the only sources of revenue going forward.

- To the extent a loan asset is “non-performing”, the Plan assumes such loan remains “non-performing” and therefore would not be a source of future inflows, although GDB, or any successor entity, reserves the right to pursue collection efforts, subject to the limitations imposed by the GDB Restructuring Act.

- The Plan assumes the continued orderly sale or other legally available disposition of real estate owned assets, until such assets are transferred to the Recovery Authority per terms of the RSA.

- GDB has segregated approximately $22 million in cash, corresponding to GDB’s obligations to former GDB employees that retired pursuant to various pre-retirement and voluntary separation programs. Promptly after the certification of the Plan, GDB shall transfer such funds to a new trust to be constituted by GDB for the benefit of said retired employees, releasing GDB from such obligations.

Employees’ Retirement System

On June 25, 2017, the Puerto Rico Legislature Assembly approved the Joint Resolutions Numbers 186, 187, 188 and 189 to adopt the budget for fiscal year 2017-2018 in the amount of $9.562 billion. This amount is compound of $9.172 billion from General Fund revenues and $390 million expected from the sale of Employees’ Retirement System of the Government of the Commonwealth of Puerto Rico (ERS), Judiciary Retirement System (JRS) and Teacher Retirement System (TRS)s’ assets, except for the headquarters building of the TRS known as the Capital Center Building, North Tower, located in Hato Rey, Puerto Rico. To make retirement systems payments effective July 1, 2017, the budget separates $2.038 billion under Office of Management and Budget supervision.

On August 23, 2017, was enacted the Act No. 106, known as the “Act to Guarantee Payment to Our Retirees and Establish a New Plan for Defined Contributions for Public Employees”. This Act determined and declared that the ERS, JRS and TRS are in a financial emergency. As a result of this financial emergency, it is estimated that by August 2017 the ERS will not have liquid funds to meet its obligations. Likewise, it is estimated that the TRS will be without liquid funds in September 2017 and that the JRS will not have sufficient liquid funds by February 2018.

On May 21, 2017, the Oversight Board, on behalf of the Government of Puerto Rico, filed a petition for the ERS to avail itself of Title III protections of PROMESA. With the submission of the petition under Title III of PROMESA, a process of restructuring of the obligations of said system under the supervision of the United States District Court for the District of Puerto Rico was initiated. Faced with this situation, the Puerto Rico Legislature Assembly approved the Act No. 106 on August 23, 2017, to ensure that retirees continue to receive their pensions, protect the individual contributions of public employees and protect the future of them. In addition, as a corrective measure, the contributions of public employees must be segregated and protected, and a New Defined Contribution Plan (DCP) was established to ensure the future of public employees. Accordingly, a Defined Contribution Account (DCA), a trust account, separated from the general assets and accounts of the Government, was created as of July 1, 2017 in the name of each Participant, as established in Chapter 3 of this Act.

The New Defined Contribution Plan created, consists of the establishment of a trust fund, which will not be subject to the provisions of Act No. 219-2012, as amended, known as the "Trusts Act". Which will contain an individual account for each Participant of the Retirement Systems that becomes part of said program, as provided in Chapter 3. Individual contributions will be credited to the New Defined Contribution Plan of each Participant and the return on investment in accordance with Article 3.6 of this Act. The benefit related to these contributions will be provided to each Participant after their separation from Service, whether by withdrawal or otherwise, will depend on the totality of the contributions to the New Defined Contribution Plan accumulated in its account from the moment this Act comes into force, or the date on which the Participant entered the DCP and the profitability of these.

By this Act is hereby declared as public policy of the Government of Puerto Rico the protection of pensions of all public service retirees who were Participants in the three Retirement Systems mentioned above. Therefore, as of July 1, 2017, pursuant to the Joint Resolution of the House of Representative No. 188 of 2017, as certified by the Oversight Board on July 13, 2017, the Government of Puerto Rico became the direct payer of the pensions of the retirees. Given the weight that this implies on the General Fund, which is estimated at billions of dollars a year, the employer's contributions that had been made to the three Retirement Systems, as well as the Additional Uniform Contribution, as per provisions of Joint Resolutions Nos. 186, 187 and 188 of 2017, the Retirement Systems shall provide their available funds and the net proceeds of the liquidation of their assets to the General Fund to assist in the payment of Accumulated Pensions.

Also, by this Act is hereby created the Account for the Payment of Accumulated Pensions, a trust account, separated from the general assets and accounts of the Government, designated to pay the Accumulated Pensions by the ERS, JRS and TRS under the "pay as you go" scheme, as established in Chapter 2 of this Act. This trust account will be centralized and segregated from the general assets and accounts of the Government, in charge of the Department of the Treasury and will be devoted solely and exclusively to the purposes set forth in this Act, and subject to the terms and conditions established therein. Once Retirement Systems exhaust their assets, the Accumulated Pension Payment Account, which will be largely nourished by the General Fund, as provided in this Act, will assume and guarantee the payment of the Accumulated Pensions as established in this Act. However, the Municipalities, the Legislative Branch, the Public Corporations, the Government and the Administration of the Courts will be obliged to pay the "Pay-Go" Charge as appropriate to each one to nurture the Account for the Payment of the Accumulated Pensions.

As of July 1, 2017, as per Act No. 106 of 2017, the Participant shall not make individual contributions or payments to the Account for the Payment of Accumulated Pensions, nor additional contributions to their respective Retirement Systems. As of the effective date of this Act, any Participant in the Retirement Systems shall obligatorily contribute a minimum of eight-point five percent (8.5%) of his/her monthly remuneration to his DCA, up to the limit established by the Code. In addition, may voluntarily provide additional amounts, as permitted by the Code. Upon entry into force of this Act, Participants in the DCP shall have the right to adjust their current contribution to Retirement Systems to the minimum authorized by this article. Participants in the DCP may vary the percentage they wish to contribute to said Plan from time to time but may never be less than the minimum percent required by this Act.

As per Act No. 106 of 2017, effective July 1, 2017 the Additional Uniform Contribution imposed by Act No. 32 of 2011 and the employer contribution imposed by Act No. 3 of 2013, was eliminated and imposes the "Pay-Go" Charge that the Financial Advisory Authority and Fiscal Agency of Puerto Rico (FAAFA) created by Act No. 2-2017, determines and imposes on the Government, the Municipalities, the Legislative Branch, the Administration of Courts, the Public Corporations and other covered entities. This charge will be equivalent to the amount in effect paid to Pensioners and Beneficiaries from each covered entity. The Secretary of the Treasury or the person or entity designated by him shall be authorized to collect the "Pay-Go" Charge. In the case of the Municipalities, the administrative charges of the "pay as you go" scheme will not be included in the computation of the "Pay-Go" Charge. Regardless of the payment of the "Pay-Go" Charge by the employer, the disbursement of the benefits of all Pensioners and Beneficiaries are guaranteed by the General Fund through the "pay as you go" scheme, with the responsibility of the entities to remit the payment of said Charge in compliance with its obligations under this Act.

The FAAFA is authorized, after making a determination that the fiscal situation of the Government has stabilized and that the condition of the fiscal permits, to recommend to the Governor, in coordination with the Retirement Board, that a quantity be included in the budget to match the contributions of the Participants to the Defined Contribution Account. This determination must be made in accordance with the Certified Fiscal Plan and the provisions of PROMESA.

Hurricanes Irma and María

On September 6, 2017 and September 20, 2017, Hurricanes Irma and María devastated Puerto Rico. The Hurricanes caused unprecedented economic and infrastructure damages disrupting the daily lives of 3.4 million of residents, including housing, infrastructure, environment, safety, health and social services, and government and municipal operations. The response to the catastrophe by the U.S, and Federal agencies has become one of the largest and most complex disaster recovery efforts in U.S. history. The eye of Hurricane Irma, a powerful Category 5 storm, skirts north of San Juan, Puerto Rico experiences a deluge and 100-mile-per-hour gusts but is avoids the worst of the storm’s effects. Irma kills four people. It cuts off power to about two-thirds of the island’s electricity customers, and about 34 percent of its population loses access to water.

María was the most devastating hurricane to hit Puerto Rico in nearly a century. Many lives were lost, homes and businesses suffered enormous damage, most crops and other agricultural assets were wiped out, and a significant part of the island’s infrastructure was severely damaged: knocked out electric power across the entire island and triggered heavy flooding after estimated 30 inches of rain, severe destruction of the housing infrastructure, commercial and public buildings damaged and devastated agriculture and tourism. After María, only 5% of cell service, 44% of potable water since there are no electric power, and gas stations are destroyed in 60%. Puerto Rico authorities have estimated in $94 billion to cover damages from insurances and assignments required from the Congress, part of which was approved by them.

Following the hurricanes, the initial job losses in Puerto Rico totaled about 4%, though employment is beginning to improve somewhat. This loss is considerably steeper than what has typically been experienced after most major natural disasters that have hit the United States. That being said, domestic air passenger data suggest that from September through November more than 150,000 people left Puerto Rico, net of arrivals. Looking ahead, recovery will be affected by a variety of factors, most notably the degree of out-migration, the level of external aid the economy receives, and the effectiveness of fiscal and other reforms in Puerto Rico.

Given the effects of this natural disaster on commercial activity in Naranjito, both the Municipal Administration and the Central Government have implemented measures to support entrepreneurs, recognizing that a large percentage of them are not in a position to comply with the payment of taxes and other obligations to the government. These measures include the granting of waivers, payment plans, extensions and exemptions in some lines of taxes. Conversely, Central Government measures have also been implemented to support consumers. These include exempting small and medium merchants from the collection and payment of the sales and use tax, as well as the sale of prepared foods.

Measures taken by the Central Government, although may facilitate the process of recovery of employers and consumers of our City, represent a considerable reduction in municipal revenues.

PROMESA

The Oversight Board approved on April 19, 2018 the New Fiscal Plan as prepared by the Oversight Board and not the Commonwealth submitted plan. With the New Fiscal Plan, the municipalities will receive the subsidy that will be amortized until fiscal year 2024 instead of eliminating it in fiscal year 2019. The scope of the Fiscal Plan is described in that Note.

In preparing these financial statements, the Municipality has evaluated significant transactions for potential recognition or disclosure through June 29, 2018, the date the financial statements were issued. Based on such analysis, no additional transaction need to be recorded or disclosed.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NARANJITO
Budgetary Comparison Schedule - General Fund
For the year ended June 30, 2017

	Budgeted Amounts		Actual Amounts Budgetary Basis	Variance with Final Budget- Positive
	Original	Final	(See Note 1)	(Negative)
REVENUES:				
Property taxes	$ 1,771,614	$ 1,771,614	$ 2,681,921	$ 910,307
Municipal license tax	1,100,000	1,100,000	1,131,943	31,943
Sales tax	1,030,000	1,030,000	1,037,568	7,568
Licenses, permits and other local taxes	107,000	107,000	85,846	(21,154)
Charges for services	190,000	190,000	297,143	107,143
Interest, fines and penalties	130,000	130,000	63,854	(66,146)
Intergovernmental	7,149,710	7,149,710	7,144,461	(5,249)
Other	183,648	183,648	245,975	62,327
Total revenues	11,661,972	11,661,972	12,688,711	1,026,739
EXPENDITURES:				
General government	6,962,201	6,962,201	6,616,707	345,493
Public safety	782,034	782,034	605,202	176,832
Public works	2,229,668	2,229,668	2,157,012	72,656
Culture and recreation	527,172	527,172	527,447	(275)
Health and welfare	884,759	884,759	811,606	73,153
Urban Development	166,151	166,151	139,332	26,819
Education	109,987	109,987	100,633	9,354
Principal	-	-	22,667	(22,667)
Total expenditures	11,661,972	11,661,972	10,980,606	681,366
EXCES OF REVENUES OVER EXPENDITURES	-	-	$ 1,708,105	$ 1,708,105

Explanation of differences:

Sources/inflows of resources	
Actual amounts (budgetary basis) "available for appropriation" from the	
Total revenues as reported on the statement of revenues, expenditures, and changes in fund balances.	$ 12,688,711
Uses/outflows of resources	
Actual amounts (budgetary basis) "total charges to appropriations" from the budgetary comparison schedule.	$ 10,980,606
Differences - budget to GAAP:	
Non-budgeted expenditures	2,953,609
Prior year encumbrances recorded as current year expenditures for GAAP basis.	184,912
Current year encumbrances recorded as expenditures for budgetary purposes	(167,137)
Total expenditures as reported on the statement of revenues, expenditures, and changes in fund balances.	$ 13,951,990

See notes to budgetary comparison schedule

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NARANJITO

Notes to Budgetary Comparison Schedule – General Fund

1. **STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY**

A. Budgetary Control

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

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

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

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

The annual budget as presented in the Budgetary Comparison Schedule-General Fund is the budget ordinance at June 30, 2017 representing the original budget. There were no supplemental appropriations for the year ended June 30, 2017.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NARANJITO
Schedule of Expenditures of Federal Awards
For the year ended June 30, 2017

FEDERAL GRANTOR/PASS THROUGH GRANTOR PROGRAM TITLE	FEDERAL CFDA NUMBER	Pass-Through Entity Identifying Number	2017 EXPENDITURES
US DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT			
Direct Programs:			
Housing Choice Voucher	14.871		$ 818,177
Supportive Housing Program	14.235		89,508
Indirect Programs:			
Passed through P.R. Office of Municipal Affairs			
State Block Grant Program	14.228	N/A	703,663
Total US Department of Housing and Urban Development			1,611,348
US DEPARTMENT OF HEALTH AND HUMAN SERVICES			
Indirect Programs:			
Passed through P.R. Office of Municipal Affairs			
Child Care and Development Grant Program	93.575	N/A	209,928
Total US Department of Health and Human Services			209,928
TOTAL FEDERAL FINANCIAL ASSISTANCE			$ 1,821,276

See notes to basic financial statements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NARANJITO

Notes to the
Schedule of Expenditures of Federal Awards
June 30, 2017

NOTE 1 - BASIS OF PRESENTATION

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of the Municipality of Naranjito and is presented on the modified accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America. The basis of accounting is the same used to prepare the fund financial statements. 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).

NOTE 2 – RELATIONSHIP TO BASIC FINANCIAL STATEMENTS

A reconciliation of total expenditures related to federal programs included in the statement of revenues, expenditures, and changes in fund balances – governmental funds to total expenditures included in the schedule of expenditures of federal awards is as follows:

NOTE 3 - FEDERAL CFDA NUMBER

The CFDA number included in this schedule were determined based on the program name, review of grant contract information and the Office of Management and Budget's Catalog of Federal Domestic Assistance.

State or local government redistributions of federal awards to the Municipality, known as "pass–through awards", should be treated by the Municipality as though they were received directly from the federal government. The Uniform Guidance requires the schedule to include the name of the pass–through entity and the identifying number assigned by the pass-through entity for the federal awards received as a sub recipient. Numbers identified as N/A are not applicable and numbers identified as N/AV are not available.

NOTE 4 – INDIRECT COST RATE

The Municipality elected not to use the ten (10) percent of the minimum indirect cost rate allowed under the Uniform Guidance.

Gil Alberto Ortiz Cabrera

Certified Public Accountants & Professional Consultants

Members of: The American Institute of Certified Public Accountants (AICPA)
Puerto Rico Board of Certified Public Accountants

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

Honorable Major and Members
of the Municipal Assembly
Municipality of Naranjito
Naranjito, Puerto Rico

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the Municipality of Naranjito, as of and for the year ended June 30, 2017, and the related notes to the financial statements, which collectively comprise Municipality of Naranjito's basic financial statements, and have issued our report thereon dated July 13, 2018

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Municipality of Naranjito'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 Municipality of Naranjito's internal control. Accordingly, we do not express an opinion on the effectiveness of the municipality of Naranjito'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 material weaknesses or, significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

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

Purpose of this Report

The purpose of this report is 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.

CPA Gil Alberto Ortiz Cabrera
License 1332
Stamp # 02759062 was affixed
to the original report.
July 13, 2018
San Juan, Puerto Rico

Gil Alberto Ortiz Cabrera
Certified Public Accountants & Professional Consultants

*Members of: The American Institute of Certified Public Accountants (AICPA)
Puerto Rico Board of Certified Public Accountants*

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE FOR EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE REQUIRED BY THE UNIFORM GUIDANCE

Honorable Major and Members
of the Municipal Assembly
Municipality of Naranjito
Naranjito, Puerto Rico

Report on Compliance for Each Major Federal Program

We have audited The Municipality of Naranjito's compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on each of the Municipality of Naranjito's major federal programs for the year ended June 30,2017. The Municipality of Naranjito's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to its federal programs.

Auditor's Responsibility

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

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

Opinion on Each Major Federal Program

In our opinion the Municipality of Naranjito's 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 major federal programs for the year ended June 30, 2017.

Report on Internal Control over Compliance

Management of Municipality of Naranjito 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 the Municipality of Naranjito'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 of Naranjito's internal control over compliance.

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

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

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 Uniform Guidance. Accordingly, this report is not suitable for any other purpose.

CPA Gil Alberto Ortiz Cabrera
License 1332 in force.
San Juan, Puerto Rico
Stamp # 02759063 was affixed
to the original report.
San Juan, Puerto Rico
July 13, 2018

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NARANJITO
SCHEDULE OF INDINGS AND QUESTIONED COSTS FOR THE YEAR ENDED

JUNE 30, 2017

PART I - SUMMARY OF AUDITOR'S RESULTS

Financial Statement

a. Type of auditor's report issued: *Qualified*

b. Internal Control over financial reporting:
- Material weakness (es) identified? No__x_ Yes ____
- Significant deficiency (ies) identified that is (are) not considered to be material weakness (es)? No__x_Yes ____

c. Material noncompliance to financial statements noted? No_x_Yes ___

Federal Awards

a. Internal Control over major programs:
- Material weakness (es) identified? No__x_ Yes ___
- Significant deficiency (ies) identified that is (are) not considered to be material weakness (es)? No __x_Yes ____

b. Type of auditor's report issued on compliance for major programs: *Unqualified*

c. Any audit findings disclosed that are required to be reported in accordance with 2 CFR 200.516 (a)? ____Yes X__No

d. The programs tested as major program are:

CFDA Numbers	Name of Federal Program of Cluster
14.871	Housing Choice Voucher
14.850	Housing Rehabilitation Program - Contract RQ-3038

The threshold for distinguishing Type A and B programs was $750,000.

Municipality qualifies as low risk auditee? X___Yes_____No

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF NARANJITO

CURRENT YEAR FEDERAL AWARD FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2017

PART II – FEDERAL AWARDS FINDINGS AND QUESTIONED COSTS

Our audit of revealed that the Municipality of Naranjito has maintained an effective system of internal control over compliance with requirements of law, regulations, contracts and grants applicable to federal programs. No Federal Award Findings and Questioned Costs were detected during the audit.

SECTION III – FEDERAL AWARDS FINDINGS AND QUESTIONED COSTS

There are no prior year findings pending to be resolved.