

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

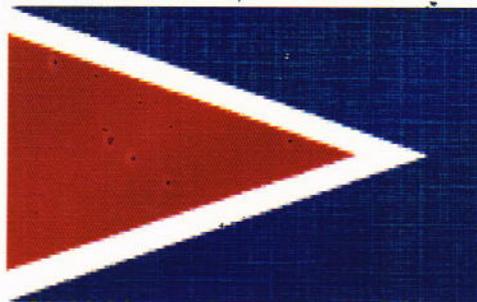
**MUNICIPIO DE CABO ROJO
AUDITORÍA 2009-2010
30 DE JUNIO DE 2010**

**COMMONWEALTH OF PUERTO RICO
AUTONOMOUS MUNICIPALITY OF CABO ROJO**

OFICINA DEL COMISIONADO
DE ASUNTOS MUNICIPALES
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**BASIC FINANCIAL STATEMENTS, REQUIRED SUPPLEMENTARY
INFORMATION AND INDEPENDENT
AUDITOR'S REPORT
(WITH ADDITIONAL REPORTS REQUIRED UNDER
OMB CIRCULAR A-133)**

**AS OF AND FOR THE FISCAL YEAR ENDED
JUNE 30, 2010**



**Hon. Perza Rodríguez-Quñones
Mayor**

**Mr. Juan Carlos Padilla
Finance Director**

COMMONWEALTH OF PUERTO RICO
AUTONOMOUS MUNICIPALITY OF CABO ROJO

BASIC FINANCIAL STATEMENTS ACCOMPANIED BY
REQUIRED SUPPLEMENTARY INFORMATION

YEAR ENDED JUNE 30, 2010

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COMMONWEALTH OF PUERTO RICO
AUTONOMOUS MUNICIPALITY OF CABO ROJO

BASIC FINANCIAL STATEMENTS ACCOMPANIED BY
REQUIRED SUPPLEMENTARY INFORMATION

YEAR ENDED JUNE 30, 2010

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INDEPENDENT AUDITOR'S REPORT

Honorable Mayor and Members of the
Municipal Assembly
Municipality of Cabo Rojo, Puerto Rico

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of **Municipality of Cabo Rojo, Puerto Rico**, as of and for the year ended June 30, 2010, which collectively comprise the Municipality of Cabo Rojo's basic financial statements as listed in the table of contents. These financial statements are the responsibility of Municipality of Cabo Rojo, Puerto Rico's management. Our responsibility is to express opinions on these financial statements based on our audit.

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

As more fully described in Note 13 to the financial statements, the Municipality of Cabo Rojo has not determined and accounted the landfill's closure and post closure care costs at June 30, 2010. Accounting principles generally accepted in the United States of America require that landfill's closure and post-closure costs are estimated and included as liability, which would decrease net assets and increase the liabilities of the governmental activities. The amount by which this departure would affect the net assets and liabilities of the governmental activities is not reasonable determinable.

In our opinion, except for the effects of the matter discussed in the preceding paragraph, the financial statements referred to previously present fairly, in all material respects, the financial position of the governmental activities of the Municipality of Cabo Rojo, Puerto Rico, as of June 30, 2010, and the changes in financial position, for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In addition, in our opinion, the financial statements referred to previously present fairly, in all material respects, the respective financial position of each major fund, and the aggregate remaining fund information of the Municipality of Cabo Rojo, Puerto Rico, as of June 30, 2010, and the respective changes in financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

INDEPENDENT AUDITOR'S REPORT

(CONTINUED)

In accordance with Government Auditing Standards, we also issued our report dated February 1, 2011, on our consideration of the Municipality of Cabo Rojo, Puerto Rico's internal control over financial reporting and 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 result of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and budgetary comparison information on pages 3 through 11 and 48 through 49 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

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



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Yauco, Puerto Rico
February 1, 2011

Stamp #2583297 was affixed to
the original of this report

**COMMONWEALTH OF PUERTO RICO
AUTONOMOUS MUNICIPALITY OF CABO ROJO**

MANAGEMENT'S DISCUSSION AND ANALYSIS

YEAR ENDED JUNE 30, 2010

This discussion and analysis of the Autonomous Municipality of Cabo Rojo (the Municipality) financial performance provides an overview of the Municipality's financial activities for the fiscal year ended on June 30, 2010. This Management Discussion and Analysis (MD&A) should be read in conjunction with the accompanying basic financial statements and the accompanying notes to those financial statements. Besides, this document includes comparative data with prior year as this information was available for the fiscal year ended on June 30, 2009. This MD&A is prepared in order to comply with such pronouncement and, among other purposes, to provide the financial statements users with the following major information:

1. a broader basis in focusing important issues;
2. acknowledgement of an overview of the Municipality's financial activities;
3. provides for an evaluation of its financial condition as of the end of fiscal year 2009-2010 compared with prior year results;
4. identification of uses of funds in the financing of the Municipality's variety of activities and;
5. assess management's ability to handle budgetary functions.

FINANCIAL HIGHLIGHTS

The financial condition and results of operations as reflected in the financial statements prepared for fiscal year 2010 constitute factual evidence of the Municipality's economic strength by the end of such year. The following comments deserve special mention:

1. Total assets of the Municipality amounted to \$100,049,149 which represents an increase of 35% compared to prior fiscal year.
2. At the end of fiscal year 2010, total liabilities amounted to \$35,752,894. Out of said amount, \$28,835,001 corresponds to long-term liabilities of which \$23,338,055 represented the outstanding balance of bonds and notes issued. The Municipality continued to meet all debt service requirements, most of which was paid from self generated revenues.
3. Total net assets of the Municipality amounted to \$64,296,255 which represents an increase of 34% compared to prior fiscal year.
4. Total revenues available for the financing of activities as reflected in the Statement of Activities amounted to \$43,810,590, derived from the following sources: \$372,719 from charges for services; \$1,053,983 from operating grants and contributions; \$20,072,154 from capital grants and contributions obtained from other sources, and \$22,311,734 from general revenues available.
5. Total expenses incurred to afford the cost of all functions and programs as reflected in the Statement of Activities amounted to \$27,610,107.
6. As reflected in the Statement of Activities, the current fiscal year operations contributed to an increase in the Net Assets figure by \$16,200,483.

**COMMONWEALTH OF PUERTO RICO
AUTONOMOUS MUNICIPALITY OF CABO ROJO**

MANAGEMENT'S DISCUSSION AND ANALYSIS – (CONTINUED)

YEAR ENDED JUNE 30, 2010

FINANCIAL HIGHLIGHTS (CONTINUED)

7. As of the close of the current fiscal year, the Municipality's Governmental Funds reported combined ending fund balances of \$27,418,360.
8. In the fund financial statements, the governmental activities revenue increased \$9,645,478 (or 34%), and governmental activities expenditures increase also by \$2,441,253 (or 8%).
9. As the end of the current fiscal year, the Municipality's general fund (the primary operating fund) reported a deficit of (\$517,425) compared to a fund balance of \$548,192 in the prior fiscal year.
10. The actual General Fund budgetary activities resulted in an unfavorable balance of (\$888,611).

FUNDAMENTALS OF FINANCIAL STATEMENTS PRESENTATION

The new approach used in the presentation of the financial statements of the Municipality is based on a government-wide view of such statements as well as a presentation of individual funds behavior during fiscal year 2010. The combination of these two perspectives provide the user the opportunity to address significant questions concerning the content of said financial statements, and provide the basis for a comparable analysis of future years performance. The comparative analysis is a meaningful and useful management tool for municipal management in the decision making process.

Under the aforementioned approach, assets and liabilities are recognized using the accrual basis of accounting which is similar to the method used by most private enterprises. This means that current year's revenues and expenses are accounted for regardless of when cash is received or paid.

FINANCIAL STATEMENTS COMPONENTS

The basic financial statements consist of the government wide financial statements, the major funds financial statements and the notes to the financial statements which provide details, disclosure and description of the most important items included in said statements.

The Statement of Net Assets reflects information of the Municipality as a whole on a consolidated basis and provides relevant information about its financial strength as reflected at the end of the fiscal year.

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

**COMMONWEALTH OF PUERTO RICO
AUTONOMOUS MUNICIPALITY OF CABO ROJO**

MANAGEMENT'S DISCUSSION AND ANALYSIS – (CONTINUED)

YEAR ENDED JUNE 30, 2010

GOVERNMENT – WIDE FINANCIAL STATEMENTS (CONTINUED)

The Statement of Activities presents information showing how the Municipality's net assets changed during the most recent fiscal year. All changes in net assets 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, 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 demonstrated 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.

According to GASB 34, the government must elect to either (a) depreciate the aforementioned assets over their estimated useful life or (b) develop a system of asset management designed to maintain the service delivery to near perpetuity. If the government develops the asset management system, (the modified approach) which periodically (at least every three years), by category, measures and demonstrate its maintenance of locally established levels of service standards, the government may record its cost of maintenance in lieu of depreciation. In this particular respect, the Municipality has elected the use of recognizing depreciation under the useful life method and it contemplates to continue this treatment on said basis.

**COMMONWEALTH OF PUERTO RICO
AUTONOMOUS MUNICIPALITY OF CABO ROJO**

MANAGEMENT'S DISCUSSION AND ANALYSIS – (CONTINUED)

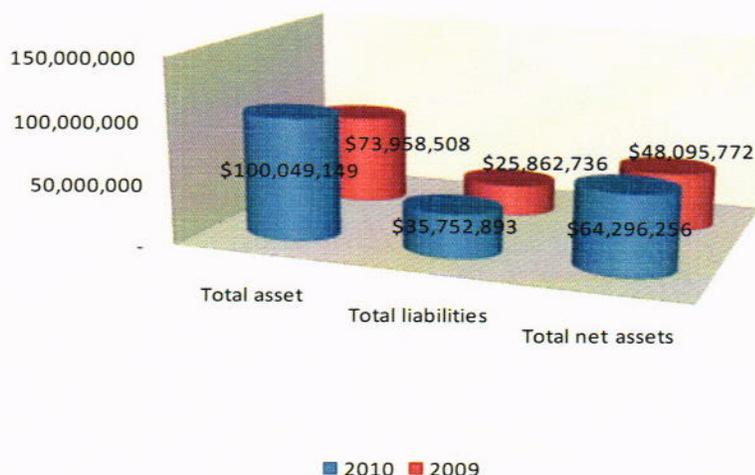
YEAR ENDED JUNE 30, 2010

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE

Net Assets

The Statement of Net Assets serves as an important indicator of the Municipality's financial position at the end of the fiscal year. In the case of the Autonomous Municipality of Cabo Rojo, primary government assets exceeded total liabilities by \$64,296,255 at the end of 2010, as compared with \$48,095,772, as restated, which reflect an increase of \$16,200,483 over previous fiscal year. The following condensed Statement of Net Assets of the Primary Government shows on a comparative basis; the most important components of the increase, are reflected in the Net Assets figure.

Condensed Statement of Net Assets	2010	2009	Change	%
Current and other assets	\$ 36,960,877	\$ 22,833,101	\$ 14,127,776	62%
Capital assets	63,088,272	51,125,407	11,962,865	23%
Total assets	100,049,149	73,958,508	26,090,641	35%
Current and other liabilities	6,917,893	4,758,978	2,158,915	45%
Long-term liabilities	28,835,001	21,103,758	7,731,243	37%
Total liabilities	35,752,894	25,862,736	9,890,158	38%
Invested in capital assets, net of related debt	36,523,217	37,582,571	(1,059,354)	6%
Restricted	28,931,756	13,890,956	15,040,800	108%
Unrestricted (deficit)	(1,158,718)	(3,377,755)	2,219,037	30%
Total net assets	\$ 64,296,255	\$ 48,095,772	\$ 16,200,483	34%



**COMMONWEALTH OF PUERTO RICO
AUTONOMOUS MUNICIPALITY OF CABO ROJO**

MANAGEMENT'S DISCUSSION AND ANALYSIS – (CONTINUED)

YEAR ENDED JUNE 30, 2010

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE (CONTINUED)

Changes in Net Assets

The Municipality's net assets increase by \$16,200,483. Approximately thirty-six percent (36%) of the Municipality's total revenue came from taxes, while sixty three percent (63%) resulted from grants and contributions, including federal aid. Charges for Services provided one percent (0.5%), Interest and Investment earnings (.05%) of total revenues. The Municipality's largest expenses included items such as general government, housing, welfare and community development, public works and sanitation, and public safety. The following table and graphic presentation includes in absolute and relative terms, the composition of revenues and expenses for the fiscal years ended on June 30, 2010 and 2009. Such analysis helps the reader to evaluate the Municipal administration performance in the administration of its current financial operations.

Condensed Statement of Activities	2010	2009	Change	%
Program revenues:				
Charges for services	\$ 372,719	\$ 5,209,870	\$ (4,837,151)	(93%)
Operating grants and contributions	1,053,983	3,826,044	(2,772,061)	(72%)
Capital grants and contributions	20,072,154	2,179,888	17,892,266	821%
General revenues:				
Property taxes	10,773,163	6,799,311	3,973,852	58%
Municipal sales and use tax	2,494,474	2,484,147	10,327	-
Municipal license tax	2,592,029	2,681,565	(89,536)	(3%)
Grants and contributions not restricted to specific programs	5,957,291	5,022,759	934,532	19%
Interest and investment earnings	283,416	429,572	(146,156)	(34%)
Miscellaneous	211,361	442,927	(231,566)	(52%)
Total revenues	<u>43,810,590</u>	<u>29,076,083</u>	<u>14,734,507</u>	51%
Expenses:				
General government	7,175,475	9,068,100	(1,892,625)	(21%)
Public works and sanitation	11,073,208	12,363,568	(1,290,360)	(10%)
Public safety	2,400,193	2,651,785	(251,592)	(9%)
Culture and recreation	1,192,677	1,801,354	(608,677)	(34%)
Health	1,110,705	823,281	287,424	35%
Economic development	7,162	-	7,162	100%
Housing, welfare and Community development	3,848,061	3,164,405	683,656	22%
Education	34,734	168,348	(133,614)	(79%)
Interest on long-term debt	767,892	767,009	883	-
Total expenses	<u>27,610,107</u>	<u>30,807,850</u>	<u>(3,197,743)</u>	(10%)
Change in net assets	16,200,483	(1,731,767)	17,932,250	(1035%)
Net assets, beginning of year (as restated)	<u>48,095,772</u>	<u>49,827,539</u>	<u>(1,731,767)</u>	(3%)
Net assets, end of year	<u>\$ 64,296,255</u>	<u>\$ 48,095,772</u>	<u>\$ 16,200,483</u>	34%

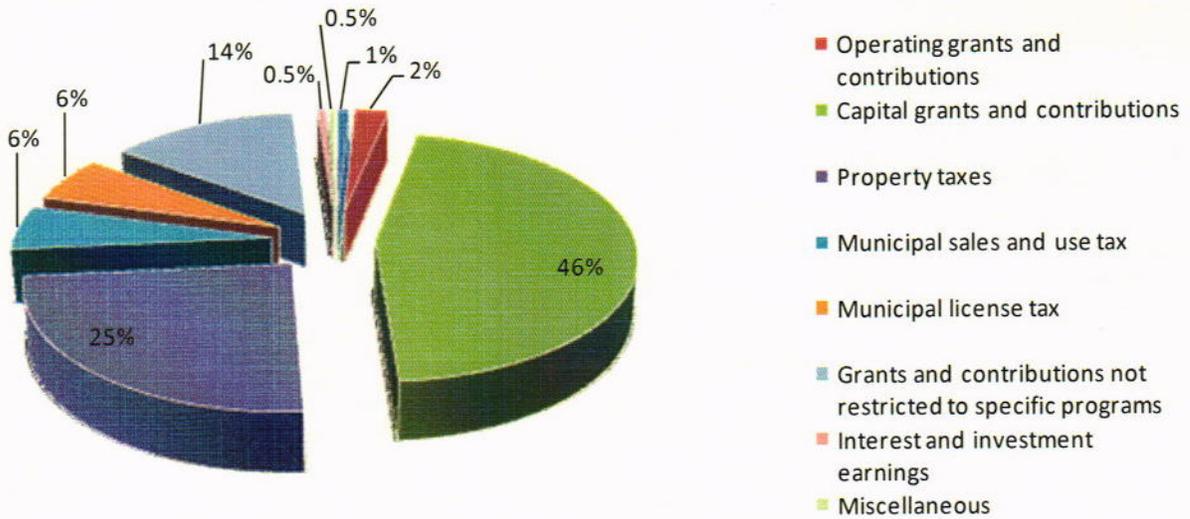
COMMONWEALTH OF PUERTO RICO
AUTONOMOUS MUNICIPALITY OF CABO ROJO

MANAGEMENT'S DISCUSSION AND ANALYSIS

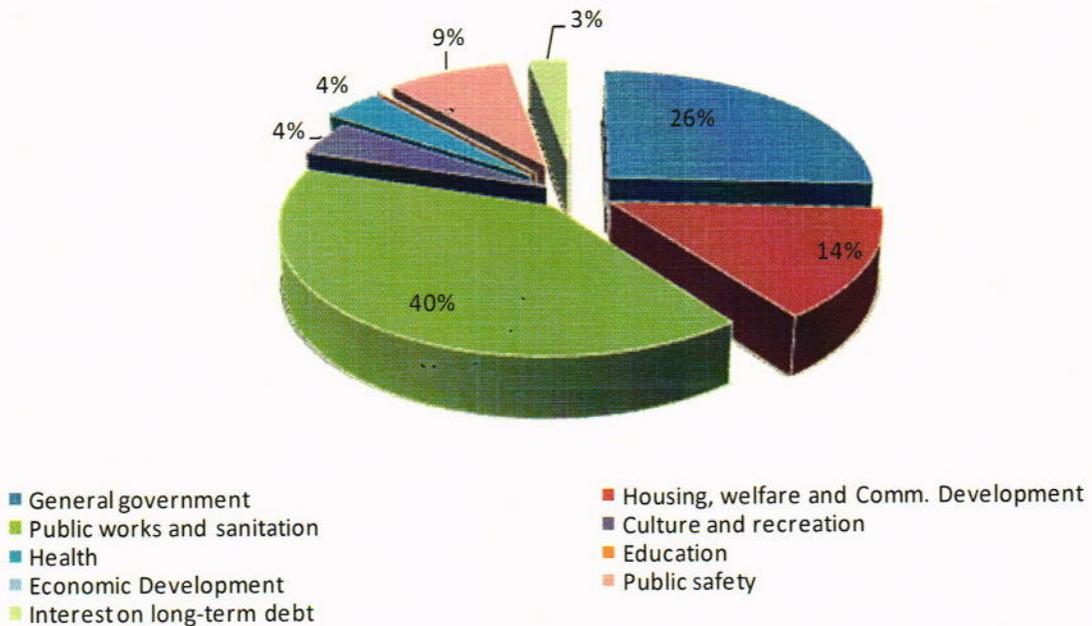
YEAR ENDED JUNE 30, 2010

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE (CONTINUED)

Revenues 2010



Expenses 2010



**COMMONWEALTH OF PUERTO RICO
AUTONOMOUS MUNICIPALITY OF CABO ROJO**

MANAGEMENT'S DISCUSSION AND ANALYSIS – (CONTINUED)

YEAR ENDED JUNE 30, 2010

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 combined ending fund balances amounting to \$27,418,360, which represents an increase of \$13,319,082 when compared with the prior year. Out of the indicated balance, \$28,204,504 were reserved or committed for the following purposes: (1) \$268,719 to liquidate contracts and purchase orders corresponding to prior fiscal year; 2) \$3,492,163 for debt service payments; 3) \$24,227,691 to pay for capital projects; and 4) \$215,931 for other purposes. The undesignated fund balance presents an amount of (\$786,144).

As of June 30, 2010, the General Fund, which is the main operating fund of the Municipality, experienced a \$1,568,870 decrease from a fund balance surplus of \$1,051,445 in the previous year to a deficit of \$517,425. The primary reason for the governmental fund's deficit in the current year was an excess of expenditures over revenues from the General Fund, mainly for waste disposal charges. The Municipality requested an operational loan to pay current waste disposal invoices to the Puerto Rico Governmental Bank (GDB). Although requested in April 2010, due to administrative processes in the GDB, the bond was approved after the close of the fiscal year. This situation forced the Municipality to present in their financial statements an account payable for those unpaid invoices, which increased its expenditures over its revenues. The Municipality understands that had the proceeds of this bond issuance were received in the current fiscal year, the financial statements would not have presented a deficit. The Municipality expects to close next fiscal year 2010-11 with a surplus in the General Fund.

GENERAL FUND BUDGETARY HIGHLIGHTS

During fiscal year 2009-2010, the Municipal Legislature approved revisions to the operational budget which resulted in further increases in revenues and current expenditures which represented transactions detected during the normal course of business. Despite these budgets readjustments and as previously stated, the Municipal administration of Cabo Rojo was able to maintain a balanced budget as required by law as reflected in exhibit, Budgetary Comparison Schedule- General Fund attached here to, budgetary analysis reflected a deficiency of (\$888,611) of total operating revenues over current expenses.

**COMMONWEALTH OF PUERTO RICO
AUTONOMOUS MUNICIPALITY OF CABO ROJO**

MANAGEMENT'S DISCUSSION AND ANALYSIS – (CONTINUED)

YEAR ENDED JUNE 30, 2010

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

The Municipality's investment in capital assets as of June 30, 2010, amounted to \$86,331,834 which upon deduction of accumulated depreciation in the amount of \$23,243,562 produced a net book value attributable to capital assets in the amount of \$63,088,272. Said investment includes land, construction in progress, buildings, improvements, equipment, infrastructure, furnishing, computers and vehicles. Infrastructure assets are composed of items 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 represented approximately twenty three percent (23%) of net book value. Depreciation charges for the year totaled \$2,583,576.

The Municipality finances a significant portion of its construction activities through bond or notes issuances. The proceeds from bond and notes 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, 2010, the Municipality has \$10,835,459 of proceeds from bond and notes issuances and other restricted assignments that are mainly committed to future construction activities for the city's Convention Center, and other public improvements.

Debt Administration

The Puerto Rico Legislature has established limitations for the issuance of 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, the Municipality must have sufficient "payment capacity" as defined in Act No. 64, which requires that the Municipality must have sufficient "payment capacity" to incur additional general obligation debt if its deposits in the Redemption Fund and the annual amounts collected with respect to such Municipality's Special Additional Tax (as defined below), as projected by GDB, is sufficient to service to maturity the Municipality's outstanding general obligation debt and the additional proposed general obligation debt.

The Municipality is required under prevailing applicable law to levy a 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. In the particular case of the Autonomous Municipality of Cabo Rojo, it has never been necessary to apply Basic Taxes to pay debt service on general obligation debt of the Municipality.

COMMONWEALTH OF PUERTO RICO
AUTONOMOUS MUNICIPALITY OF CABO ROJO

MANAGEMENT'S DISCUSSION AND ANALYSIS – (CONTINUED)

YEAR ENDED JUNE 30, 2010

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

The Municipality relies primarily on property and municipal taxes as well as federal and state grants to carry out the governmental activities. Historically, property and municipal taxes have been very predictable with increases of approximately five percent. Federal and State grant revenues may vary if new grants are available, but the revenue can be also predictable. Those factors were considered when preparing the Municipality's budget for the fiscal year 2009-2010.

On August 24, 2010, the Municipal Legislature approved the issuance of a special obligation bond charged to the Municipal Redemption Fund, for the amount of \$4,530,000, for the financing of waste disposal services and landfill administration. Repayment of the bond is scheduled from July 2011 through July, 2020.

CONTACT US

The Municipality's financial statements are designed to present users (citizens, taxpayer, 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 Finance Director at (787) 851-1025. Feel free to visit our offices during working hours at Cabo Rojo City Hall, Calle Betances #28 Cabo Rojo, P.R., or visit our website at www.ciudadcaborojo.net.

Commonwealth of Puerto Rico
Autonomous Municipality of Cabo Rojo
Statement of Net Assets
June 30, 2010

	Governmental Activities
Assets	
Cash and cash equivalents	\$ 1,832,419
Accounts receivable:	
Municipal license tax	1,823
Municipal sales and use taxes	159,206
Rents and construction permits	110,521
Others	200,822
Due from:	
Commonwealth government	1,555,374
Federal government	143,172
Restricted assets:	
Cash and cash equivalents	8,325,328
Cash with fiscal agent	16,042,993
Investment held in commercial banks	8,589,219
Capital assets:	
Land, improvements, and construction in progress	20,819,518
Other capital assets, net of depreciation	42,268,754
Total capital assets, net	63,088,272
Total assets	\$ 100,049,149
Liabilities	
Accounts payable and accrued liabilities	\$ 4,538,513
Interest payable	404,029
Due to:	
Commonwealth government	166,761
Deferred revenues:	
Municipal license tax	1,699,433
Federal grant revenues	12,604
Other	96,553
Noncurrent liabilities:	
Due within one year	2,617,821
Due in more than one year	26,217,180
Total liabilities	35,752,894
Net Assets	
Invested in capital assets, net of related debt	36,523,217
Restricted for:	
Capital projects	24,227,691
Debt service	4,488,134
Other specified purposes	215,931
Unrestricted (deficit)	(1,158,718)
Total net assets	\$ 64,296,255

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

Commonwealth of Puerto Rico
Autonomous Municipality of Cabo Rojo
Statement of Activities
For the Year Ended June 30, 2010

Functions/Programs	Expenses	Program Revenues			Net (Expense) Revenue and
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Changes in Net Assets
					Governmental Activities
General government	\$ 7,175,475	\$ 219,815	\$ 6,515	\$ -	\$ (6,949,145)
Public safety	2,400,193	-	52,700	52,968	(2,294,525)
Public works and sanitation	11,073,208	-	-	13,287,495	2,214,287
Health	1,110,705	-	41	-	(1,110,664)
Culture and recreation	1,192,677	152,904	-	5,496,919	4,457,146
Economic development	7,162	-	7,162	-	-
Housing, welfare and community development	3,848,061	-	930,740	1,234,772	(1,682,549)
Education	34,734	-	56,825	-	22,091
Interest on long-term debt	767,892	-	-	-	(767,892)
Total governmental activities	\$27,610,107	\$ 372,719	\$ 1,053,983	\$20,072,154	\$ (6,111,251)
General revenues:					
Property taxes					10,773,163
Municipal license tax					2,592,029
Municipal sales and use tax					2,494,474
Licences, permits, and other local taxes					2,141,958
Grants and contributions not restricted to specific programs					3,815,333
Interest and investment earnings					283,416
Net gain on disposition of capital assets					56,899
Other					154,462
Total general revenues					22,311,734
Change in net assets					16,200,483
Net assets - beginning, as restated					48,095,772
Net assets - ending					\$ 64,296,255

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

Commonwealth of Puerto Rico
Autonomous Municipality of Cabo Rojo
Balance Sheet
Governmental Funds
June 30, 2010

	General Fund	Community Development Block Grant Program	Debt Service Fund	Commonwealth Legislative Resolutions	Convention Center Fund	Other Governmental Funds	Total Governmental Funds
Assets							
Cash and cash equivalents	\$ 1,832,419	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 1,832,419
Accounts receivable:							
Municipal license tax	1,823	-	-	-	-	-	1,823
Municipal sales and use tax	159,206	-	-	-	-	-	159,206
Rents and construction permits	110,521	-	-	-	-	-	110,521
Others	147,619	-	-	44,553	-	8,650	200,822
Due from:							
Commonwealth government	1,038,623	-	118,658	123,093	-	275,000	1,555,374
Federal government	-	37,842	-	-	-	105,330	143,172
Other funds	439,495	-	-	-	-	-	439,495
Restricted assets:							
Cash and cash equivalents	-	6,638	-	4,894,409	-	3,424,281	8,325,328
Cash with fiscal agent	-	-	5,207,534	-	8,863,870	1,971,589	16,042,993
Investment held in commercial banks	-	-	-	8,589,219	-	-	8,589,219
Total assets	\$ 3,729,706	\$ 44,480	\$ 5,326,192	\$ 13,651,274	\$ 8,863,870	\$ 5,784,850	\$ 37,400,372
Liabilities and Fund Balances							
Liabilities:							
Accounts payable and accrued liabilities	\$ 1,598,245	\$ 26,437	\$ -	\$ 2,400,790	\$ -	\$ 513,040	\$ 4,538,512
Matured bonds and interest payable	-	-	1,804,029	-	-	-	1,804,029
Due to:							
Commonwealth government	166,761	-	-	-	-	-	166,761
Other funds	-	18,043	-	99,743	-	321,709	439,495
Deferred revenues:							
Municipal license tax	1,699,433	-	-	-	-	-	1,699,433
Intergovernmental	782,692	-	30,000	123,093	-	275,000	1,210,785
Federal grants	-	13,353	-	-	-	13,091	26,444
Others	-	-	-	-	-	96,553	96,553
Total liabilities	4,247,131	57,833	1,834,029	2,623,626	-	1,219,393	9,982,012
Fund balances (deficits):							
Reserved for:							
Encumbrances	268,719	-	-	-	-	-	268,719
Debt service fund	-	-	3,492,163	-	-	-	3,492,163
Capital projects	-	-	-	11,027,648	8,863,870	4,336,173	24,227,691
Other specified purposes	-	(13,353)	-	-	-	229,284	215,931
Unreserved and undesignated	(786,144)	-	-	-	-	-	(786,144)
Total fund balances (deficits)	(517,425)	(13,353)	3,492,163	11,027,648	8,863,870	4,565,457	27,418,360
Total liabilities and fund balances (deficits)	\$ 3,729,706	\$ 44,480	\$ 5,326,192	\$ 13,651,274	\$ 8,863,870	\$ 5,784,850	\$ 37,400,372

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

Commonwealth of Puerto Rico
Autonomous Municipality of Cabo Rojo
Statement of Revenues, Expenditures and Changes in Fund Balances
Governmental Funds
For the Year Ended June 30, 2010

	General Fund	Community Development Block Grant Program	Debt Service Fund	Commonwealth Legislative Resolutions	Convention Center Fund	Other Governmental Funds	Total Governmental Funds
Revenues							
Property taxes	\$ 8,126,346	-	\$ 2,646,817	\$ -	\$ -	-	\$ 10,773,163
Municipal license taxes	2,592,030	-	-	-	-	-	2,592,030
Municipal sales and use taxes	2,040,371	-	454,102	-	-	-	2,494,473
Licenses, permits and other local taxes	2,048,785	-	-	-	-	-	2,048,785
Intergovernmental	3,815,333	-	-	11,226,275	-	1,429,188	16,470,796
Fees, fines and charges for services	134,260	-	-	-	-	-	134,260
Rent of property	153,834	-	-	-	-	-	153,834
Interest and investment earnings	283,416	-	-	-	-	-	283,416
Federal grants	-	1,308,901	-	-	-	1,608,049	2,916,950
Miscellaneous	389,160	-	-	-	-	56,805	445,965
Total revenues	19,583,535	1,308,901	3,100,919	11,226,275	-	3,094,042	38,313,672
Expenditures							
Current:							
General government	7,258,824	-	-	-	-	-	7,258,824
Public safety	2,383,797	-	-	-	-	-	2,489,465
Public works and sanitation	8,138,061	-	-	5,488,096	-	105,668	16,193,864
Health	807,796	-	-	-	-	94,582	902,378
Culture and recreation	875,601	-	-	-	507,338	507,337	1,890,276
Housing, welfare and community development	1,771,063	1,308,901	-	-	-	768,958	3,848,922
Education	33,480	-	-	-	-	25,914	59,394
Debt service:							
Principal	-	-	1,549,000	-	-	-	1,549,000
Interest	-	-	725,283	-	-	-	725,283
Total expenditures	21,268,622	1,308,901	2,274,283	5,488,096	507,338	4,070,166	34,917,406
Excess (deficiency) of revenues over (under) expenditures	(1,685,087)	-	826,636	5,738,179	(507,338)	(976,124)	3,396,266
Other financing sources (uses)							
Long-term debt issued	-	-	-	-	9,405,000	-	9,405,000
Bond issuance costs	-	-	-	-	(33,792)	-	(33,792)
Transfers in	117,217	-	-	1,000	-	-	118,217
Transfers out	(1,000)	-	-	(43,182)	-	(74,035)	(118,217)
Total other financing sources (uses)	116,217	-	-	(42,182)	9,371,208	(74,035)	9,371,208
Net change in fund balances	(1,568,870)	-	826,636	5,695,997	8,863,870	(1,050,159)	12,767,474
Fund balance, beginning as restated	1,051,445	(13,353)	2,665,527	5,331,651	-	5,615,616	14,650,886
Fund balance, ending	\$ (517,425)	\$ (13,353)	\$ 3,492,163	\$ 11,027,648	\$ 8,863,870	\$ 4,565,457	\$ 27,418,360

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

Commonwealth of Puerto Rico
Autonomous Municipality of Cabo Rojo
Reconciliation of the Balance Sheet - Governmental Funds
to the Statement of Net Assets
For the Year Ended June 30, 2010

Total Fund Balances - Governmental Funds \$ 27,418,360

Amounts reported for Governmental Activities in the Statement of Net Assets are different because:

Capital Assets used in governmental activities are not financial resources and therefore, are not reported in the funds. In the current period, these amounts are:

Non Depreciable Capital Assets	\$ 20,819,518
Depreciable Capital Assets, net of depreciation	<u>42,268,754</u>

Total Capital Assets 63,088,272

Other assets are not available to pay for current period expenditures and therefore, are deferred in the funds:

P.R. Department of Treasury -Christmas bonus reimbursement	188,756
CDBG-Federal Grants	13,353
Commonwealth Legislative Resolutions	123,093
Solid Waste Management Authority-grant for municipal landfill	275,000
Sales tax (Debt Service Fund)	30,000
P.R. Department of Labor (Law 52 and Law 82 Funds)	93,490
P.R. Electric Power Authority	501,588

Some liabilities are not due and payable in the current period and therefore, are not reported in the funds. Those liabilities consist of:

General Bonds and Notes Payable	21,938,711
LIMS repayment plan	131,261
Property taxes debt	392,905
Department of Labor	271,836
P.R. Solid Waste Management Authority	6,219
Obligation under capital leases	125,250
Compensated absences	3,665,376
Christmas bonus	377,511
P.R. Electric Power Authority	501,588
Claims and judgment	<u>25,000</u>

Total Long-Term Liabilities (27,435,657)

Total Net Assets of governmental activities \$ 64,296,255

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

**Commonwealth of Puerto Rico
Autonomous Municipality of Cabo Rojo
Reconciliation of the Statement of Revenues,
Expenditures, and Changes in Fund Balances of
Governmental Funds to the Statement of Activities
For the Year Ended June 30, 2010**

Net Change in Fund Balances - Total Governmental Funds \$ 12,767,474

Amounts reported for governmental activities in the Statement of Activities are different because:

Governmental Funds report capital outlays as expenditures. However, in the Government-Wide Statement of Activities and Changes in Net Assets, the cost of those assets is allocated over their estimated useful lives as depreciation expense. This is the amount of capital assets recorded in the current period. 9,052,347

Capital assets received as a donation are not recorded in the Governmental Funds, because current financial resources are not involved; however, the transaction must be reflected in the Government-Wide Financial Statements based on the fair value of the donated property. This is the amount of donated capital assets recorded in the current period. 5,496,919

Depreciation expense on capital assets is reported in the Government-Wide Statements of Activities and Change in Net Assets, but they do not require the use of current financial resources. Therefore, depreciation expense is not reported as expenditures in Governmental Funds. (2,583,576)

Governmental Funds report capital assets sold as revenues. However, in the Government-Wide Statement of Activities and Changes in Net Assets, Disposal of capital assets require removal of cost of the capital assets from the capital asset account on the Government-Wide Statement of Net Assets. (2,825)

Interest expense on long-term debt was reported in the Government-Wide Statement of Activities and Change in Net Assets, but it did not require the use of current financial resources. Therefore, interest expense was not reported as expenditures in Governmental Funds. The following amount represented the change in accrued interest prior year. (42,609)

Revenues reported in funds which are not reported as revenues in the Statement of Activities, include: P.R. Department of Treasury-Christmas bonus, Commonwealth Legislative Resolutions, P.R. Electric Power Authority, and other grants and miscellaneous receivables (850,709)

Bonds and notes proceeds provide current financial resources to Governmental Funds, but issuing debt increase long-term liabilities in the Government-Wide statement of Net Assets. Repayment of bonds and notes principal is an expenditure in Governmental Funds, but the repayment reduces long-term liabilities in the Government-Wide Statement of Net Assets. This is the amount by which the debt proceeds exceed debt service principal payments. (8,071,000)

Retirement System Administration payment plan, was reported in the Government-Wide Statement of Activities and Change in Net Assets, Repayment of long-term payment plan debt is an expenditure in Governmental Funds, but the repayment reduces long-term property tax advance debt in the Government-Wide Statement of Net Assets. The following represented the change in property tax debt. 35,456

Continue

Commonwealth of Puerto Rico
Autonomous Municipality of Cabo Rojo
Reconciliation of the Statement of Revenues,
Expenditures, and Changes in Fund Balances of
Governmental Funds to the Statement of Activities (Continued)
For the Year Ended June 30, 2010

Property tax debt related to current year final liquidation and LIMS repayment plan, was reported in the Government-Wide Statement of Activities and Change in Net Assets, Repayment of long-term property tax advance debt is an expenditure in Governmental Funds, but the repayment reduces long-term property tax advance debt in the Government-Wide Statement of Net Assets. The following represented the change in property tax debt.	79,667
Long-term compensated absences are reported in the Government-Wide Statement of Activities and Changes in Net Assets, but they do not require the use of current financial resources. Therefore, long-term compensated absences were not reported as expenditures in Governmental Funds. The following amount represents the change in long-term compensated absences from prior year.	(143,517)
Certain expenditures reported in the Governmental Funds which required the use of current financial resources had already been reported as expenses in the Statement of Activities in prior years.	<u>462,856</u>
Change in Net Assets of Governmental Activities	<u>\$ 16,200,483</u>

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

**COMMONWEALTH OF PUERTO RICO
AUTONOMOUS MUNICIPALITY OF CABO ROJO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2010

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Autonomous Municipality of Cabo Rojo (the Municipality) was founded on the year 1771. The Municipality's governmental system consists of an executive and legislature body. It is governed by a Mayor and a fourteen-member Municipal Legislature who are elected for a four-year term.

The Municipality provides a full range of services for its citizens. These services include public safety, public works, culture and recreation, health and welfare, community development, education, and other miscellaneous services.

The accounting policies and financial reporting practices of the Municipality conform to accounting principles generally accepted in the United States of America ("USGAAP") as applicable to governmental units.

In June 1999, the Governmental Accounting Standards Board (GASB) issued Statement No. 34, "Basic Financial Statements and Management's and Discussion and Analysis for State and Local Governments." This Statement, known as the Reporting Model, provides for the most significant change in financial reporting for state and local governments in over 20 years and affects the way the Municipality prepares and presents financial information. The Statement was adopted as of July 1, 2002. In addition to this Statement, GASB Statement No. 37, "Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments: Omnibus" and GASB Statement No. 38, "Certain Financial Statement Note Disclosures" have been adopted and are reflected in these financial statements.

The following is a summary of the significant accounting policies of the Municipality:

A. Component Units

In evaluating how to define the Municipality for financial reporting purposes, management has considered all potential component units. The decision to include a potential component unit in the reporting entity was made by applying the provisions of Statement No. 14, The Financial Reporting Entity, of the GASB, as amended by GASB Statement No. 39, "Determining Whether Certain Organizations Are Components Units an amendment of GASB Statement 14". The basic, but not the only criterion for including a potential component unit within the reporting entity is if elected officials of a primary government are financially accountable for the entity. Financial accountability exists if the primary governmental appoints a voting majority of the entity's governing body, and if either one of the following conditions exist: the primary government can impose its will on the other entity or the potential exists for the other entity to (1) provide specific financial benefits to or (2) impose specific financial burdens on the primary government. A second criterion used in evaluating potential component units is if the nature and significance of the relationship between the entity and a primary government are such that to exclude the entity from the financial reporting entity would render the financial statements misleading or incomplete. Based on the above criteria the Municipality does not have component units to include within its reporting entity.

COMMONWEALTH OF PUERTO RICO
AUTONOMOUS MUNICIPALITY OF CABO ROJO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2010

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

B. Government-wide and fund financial statements

Financial information of the Municipality is presented in this report as follow:

1. Management's discussion and analysis introduces the basic financial statements and provides an analytical overview of the Municipality's financial activities.
2. The government-wide financial statements (i.e. the statement of net assets and the statement of activities) report information on all the activities of the Municipality and its component units, if any. Governmental activities, which normally are supported by taxes and intergovernmental revenues, are reported separately from business-type activities, if any, which rely to a significant extent on fees and charges for support. Interfund activity has been removed from these statements to minimize the duplicating effect on assets and liabilities within the governmental activities.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment is offset by program revenue. Direct expenses are those that are charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment and grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items not properly included among program revenues are reported instead as general revenues.

3. Fund financial statements focus on information about the Municipality's major governmental funds. Major individual governmental funds are reported as separate columns in the fund financial statements. Each fund is accounted for by providing a separate set of self balancing accounts that comprise its assets, liabilities, reserves, fund equity, revenues and expenditures.

Funds are segregated according to their intended purpose which helps management in demonstrating compliance with legal, financial, and contractual provisions. Governmental funds are those through a Balance Sheet and a Statement of Revenues, Expenditures and Changes in Fund Balances with one column for the general fund, one for each major fund and one column combining all non-major governmental funds. Major funds are determined based on a minimum criterion, that is, a percentage of the assets, liabilities, revenues and expenditures (for Commonwealth Legislative Resolutions Fund and Debt Service Fund) or based on the Municipality's official's criteria, if the fund is particularly important to financial statements users (for Community Development Block Grant Program Fund). The Municipality reports the following major governmental funds:

General Fund - is the accounting entity in which all governmental activity, except that which is required to be accounted for in another fund, is accounted for. Its revenues consist mainly of taxes, licenses and permits, intergovernmental revenue, charges for services and other.

COMMONWEALTH OF PUERTO RICO
AUTONOMOUS MUNICIPALITY OF CABO ROJO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2010

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

B. Government-wide and fund financial statements (continued)

Community Development Block Grant - is used to account for revenues sources for the development of viable urban communities by providing decent housing, a suitable living environment and expanding economic opportunities, principally for persons of low and moderate income.

Debt Service Fund - is used to account for the accumulation of resources for, and the payment of general long-term debt principal and interest.

Commonwealth Legislative Resolutions Fund - is used to account for revenue sources to be used for the construction and improvement of capital facilities and for welfare purposes.

Convention Center Fund - is used to account for the construction of the Convention Center in Cabo Rojo, Puerto Rico.

The other governmental funds of the Municipality account for grants and other resources whose use is restricted for a particular purpose.

1. The notes to the financial statements provide information that is essential to a user's understanding of the basic financial statements.
2. Required supplementary information such as the budgetary comparison schedule-general fund and other types of data required by GASB.
3. Notes to the budgetary comparison schedule-general fund.

C. Financial reporting presentation

The accounts of the Municipality are organized on the basis of funds, each of which is considered a separate accounting entity. The operations of each fund are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues, and expenditures. Fund types are as follows:

General Fund - General Fund is the general operating fund of the Municipality. It is used to account for all governmental activity, except those required to be accounted for in another fund.

Special Revenue Fund - Federal Grants - Special Revenue Funds are used to account for revenues derived from federal grants. The uses and limitations of each special revenue fund are specified by Municipality ordinances or federal and state statutes.

COMMONWEALTH OF PUERTO RICO
AUTONOMOUS MUNICIPALITY OF CABO ROJO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2010

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Special Revenue Fund - Local and State Grants - Special Revenue Funds are used to account for revenues derived from local funds, state grants or other restricted revenue sources. The uses and limitations of each special revenue fund are specified by Municipality ordinances or federal and state statutes.

Special Revenue Fund - Section 8 Housing Choice Voucher - Special Revenue Funds are used to account for revenues derived from Section 8 Housing Choice Voucher Program. The uses and limitations of each special revenue fund are specified by Municipality ordinances or federal and state statutes.

Capital Projects Fund - Local and State Grants - Capital Projects Funds are used to account for financial resources used for the acquisition or construction of major capital facilities.

Debt Service Fund - Debt Service Funds are used to account for the accumulation of resources for and the payment of, general long-term debt principal, interest, and related costs.

D. Measurement focus, basis of accounting and financial presentation

Except for budgetary purposes, the basis of accounting used by the Municipality conform to accounting principles generally accepted in the United States of America ("USGAAP") as applicable to governmental units. The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. The Municipality has elected not to apply all Statements and Interpretations issued by the Financial Accounting Standard Board after November 30, 1989, in accordance with GASB Statement No. 20.

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. Property taxes are recognized as revenues in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

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 government considers revenues to be available if they are collected within 60 days of the end of the current fiscal period.

COMMONWEALTH OF PUERTO RICO
AUTONOMOUS MUNICIPALITY OF CABO ROJO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2010

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

D. Measurement focus, basis of accounting and financial presentation (continued)

Expenditures are recorded when the related fund liability is incurred, except for principal and interest on general long-term debt, claims and judgments, and compensated absences, which are recognized as expenditures when payment is due. General capital asset acquisitions are reported as expenditure in governmental funds. Proceeds from issuance of general long-term debt was reported as other financing sources.

Property taxes, other taxes, licenses, rent, and interest associated with the current fiscal period are all considered to be susceptible to accrual and so have been recognized as revenues of the current fiscal period. All other revenue items are considered to be measurable and available only when the government receives cash.

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed in the government-wide financial statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. Governments also have the option of following subsequent private-sector guidance for their business-type activities and enterprise funds, subject to this same limitation. The Municipality has elected not to follow subsequent private-sector guidance.

Amounts reported as program revenues include 1) charges to customers or applicants for goods, services, or privileges provided, 2) operating grants, and contributions, and 3) capital grants and contributions, including special assessments, if any. Internally dedicated resources are reported as general revenues rather than as program revenues. Likewise, general revenues include all taxes.

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

The preparation of the financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

COMMONWEALTH OF PUERTO RICO
AUTONOMOUS MUNICIPALITY OF CABO ROJO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2010

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

E. Assets, liabilities and net assets

- 1. Cash, cash equivalents, cash with fiscal agent, and investments held in commercial bank** - The Municipality's cash and cash equivalents are considered to be cash on hand, demand deposits, and short-term investments with original maturities of three months or less from the date of acquisition.

Cash with fiscal agent in the debt service fund represents special additional property tax collections retained by the Commonwealth of Puerto Rico and restricted for the payment of the Municipality's debt service, as established by law. Also, cash with fiscal agent consists of unused proceeds of bonds and notes issued for the acquisition of equipment and construction of major capital improvements.

Investments held in commercial bank in the commonwealth resolutions fund mainly consist of U.S. government and agencies' obligations, Puerto Rico state and local government obligations, and corporate obligations. Investment securities are presented at fair value, except for money market investments which are presented at cost. Changes in the fair value of investments are presented as investment and interest earnings in the statement of activities, the statement of revenues, expenditures, and changes in fund balances. Fair value is determined based on quoted market prices. When securities are not listed on national exchanges, quotations are obtained from brokerage firms.

- 2. Receivables and payables** - Activity between 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" (the current portion) or "advances to/from other funds" (the non-current portion). All other outstanding balances between funds are reported as "due to/from other funds."

Advances between funds, as reported in the fund financial statements, if any, are offset by a fund balance reserve account in applicable governmental funds to indicate that they are not available for appropriation and are not expendable available financial resources.

Receivables are stated net of estimated allowances for uncollectible accounts, which are determined based upon past collection experience and current economic conditions. Intergovernmental receivables in the General Fund represents the balance due from the Municipal Revenue Collection Center (CRIM) resulting from the final liquidations of advances made by CRIM to the Municipality corresponding to collections from property taxes and legislative appropriations from the Commonwealth of Puerto Rico plus final liquidation of contributions in lieu of taxes payable by the Puerto Rico Electric Power Authority (PREPA) to the Municipality. Intergovernmental Receivables in the debt service fund represent the amounts due from the CRIM resulting from the excess of current year property tax collections over current year advances. Intergovernmental receivable in the special revenue or capital project funds represent amounts owed to the Municipality for reimbursement of expenditures incurred pursuant to federally funded or state funded programs. The Municipal sales and use tax is collected on a contract basis with the Commonwealth of Puerto Rico Department of Treasury.

COMMONWEALTH OF PUERTO RICO
AUTONOMOUS MUNICIPALITY OF CABO ROJO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2010

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

E. Assets, liabilities and net assets (continued)

3. **Inventories** - Inventories in the general fund is recorded as expenditure and, consequently, the inventory is not recorded in the statement of net assets.
4. **Capital assets** - Capital assets, which include property, equipment and infrastructure assets (e.g., roads, bridges, sidewalks and similar items), are reported in the governmental activities column in the governmental-wide financial statements. The Municipality defines capital asset as assets with an initial, individual cost of more than \$25 and an estimated useful life in excess of one year. Such assets are reported at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation.

The cost of normal maintenance and repairs that do not add to the value of the asset or materially extend assets lives are not capitalized.

Major outlays for capital assets and improvements are capitalized as projects construction costs are incurred.

Capital assets of the Municipality are depreciated using the straight-line method over the following estimated useful lives:

<u>Description</u>	<u>Useful Life</u>
Land improvements	20 years
Building and building improvements	20-50 years
Infrastructure	20-40 years
Vehicles, machinery and equipment	5 to 15 years

5. **Long-term obligations** - The liabilities reported in the government-wide financial statements included general and special obligation bonds and notes, and other long-term liabilities, such as vacation, sick leave, litigation, long-term liabilities to other governmental entities.

In the fund financial statements, governmental fund types recognize bond issuances cost, during the current period. The face amount of debt issued is reported as other financing sources, while bond issuance costs, whether or not withheld from the actual debt proceeds received, are reported as expenditures.

6. **Deferred bond issuance costs** - Bond issuance costs are reported as deferred charges and amortized as required by current standards. Governmental fund types recognize bond issuance costs as expenditures during the current period. Those issuance costs, whether or not withheld from the actual debt proceeds received, are reported as expenditures in the appropriate fund.

COMMONWEALTH OF PUERTO RICO
AUTONOMOUS MUNICIPALITY OF CABO ROJO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2010

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

E. Assets, liabilities and net assets (Continued)

7. **Deferred bond issuance costs** - Bond issuance costs are reported as deferred charges and amortized as required by current standards. Governmental fund types recognize bond issuance costs as expenditures during the current period. Those issuance costs, whether or not withheld from the actual debt proceeds received, are reported as expenditures in the appropriate fund.

8. **Compensated absences** - Employees accumulate vacation leave at a rate of 2.5 days per month up to a maximum of 60 days. Unpaid vacation time accumulated is fully vested to the employees from the first day of work. All vacation pay is accrued when incurred in the government-wide financial statements.

Employees accumulate sick leave at a rate of 1.5 days per month up to a maximum of 90 days. Upon retirement, an employee receives compensation for all accumulated and unpaid sick leave at the current rate, if the employee has at least 10 years of service with the Municipality. All sick leave pay and salary related benefits are accrued when incurred in the governmental-wide financial statements when the employee meets such criteria.

9. **Claims and judgments** - The estimated amount of the liability for claims and judgments, which is due on demand, such as from adjudicated or settled claims, is recorded in the general fund when the liability is incurred.

10. **Reservations of fund balance** - Reservations of fund balance in the fund financial statements represent portions of fund balances that are legally segregated for specific future use or are not appropriated for expenditure. The Municipality has the following reservations of fund balance:

a. **Encumbrances**- Represent future expenditures under purchase orders, contracts and other commitments. These committed amounts generally will become liabilities in future periods as the goods or services are received.

b. **Debt Service Fund** - Represents net assets available to finance future debt service payments.

c. **Capital Projects**- Represent the reservation of amounts to be used for future expenditures for capital projects under contracts and other commitments. These reserved amounts generally will become liabilities in future periods as the projects are completed.

d. **Other Specified Purposes** - Represents amounts to be used for future expenditures of Federal and Commonwealth's grants as well as funds reserved through enabling legislation passed by government itself, to be used to finance activities other than construction or capital improvement commitments.

COMMONWEALTH OF PUERTO RICO
AUTONOMOUS MUNICIPALITY OF CABO ROJO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2010

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

E. Assets, liabilities and net assets (Continued)

11. **Net Assets** -In the government-wide statements, net assets are segregated into three categories:

- a. Invested in capital assets, net of related debt: Consist of capital asset balances net of accumulated depreciation and outstanding balances of any bonds, notes and other borrowings that are attributable to the acquisition, construction, or improvement of those assets. This category should not include cash that is restricted to capital asset acquisition or construction (unspent bond proceeds) and any unamortized debt issue costs.
- b. **Restricted net assets** - Represent net assets that are subject to restrictions beyond the Municipality's control. These include restrictions that are externally imposed (by creditors, grantors, contributors, or laws and regulations of other governments) or restrictions imposed by the law through constitutional provisions or enabling legislation (including enabling legislation passed by the government itself).
- c. **Unrestricted net assets** - Represent net assets that do not meet the definition of net assets invested in capital assets, net of related debt or restricted. Unrestricted assets are often designated to indicate that management does not consider them to be available for general operations. These types of constraints are internal and management can remove or modify them. Designations are not reported on the face of the statement of net assets.

12. **Accounting for Pension Costs** - For the purpose of applying the requirements of GASB Statements No. 27, *Accounting for Pensions by State and Local Government Employers* (GASB No. 27), the state government of the Commonwealth of Puerto Rico is considered to be the sponsor of the Employee's Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS) and System 2000, a multi-employer cost-sharing defined benefit 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. Accordingly, no portion of the net pension obligation (NPO) related to ERS has been allocated to the Municipality in the accompanying basic financial statements. The basic financial statements of the Commonwealth of Puerto Rico report the total amount of the net pension obligation of ERS, including any amount that may correspond to the Municipality.

COMMONWEALTH OF PUERTO RICO
AUTONOMOUS MUNICIPALITY OF CABO ROJO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2010

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

E. Assets, liabilities and net assets (Continued)

13. Interfund and intra-entity transactions - The Municipality has the following types of transactions among funds:

- a. Operating Transfers- Legally required transfers that are reported when incurred as "Operating transfer-in" by the recipient fund and as "Operating transfers-out" by the disbursing fund.
- b. Intra-Entity Transactions- Transfers between the funds of the primary government are reported as interfund transfers with receivables and payables presented as amounts due to and due from other funds.

14. Risk financing - The Municipality carries commercial insurance to cover casualty, theft, tort claims and other losses. Insurance policies are negotiated by the Puerto Rico Treasury Department and costs are allocated among all the Municipalities of Puerto Rico.

Cost of insurance allocated to the Municipality and deducted from the gross property tax collections by the Municipal Revenue Collection Center ("CRIM") for the year ended June 30, 2010 amounted to \$410,897. The current insurance policies have not been cancelled or terminated. The CRIM also deducted \$511,812 for workers compensation insurance covering all municipal employees.

15. Use of estimates - The preparation of the basic financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the basic financial statements and the reported amounts of revenues and expenditures during the reporting period. Actual results could differ from those estimates.

2. CASH, CASH EQUIVALENTS, AND INVESTMENTS IN COMMERCIAL BANKS

The Municipality maintains its cash deposits in various commercial banks located in Puerto Rico and Government Development Bank for Puerto Rico (GDB). Proceeds from bonds and funds related to certain grant awards are required by law to be held with GDB.

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

**COMMONWEALTH OF PUERTO RICO
AUTONOMOUS MUNICIPALITY OF CABO ROJO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2010

2. CASH, CASH EQUIVALENTS, AND INVESTMENTS IN COMMERCIAL BANKS (CONTINUED)

Credit risk – This is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. In compliance with the laws and regulations of the Commonwealth, the Municipality has adopted, as its custodial and credit risk policy, the *Statement of Investment Guidelines for the Government of the Commonwealth of Puerto Rico*. Accordingly the Municipality invests only in obligations of the Commonwealth, obligations of the United States of America, certificates of deposits, commercial paper, bankers' acceptances, or in pools of obligations of the municipalities of Puerto Rico, which are managed by GDB. According to the aforementioned investment guidelines, the Municipality does not invest in marketable securities or any types of investments for which credit risk exposure may be significant. Therefore, the Municipality's management has concluded that the risk related to any possible loss related to defaults by commercial banks on the Municipality's deposits is considered low at June 30, 2010.

Interest rate risk – This is the risk that changes in interest rates and fair values of debt investments will adversely affect the fair value of an investment. As of June 30, 2010, the Municipality's investments held in commercial bank consist of the following debt securities:

	<u>Maturities</u>	<u>Fair Values as of June 30, 2010</u>
Tennessee VY Authority, continuously callable from 3/15/2013 ¹	3/15/2025	\$ 500,780
First PR Tax Target Mat Income, callable	4/1/2025	213,925
PR Government Development Bank, continuously callable from 2/1/2011 ¹	2/1/2015	1,161,811
PR Government Development Bank, continuously callable from 2/1/2011 ¹	2/1/2017	707,490
PR Government Development Bank, continuously callable from 2/1/2011 ¹	2/1/2020	808,272
PR Government Development Bank, continuously callable from 2/1/2011 ¹	2/1/2020	1,414,476
PR Government Development Bank, continuously callable from 2/1/2011 ¹	2/1/2022	2,020,080
PR Government Development Bank, continuously callable from 2/1/2011 ¹	2/1/2022	1,010,040
Federal Home Loan Banks, continuously callable from 12/10/2010 ¹	12/10/2024	254,845
Federal Home Loan Banks	2/26/2025	<u>497,500</u>
	Total	<u>\$ 8,589,219</u>

¹These bonds are callable on any date after the first call date until its maturity.

The Municipality does not have a formal policy limiting investment maturities that would help manage its exposure to fair value losses from increasing interest rates.

COMMONWEALTH OF PUERTO RICO
AUTONOMOUS MUNICIPALITY OF CABO ROJO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2010

2. CASH, CASH EQUIVALENTS, AND INVESTMENTS IN COMMERCIAL BANKS (CONTINUED)

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 pledged as collateral when held, in the Municipality's name, by the agents of the Commonwealth's Secretary of Treasury. Deposits with GDB and investments held in commercial bank are uninsured and uncollateralized. However, no losses related to defaults by GDB on deposit transactions or the banks currently holding the Municipality's investments have been incurred by the Municipality through June 30, 2010. Therefore, the Municipality's management has concluded that at June 30, 2010 the custodial credit risk associated with the Municipality's cash, cash equivalents, and investments held in commercial bank is considered low.

Foreign exchange risk – The risk that changes in exchange rates will adversely affect the value of an investment or a deposit. According to the aforementioned investment guidelines, the Municipality is prevented from investing in foreign securities or any other types of investments in which foreign exchange risk exposure may be significant. Accordingly, management has concluded that the foreign exchange risk related to the Municipality's deposits is considered low at June 30, 2010.

Cash in Banks –The Municipality's cash and investments at June 30, 2010 are composed of: (1) demand deposits in commercial banks, (2) demand deposits in the Government Development Bank of Puerto Rico (GDB, fiscal agent), and (3) cash equivalents in commercial banks.

Commonwealth of Puerto Rico laws authorize governmental entities to invest in direct obligations or obligations guaranteed by the federal government or Puerto Rico's Government. The Municipality is also allowed to invest in bank acceptances, other bank obligations and certificates of deposit in financial institutions authorized to do business under the federal and Government laws.

Under Commonwealth of 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.

The Municipality's bank balances in commercial banks of approximately \$1,832,419 in the general fund were fully collateralized at June 30, 2010. The deposits at GDB of approximately \$5,207,534 in the debt service fund, \$8,863,870 that is restricted for the construction of a convention center and, \$1,971,589 that is restricted for other governmental funds, are unsecured and uncollateralized, as no collateral is required to be carried by governmental banks.

Investment held with Commercial bank - The investment held with commercial bank consists of \$7,550,000 undisbursed proceeds of Commonwealth Legislative Resolutions. The funds earn interest at a variable rate between 4.62% and 6% and are valued at fair market prices.

COMMONWEALTH OF PUERTO RICO
AUTONOMOUS MUNICIPALITY OF CABO ROJO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2010

3. RECEIVABLES

- A. Municipal License Tax** - The Municipality imposes a municipal license tax on all businesses that operate within the Municipality, which are not totally or partially exempt from the tax pursuant to the Industrial Incentives Act of the Commonwealth of Puerto Rico. Municipal license tax receivable of \$1,823 represents filed municipal license tax returns that were uncollected as of June 30, 2010, net of allowance for uncollectibles.
- B. Municipal Sales and Use Tax** - Individuals, organizations and entities subject to collect the municipal sales and use tax must file a tax return to the Municipality. The tax is due the 10th day of each month based on tax collected in the preceding month. Municipal sales and use tax receivable of \$159,206 represents the tax collected on June by individuals, organizations and entities but reported and paid to the Municipality on or before July 10, net of uncollectible accounts.
- C. Rents and Construction Permits** - The Municipality has various facilities which generate rent revenue, and had reported \$1,167 for rents due but not paid as of June 30, 2010. The Municipality imposes a construction permit tax on construction activities performed within its territory, and had reported \$109,356 for eligible construction activities which had not yet paid the tax as of June 30, 2010.
- D. Others** - Other receivables mainly consist of other taxes, fines and penalties receivable and accrued interest receivable.

4. DUE FROM (TO) GOVERNMENTAL ENTITIES

Amounts due from governmental entities as of June 30, 2010 follows:

Commonwealth government:

<u>Governmental Entity</u>	<u>Amount</u>
Municipal Revenue Collection Center ("CRIM") (General Fund)	\$ 250,556
Municipal Revenue Collection Center ("CRIM") (Debt Service Fund)	49,485
P.R. Treasury Department (Christmas bonus)	188,756
P.R. Treasury Department (Sales and Use Tax-Debt Service Fund)	69,173
P.R. Department of Labor-Law No.52	57,397
P.R. Department of Labor-Law No.82	39,097
Commonwealth Legislative Resolutions	123,093
P.R. Electric Power Authority (PREPA)	501,588
P.R. Solid Waste Management Authority	275,000
Others	1,229
Total	<u>\$ 1,555,374</u>

COMMONWEALTH OF PUERTO RICO
AUTONOMOUS MUNICIPALITY OF CABO ROJO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2010

4. DUE FROM (TO) GOVERNMENTAL ENTITIES (CONTINUED)

Amounts due from governmental entities as of June 30, 2010 follows:

Federal government:

<u>Governmental Entity</u>	<u>Amount</u>
Child Care Block Grant	\$ 101,865
Energy Efficiency Block Grant	2,980
US Department of Housing and Urban Development-CDBG	37,842
Others	<u>485</u>
Total	<u>\$ 143,172</u>

5. INTERFUND TRANSACTIONS

Interfund receivables and payables at June 30, 2010, and interfund transfers during the fiscal year ended at June 30, 2010, are summarized as follows:

a. Due from/to other fund and Advances from/to other funds:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Purpose</u>	<u>Amount</u>
General Fund	HUD Programs Fund	Reimbursable Expenditures	\$ 18,043
General Fund	Commonwealth Legislative Resolutions Fund	Reimbursable Expenditures	99,743
General Fund	Other Governmental Funds	Reimbursable Expenditures	<u>321,709</u>
Total			<u>\$439,495</u>

b. Transfer in/out to other fund

<u>Transfer out</u>	<u>Transfer in</u>	<u>Purpose</u>	<u>Amount</u>
General Fund	Commonwealth Legislative Resolutions Fund	Reimbursable expenditures	\$ 1,000
Commonwealth Legislative Resolutions Fund	General Fund	Capital Projects	43,182
Other Governmental Funds	General Fund	Reimbursable expenditures	<u>74,035</u>
Total			<u>\$ 118,217</u>

**COMMONWEALTH OF PUERTO RICO
AUTONOMOUS MUNICIPALITY OF CABO ROJO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2010

6. CAPITAL ASSETS

Capital assets and depreciation activity as of and for the year ended June 30, 2010 is as follows:

<u>Governmental Activities:</u>	<u>Balance July 1, 2009</u>	<u>Additions</u>	<u>Retirements</u>	<u>Balance June 30, 2010</u>
Capital assets, not being depreciated:				
Land	\$ 3,461,491	\$ 6,482,919	\$ (2,036)	\$ 9,942,374
Construction in progress	<u>5,674,970</u>	<u>6,620,343</u>	<u>(1,418,169)</u>	<u>10,877,144</u>
Total capital assets not being depreciated	<u>9,136,461</u>	<u>13,103,262</u>	<u>(1,420,205)</u>	<u>20,819,518</u>
Capital assets, being depreciated:				
Land improvements	2,727,013	-	-	2,727,013
Buildings and building improvements	29,638,133	1,211,338	(16,004)	30,833,467
Infrastructure	20,351,963	1,099,355		21,451,318
Vehicles, machinery and equipment	<u>9,945,923</u>	<u>555,516</u>	<u>(921)</u>	<u>10,500,518</u>
Total capital assets being depreciated	<u>62,663,032</u>	<u>2,866,209</u>	<u>(16,925)</u>	<u>65,512,316</u>
Less accumulated depreciation for:				
Land improvements	(1,697,921)	(132,576)	-	(1,830,497)
Buildings and building improvements	(6,562,907)	(804,669)	13,403	(7,354,173)
Infrastructure	(7,511,225)	(1,007,848)		(8,519,073)
Vehicles, machinery and equipment	<u>(4,902,033)</u>	<u>(638,483)</u>	<u>697</u>	<u>(5,539,819)</u>
Total accumulated depreciation	<u>(20,674,086)</u>	<u>(2,583,576)</u>	<u>14,100</u>	<u>(23,243,562)</u>
Total capital assets being depreciated, net	<u>41,988,946</u>	<u>282,633</u>	<u>(2,825)</u>	<u>42,268,754</u>
Governmental activities capital assets, net	<u>\$ 51,125,407</u>	<u>\$13,385,895</u>	<u>\$(1,423,030)</u>	<u>\$ 63,088,272</u>

Depreciation expense was charged to functions/programs of the Municipality as follows:

<u>Governmental activities:</u>	<u>Amount</u>
General government	\$ 348,864
Public works and sanitation	1,376,092
Public safety	138,582
Culture and recreation	601,776
Health	324
Welfare and community development	110,755
Education	<u>7,183</u>
Total depreciation expense-governmental activities	<u>\$2,583,576</u>

**COMMONWEALTH OF PUERTO RICO
AUTONOMOUS MUNICIPALITY OF CABO ROJO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2010

7. DUE TO OTHER GOVERNMENTAL ENTITIES:

The amounts due to other governmental entities in the General Fund include the following:

<u>Governmental Entity</u>	<u>Amount</u>
General Services Administration	\$ 1,348
Retirement System Administration	151,553
Puerto Rico Aqueduct and Sewer Authority	<u>13,860</u>
Total	<u>\$ 166,761</u>

8. DEFERRED REVENUES

A. Municipal License Tax - The deferred revenues of \$1,699,433 in the general fund relates to municipal license tax collected in fiscal year 2009-10 that will be earned in fiscal year 2010-11.

B. Intergovernmental - Deferred revenues from the Commonwealth Government which represents revenues not available as required by current standards. The detail of those balances as of June 30, 2010 is as follows:

<u>Major fund-General Fund:</u>	<u>Amount</u>
P.R. Electric Power Authority	\$ 501,588
P.R. Department of Treasury-Christmas Bonus reimbursement	188,756
P.R. Department of Labor –Law No. 52	53,250
P.R. Department of Labor –Law No. 82	39,098
 Major fund-Debt Service Fund:	
P.R. Department of Treasury – sales and use taxes (debt service fund)	30,000
 Major fund-Commonwealth Legislative Resolutions Fund:	
Commonwealth Legislative Resolutions	123,093
 Other governmental funds:	
P.R. Solid Waste Management Authority	<u>275,000</u>
Total	<u>\$ 1,210,785</u>

C. Federal Government - Deferred revenues represent the portion of federal grants received for which qualifying expenditures have not been incurred, detailed as follows:

<u>Major fund-Community Development Block Grant Fund:</u>	<u>Amount</u>
US Department of Housing and Urban Development-CDBG	\$ 13,353
 Other governmental funds:	
Office of Elderly Affairs	12,606
Others	<u>485</u>
Total	<u>\$ 26,444</u>

**COMMONWEALTH OF PUERTO RICO
AUTONOMOUS MUNICIPALITY OF CABO ROJO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2010

9. LONG-TERM LIABILITIES

Long-term liability activity for the year ended June 30, 2010, was as follows:

Description	Beginning Balance	Borrowings or Additions	Payments or Deductions	Ending Balance	Due Within One Year
General, Special Obligations Bonds and Notes	\$15,267,055	\$ 9,405,000	\$(1,334,000)	\$ 23,338,055	\$ 1,493,055
Notes payable to CRIM-LIMS	212,569	-	(81,308)	131,261	86,218
Note payable to CRIM-Financing of delinquent accounts	306,689	-	(13,335)	293,354	13,334
Note payable to P.R. Department of Labor	-	271,836	-	271,836	90,612
Note payable to P.R. Solid Waste Management Authority	13,466	-	(7,247)	6,219	6,219
Note payable to solid waste landfill contractor	583,657	-	(583,657)	-	-
Note payable to ERS	35,456	-	(35,456)	-	-
Obligation under capital leases	160,911	-	(35,661)	125,250	36,978
Compensated absences	3,521,859	819,027	(675,510)	3,665,376	250,000
Christmas bonus	421,275	377,511	(421,275)	377,511	377,511
Claims and judgments	134,000	25,000	(134,000)	25,000	25,000
Payable to PREPA	362,246	278,685	(139,343)	501,588	139,343
Payable to CRIM-excess of property tax advances over actual collections	84,575	14,976	-	99,551	99,551
Total	<u>\$21,103,758</u>	<u>\$11,192,035</u>	<u>\$(3,460,792)</u>	<u>\$ 28,835,001</u>	<u>\$ 2,617,821</u>

- General and special obligation bonds and notes** – The Municipality's outstanding general and special obligation bonds and notes at June 30, 2010 amount to \$23,338,055. All these bonds are serviced by the Governmental Development Bank of Puerto Rico (GDB) maturing at various dates. As required by law, the Commonwealth Government is obligated to collect property taxes for payment of principal and interest on bonds and notes. In addition, .2% of the .5% municipal sales and use tax collected by the P.R. Department of Treasury is deposited in a "Municipal Redemption Fund" to finance loans to Municipalities subject to restrictions imposed by law. Debt service funds has been established for the bonds and notes at GDB with the proceeds of those property and sales and use taxes, whereby sufficient funds must be set aside in order to cover the projected debt service requirement, before any new bonds are issued.

**COMMONWEALTH OF PUERTO RICO
AUTONOMOUS MUNICIPALITY OF CABO ROJO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2010

9. LONG-TERM LIABILITIES (CONTINUED)

A detail of the general and special obligation bonds and notes as of June 30, 2010 follows:

	Outstanding Amount
1985 public improvement bonds of \$300,000 due in annual installments ranging from \$4,000 to \$22,000 through January 1, 2011; bearing interest at 6.125 %	\$ 22,055
1992 public improvement bonds of \$880,000 due in annual installments ranging from \$20,000 to \$61,000 through January 1, 2016; bearing interest at 5.0 %	324,000
1993 public improvement bonds of \$454,000 due in annual installments ranging from \$10,000 to \$32,000 through January 1, 2017; bearing interest at 5.0 %	192,000
1996 public improvement bonds of \$105,000 due in annual installments ranging from \$5,000 to \$10,000 through January 1, 2010; bearing interest at 6.30 %	10,000
1997 public improvement bonds of \$765,000 due in annual installments ranging from \$15,000 to \$75,000 through January 1, 2016; bearing interest at rates ranging from 6.23% to 6.58% (6.30% at June 30, 2010)	405,000
1997 general obligation notes of \$1,735,000 due in annual installments ranging from \$40,000 to \$165,000 through January 1, 2016; bearing interest at rates ranging from 6.23% to 6.58% (6.30% at June 30, 2010)	920,000
1999 general obligation bonds of \$830,000 due in annual installments ranging from \$10,000 to \$70,000 through July 1, 2023; bearing interest at rates ranging from 5.86% to 6.56% (5.86% at June 30, 2010)	630,000
1999 general obligation bonds of \$1,310,000 due in annual installments ranging from \$50,000 to \$140,000 through July 1, 2013; bearing interest rates ranging from 5.86% to 6.11% (5.86% at June 30, 2010)	500,000
2000 general obligation bonds of \$2,040,000 due in annual installments ranging from \$80,000 to \$215,000 through July 1, 2014; bearing interest at rates ranging from 4.30% to 4.73% (4.30% at June 30, 2010)	935,000
2003 general obligation bonds of \$4,425,000 due in annual installments ranging from \$75,000 to \$345,000 through July 1, 2026; bearing interest at rates ranging from 4.30% to 5.60% (4.30% at June 30, 2010)	3,670,000
2004 general obligation bonds of \$305,000 due in annual installments ranging from \$35,000 to \$50,000 through July 1, 2010; bearing interest of 4.50%	50,000

Continue

**COMMONWEALTH OF PUERTO RICO
AUTONOMOUS MUNICIPALITY OF CABO ROJO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2010

9. LONG-TERM LIABILITIES (CONTINUED)

	Outstanding Amount
2004 general obligation bonds of \$505,000 due in annual installments ranging from \$10,000 to \$40,000 through July 1, 2028; bearing interest at rates ranging from 4.36% to 5.31% (4.50% at June 30, 2010)	435,000
2004 general obligation bonds of \$545,000 due in annual installments ranging from \$10,000 to \$35,000 through July 1, 2028; bearing interest rates ranging from 4.36% to 5.31% (4.50% at June 30, 2010)	465,000
2004 general obligation bonds of \$1,000,000 due in annual installments ranging from \$20,000 to \$75,000 through July 1, 2028; bearing interest at rates ranging from 4.36% to 5.31% (4.50% at June 30, 2010)	870,000
2004 general obligation bonds of \$505,000 due in annual installments ranging from \$40,000 to \$65,000 through July 1, 2014; bearing interest at rates ranging from 4.36% to 4.73% (4.50% at June 30, 2010)	285,000
2006 general obligation bonds of \$850,000 due in annual installments ranging from \$100,000 to \$145,000 through July 1, 2012; bearing interest at rates ranging from 1.53438% to 7.00% (1.53438% at June 30, 2010)	410,000
2006 general obligation bonds of \$355,000 due in annual installments ranging from \$5,000 to \$25,000 through July 1, 2030; bearing interest at rates ranging from 4.36% to 5.31% (4.50% at June 30, 2010)	335,000
2006 general obligation note of \$1,775,000 due in annual installments ranging from \$200,000 to \$315,000 through July 1, 2013; bearing interest at rates ranging from 1.53438% to 7.50% (1.53438% at June 30, 2010)	1,125,000
2007 general obligation note of \$710,000 due in annual installments ranging from \$80,000 to \$125,000 through July 1, 2014; bearing interest at rates ranging from 1.53438% to 7.50% (1.53438% at June 30, 2010)	545,000
2008 general obligation note of \$1,850,000 due in annual installments ranging from \$45,000 to \$175,000 through July 1, 2028; bearing interest at rates ranging from 1.53438% to 7.50% (1.53438% at June 30, 2010)	1,805,000
2010 general obligation bonds of \$9,405,000 due in annual installments ranging from \$135,000 to \$785,000 through July 1, 2034; bearing interest ranging from 6.00% to 7.50%.	9,405,000
Total	\$ 23,338,055

**COMMONWEALTH OF PUERTO RICO
AUTONOMOUS MUNICIPALITY OF CABO ROJO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2010

9. LONG-TERM LIABILITIES (CONTINUED)

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

<u>Year Ending June 30,</u>	<u>Principal</u>	<u>Interest</u>
2011	\$ 1,493,055	\$ 880,555
2012	1,515,000	1,393,279
2013	1,623,000	1,295,774
2014	1,582,000	1,196,135
2015	1,211,000	1,111,396
2016-2020	3,774,000	4,755,310
2021-2025	4,395,000	3,507,291
2026-2030	4,305,000	1,964,452
2031-2035	<u>3,440,000</u>	<u>677,690</u>
Total	<u>\$ 23,338,055</u>	<u>\$ 16,781,882</u>

2. **LIMS Repayment Plan** - During the fiscal year 2000-2001, the Municipality authorized the CRIM to retain the corresponding portion for the financing project of Land Information Management System- LIMS, contracted by the CRIM. A total of \$691,648 is to be retained in a ten years period at an interest rate of 5.95% until November 28, 2011. At June 30, 2010, the outstanding debt balance is \$131,261. This amount is presented in the government-wide financial statements

3. **Property Taxes Debts** - These amounts represents the balance owed to the Treasury Department and to the Municipal Revenue Collection Center ("CRIM") at June 30, 2010 as described in Note 10.

4. **Note Payable to Puerto Rico Solid Waste Management Authority** - On February 2006, the Municipality entered into a financing agreement with the Authority for a total amount of \$50,256 for goods and services provided in prior years. The agreement is in the form of a non-interest bearing note (imputed interest of 5.09%) payable in monthly installments of \$647, and a final payment of \$1,827 due in February 2011. The note balance as of June 30, 2010 is net of an unamortized discount of \$655 and is being paid from unrestricted funds.

COMMONWEALTH OF PUERTO RICO
AUTONOMOUS MUNICIPALITY OF CABO ROJO
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
YEAR ENDED JUNE 30, 2010

9. LONG-TERM LIABILITIES (CONTINUED)

5. **Note payable to solid waste landfill site contractor** - These amount represents the balance owed to the municipal landfill administrator and a waste disposal services contractor as of June 30, 2010. The owed balance is being paid from proceeds from debt issuance.
6. **Compensated absences** - The government-wide statement of net assets includes approximately \$2,041,357 of accrued sick leave benefits, approximately \$1,394,513 of accrued vacation benefits, and approximately \$229,506 for compensatory leave benefits, representing the Municipality's commitment to fund such costs from future operations.
7. **Operating leases** -The Municipality is obligated under certain leases accounted for as operating leases. Operating leases do not give rise to property rights or lease obligations, and therefore, the results of the lease agreements are not reflected in the Municipality's financial statements.

The following is a schedule by years of future minimum rental payments under operating leases that have initial or remaining non-cancelable lease terms in excess of one year as of June 30, 2010:

<u>Year Ending June 30,</u>	<u>Governmental Activities</u>
2011	\$ 40,916
2012	40,916
2013	40,916
2014	10,229
Amount Representing interest	<u>(7,727)</u>
Total minimum payments required	<u>\$ 125,250</u>

8. **Christmas Bonus** - represents the accrued portion corresponding to fiscal year 2009-2010 of the Christmas bonus to be paid in December 2010.
9. **Claims and Judgments** - represent the final settlement of legal cases paid subsequent to June 30, 2010. The awarded amount will be paid with unrestricted funds.
10. **Payable to CRIM, property tax advances** - represent amount reported by CRIM on preliminary settlement of excess of advances over actual collections of property taxes.

**COMMONWEALTH OF PUERTO RICO
AUTONOMOUS MUNICIPALITY OF CABO ROJO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2010

9. LONG-TERM LIABILITIES (CONTINUED)

11. **Payable to PREPA** - As required by Act No. 83 of May 2, 1941, the Puerto Rico Electric Power Authority ("PREPA") should annually pay to the Municipality's of Puerto Rico a contribution in lieu of tax ("CELL") based on certain requirements as specified by the mentioned Act. The amount of CELL obligation is used by the Municipalities to finance the annual electric utility expense payment to PREPA. For fiscal year 2006-2007, the excess of \$418,027 of the Municipality's annual energy charges over the CELL obligation determined by PREPA was recorded as a payable to the Municipality and will be amortized over a 3 year period against the corresponding receivable for the same amount. As of June 30, 2010, the outstanding amount of \$278,685 is recognized by the Municipality as a receivable and a liability to PREPA. Also, as communicated by PREPA, the excess amount of \$222,903 corresponding to fiscal year 2007-2008 was also recorded as a payable and a receivable for the same amount. No amortization period was established by PREPA.

10. 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 Municipal Revenue Collection Center ("CRIM"), a governmental entity created by the government of Puerto Rico as part of the Municipal Legislation approved in 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 1 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 collect for the ensuing fiscal year. Throughout the year, the CRIM advances funds to the Municipality based on the initial estimated collections, as modified by the quarterly revisions of estimates required by law. The CRIM is required by law to prepare a liquidation 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 preliminary liquidation has to be completed on a preliminary basis not later than three months after fiscal year-end, and a final liquidation made not later than six months after year-end, subject to the verification by its Independent Auditors. 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, a payable to the CRIM is recorded at June 30. The CRIM issued the preliminary settlement noting that the collections exceeded advances by \$250,556.

**COMMONWEALTH OF PUERTO RICO
AUTONOMOUS MUNICIPALITY OF CABO ROJO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2010

10. PROPERTY TAXES (CONTINUED)

On December 31, 1992, the Municipality entered into an agreement with the Commonwealth of Puerto Rico for the repayment of excess property tax advances. As of June 30, 2010, the related unpaid property tax advances included in the Statement of Net Assets amounted to \$99,551 and is payable as follows:

<u>Year Ending June 30,</u>	<u>Amount</u>
2011	<u>\$99,551</u>
Total	<u>\$99,551</u>

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 owned 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. The loan is being paid by the municipalities thru a 30 year long-term financing negotiated by the CRIM with GDB on behalf of such municipalities as authorized by the indicated Law. During the first five years of the note, commenced in July 1, 2003, the Municipality shall pay only interest. At the end of the first five years of the note, the repayment terms and conditions of the note shall be renegotiated to allow the Municipality to pay the outstanding balance of the note in equal installments of principal plus interest, through maturity. As of June 30, 2010, the related unpaid property tax advances included in the Statement of Net Assets amounted to \$293,354.

The annual tax rate is 9.03% for real property and 7.03% 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) 4.0% and 6.0%, 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) 2.0% represents the ad valorem tax restricted for debt service and accounted for in the debt service fund.

**COMMONWEALTH OF PUERTO RICO
AUTONOMOUS MUNICIPALITY OF CABO ROJO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2010

10. PROPERTY TAXES (CONTINUED)

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.

11. MUNICIPAL SALES AND USE TAX:

On July 4, 2006, the Commonwealth Legislature approved Act. No. 117 ("Act 117") which amends the Puerto Rico Internal revenue Code of 1994 to provide, among other things, for a sales and use tax of 5.5% to be imposed by the Commonwealth Government. Act 117 also authorizes each municipal government to impose a municipal sales and use tax of 1.5%. This municipal sales and use tax has in general the same tax base and limitations (except for unprocessed foods) as those provided by the Commonwealth's sales and use tax.

Section 6189 of the Puerto Rico Internal Revenue Code of 1994, as amended, authorizes the Municipalities in Puerto Rico to impose a sales and use tax to consumers. This tax must be imposed in conformity with the base, exemptions and limitations contained in Subtitle BB of the Code. The municipal sales and use tax is specifically imposed over all sales transactions of taxable items and combined transactions (as defined by the municipal internal regulation) taken place within municipal limits. The municipal sales and use tax is also specifically impose over the purchase price for the use, storage or consumption of taxable transactions (as defined by the municipal internal regulation) taken place within municipal limits. The Municipal Legislature approved the imposition of the municipal sales and use tax effective on November 15, 2006.

On July 29, 2007, the Commonwealth of Puerto Rico Legislature approved Act No. 80 ("Act 80") which amends Act No. 117 of July 4, 2006 to impose to all municipalities of Puerto Rico a uniform municipal sales and use tax of 1.5%. Effective on August 1, 2007 1% of the 1.5% is collected by the Municipality's and the remaining .5% of the 1.5% is collected by the Puerto Rico Department of the Treasury (PRDT). Act 80 also provides for restrictions on the use of the sales tax, which is required to be invested in solid waste and recycling programs, capital improvements and health and public safety costs.

**COMMONWEALTH OF PUERTO RICO
AUTONOMOUS MUNICIPALITY OF CABO ROJO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2010

11. MUNICIPAL SALES AND USE TAX: (CONTINUED)

Amount collected by the PRDT (the remaining .5% of the 1.5%) is deposited in accounts or special funds in the Governmental Development Bank ("GDB"), subject to restrictions imposed and distributed as follows:

- .2% of the .5% will be deposited in a "Municipal Development Fund" to finance costs as restricted by the Act,
- .2% of the .5% will be deposited in a "Municipal Redemption Fund" to finance loans to Municipalities subject to restrictions imposed by the Act, and;
- .1% of the .5% will be deposited in a "Municipal Improvement Fund" to finance capital improvement projects; this funds will be distributed based on legislation from the Commonwealth 's Legislature

The Municipal Legislature amended Municipal Ordinance No. 3 Series 2006-2007 to conform to dispositions of Act 80.

Individuals, organizations and entities subject to collect the municipal sales and use tax must file a return to the Municipality. Tax is due each 20th day of each month based on tax collected in the preceding month.

The Municipality collected \$2,040,371 during the year ended June 30, 2010. Also, \$1,215,808 from the Municipal Redemption Fund are included in the Debt Service Fund.

12. PENSION PLAN

The Employee's Retirement System of the Commonwealth and its Instrumentalities (the Retirement System) is a cost-sharing multiple defined benefit pension plan sponsored by, and reported as a component unit of the Commonwealth of Puerto Rico. All regular employees of the Municipality under 55 years of age at the date of employment become members of the Retirement System as a condition to their employment.

The Retirement System provides retirement, death and disability benefits pursuant to legislation enacted by the Government of Puerto Rico's legislature. Disability retirement benefits are available to members for occupational and non-occupational disabilities.

Retirement benefits depend upon age at retirement and the number of years of creditable service. Benefits vest after ten years of plan participation.

COMMONWEALTH OF PUERTO RICO
AUTONOMOUS MUNICIPALITY OF CABO ROJO

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2010

12. PENSION PLAN (CONTINUED)

Members who have attained 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 ten years of creditable service are entitled to an annual benefit payable monthly for life.

The amount of the annuity shall be one and one-half percent of the average compensation, as defined, multiplied by the number of years of creditable service up to twenty years, plus two percent 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 percent of the average compensation, as defined; otherwise they will receive 75 percent of the average compensation, as defined. No benefits are payable if the participant receives a refund of his/her accumulated contributions.

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 by the same statute to contribute 9.275% of the participant's gross salary. Total Municipality contributions during the year ended June 30, 2010 amounted to approximately \$734,264. This amount represented 100% of the required contribution.

On September 24, 1999, an amendment to Act No. 447 of May 15, 1951, which created the Retirement System, was enacted with the purpose of establishing a new pension program (System 2000). Employee's participation in the current system as of December 31, 1999, may elect to stay in the defined benefit plan or transfer to the new program. Persons joining the Municipality on or after January 1, 2000, will only be allowed to become members of System 2000. System 2000 will reduce the retirement age from 65 years to 60 for those employees who joined the current plan on or after April 1, 1990.

System 2000 is a hybrid defined contribution plan, also known as a cash balance plan. Under this new plan, there will be a pool of pension assets, which will be invested by ERS together with those of the current defined benefit plan. The Commonwealth of Puerto Rico will not guarantee benefits at retirement age. The annuity will be based on a formula which assumes that each year the employee's contribution (with a minimum of 8.275% to the employee's salary up to a maximum of 10%) will be invested in an account which will either: (1) earn a fixed rate based on the two-year Constant Maturity Treasury Note or, (2) earn a rate equal to 75% of the return of the ERS's investment portfolio (net of management fees), or (3) earn a combination of both alternatives.

**COMMONWEALTH OF PUERTO RICO
AUTONOMOUS MUNICIPALITY OF CABO ROJO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2010

12. PENSION PLAN (CONTINUED)

Participants will receive periodic account statements similar to those of defined contribution plans showing their accrued balances. Disability pensions will not be granted under System 2000. The employer's contribution (9.275% of the employee's salary) will be used to fund the current plan.

Additional information on the Retirement System is provided in its financial statements for the year ended June 30, 2010, a copy of which can be obtained from the Retirement System, Minillas Station, PO Box 42003, San Juan, PR 00940-2003.

13. LANDFILL CLOSURE AND POSTCLOSURE CARE COSTS OBLIGATIONS

The Municipality discontinued the operation and ceased to accept solid waste in one of its two landfills. State and Federal laws and regulations require the Municipality to perform certain closure procedures and establish monitoring and maintenance procedures at the landfill site for thirty (30) years after closure. The closure and post closure care procedures are being assumed by the Municipality. As guidance for calculation of total closure costs, the Municipality utilized an estimate provided by the Puerto Rico Waste Disposal Authority. The Municipality is required to provide post closure care after the closure is completed. Total post closure care costs has not been determined and accounted as required by accounting principles generally accepted in the United States of America as of June 30, 2010.

The Municipality also has a solid waste landfill, which is in operation as of June 30, 2010. The total estimate of the closure and post closure care costs of the landfill and the portion of the estimated current costs of closure and post closure care costs has not been determined and recorded as required by accounting principles generally accepted in the United States of America as of June 30, 2010. The final effect of these matters cannot be properly determined. The Municipality has reserved \$14,507 as of June 30, 2010 to finance future closure and post closure care costs of this solid waste landfill. This reserve has been created by legislation.

14. RISK MANAGEMENT

The Property Division of the Municipality is responsible of assuring that the Municipality's property is properly insured. Annually, the Property Division compiles the information of all property owned and its respective market value. After evaluating this information, the Property Division submits the data regarding the Municipality's properties to the Public Insurance Department at the Department of the Treasury of the Commonwealth of Puerto Rico who is responsible for purchasing all property and casualty insurance policies of all municipalities. Settled claims have not exceeded commercial coverage in any of the past three (3) fiscal years.

**COMMONWEALTH OF PUERTO RICO
AUTONOMOUS MUNICIPALITY OF CABO ROJO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2010

15. COMMITMENTS AND CONTINGENCIES

A. Federal Grants:

The Municipality participates in a number of federal financial assistance programs funded by the Federal Government. Although the Municipality's grant programs have been audited in accordance with the provisions of the Single Audit Act of 1996, through June 30, 2010, these programs are still subject to financial and compliance audits by the granting agencies and the resolution of previously identified questioned costs. The amount, if any, of expenditures which may be disallowed by such audits cannot be determined at this time, although the Municipality management expects such amounts, if any, not to be material.

B. Claims and lawsuits:

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

With respect to pending and threatened litigation, the Municipality has reported liabilities of approximately \$25,000 for awarded or anticipated unfavorable judgments in the Government-Wide financial statements. This amount was included in the financial statements and represents the amount estimated as a probable liability or a liability with a fixed or expected due date, which will require future available financial resources for its payment.

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

C. Construction commitments

The Municipality has commitments at June 30, 2010 of approximately \$18.6 million for the construction, improvement and renovation of various municipal infrastructure and buildings.

16. FUTURE ADOPTION OF ACCOUNTING PRONOUNCEMENTS

The GASB has issued the following statements that have effective dates after June 30, 2010, for which their impact on the Municipality's basic financial statements have not yet been determined:

- a. GASB Statement No.54, Fund Balance Reporting and Governmental Fund Type Definitions, which is effective for periods beginning after June 15, 2010.
- b. GASB Concepts Statement No. 5, *Service Efforts and Accomplishments- an Amendment of GASB Concepts Statements No. 2*. This Statement provides a framework to be used by the GASB in considering guidance for reporting SEA by state and local governmental entities and amends terminology and other information in GASB:CS-2.

**COMMONWEALTH OF PUERTO RICO
AUTONOMOUS MUNICIPALITY OF CABO ROJO**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2010

17. PRIOR PERIOD ADJUSTMENTS

A. GOVERNMENTAL FUND FINANCIAL STATEMENTS

The following restatements have been made in the governmental fund financial statements, which are reported as an adjustment to the beginning fund balances:

Description	General Fund	Community Development Block Grant Fund	Debt Service Fund	Commonwealth Legislative Resolutions Fund	Convention Center Fund	Other Governmental Funds	Total
Fund balance ,beginning	\$ 548,192	(\$ 13,353)	\$2,665,527	\$5,331,651	\$ -	\$5,567,261	\$14,099,278
Reclassification from Fund Financial Statements to GWFS (Department of Labor debt)	205,805	-	-	-	-	-	205,805
To adjust prior year due to General Fund	(28,751)	-	-	-	-	48,355	19,604
To adjust prior year accounts payable	<u>326,199</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>326,199</u>
Fund balance beginning, as restated	<u>\$1,051,445</u>	<u>(\$13,353)</u>	<u>\$2,665,527</u>	<u>\$5,331,651</u>	<u>\$ -</u>	<u>\$5,615,616</u>	<u>\$14,650,886</u>

B. GOVERNMENTAL-WIDE FINANCIAL STATEMENTS

The following restatements have been made in the governmental-wide financial statements, which are reported as an adjustment to beginning net assets:

<u>Description</u>	<u>Total</u>
Net assets, beginning	\$47,889,967
Reclassification from Fund Financial Statements to GWFS (Department of Labor debt)	<u>205,805</u>
Net assets, beginning as restated	<u>\$48,095,772</u>

18. SUBSEQUENT EVENTS

On August 24, 2010, the Municipal Legislature approved the issuance of a special obligation bond charged to the Municipal Redemption Fund, for the amount of \$4,530,000, for the financing of waste disposal services and landfill administration. Repayment of the bond is scheduled from July 2011 through July 2020.

END OF NOTES

**COMMONWEALTH OF PUERTO RICO
AUTONOMOUS MUNICIPALITY OF CABO ROJO**

**BUDGETARY COMPARISON SCHEDULE- GENERAL FUND
(SEE NOTE TO BUDGETARY COMPARISON SCHEDULE)**

YEAR ENDED JUNE 30, 2010

	<u>Budgeted Amounts</u>		<u>Actual Amounts</u> (Budgetary Basis) (See Note 1)	<u>Variance with</u> <u>Final Budget</u> <u>Positive</u> <u>(Negative)</u>
	<u>Original</u>	<u>Final</u>		
REVENUES:				
Property taxes	\$ 7,134,926	\$ 7,134,926	\$ 7,875,790	\$ 740,864
Municipal license tax	2,652,500	2,652,500	2,621,323	(31,177)
Intergovernmental	2,755,970	3,085,666	3,085,664	(2)
Fees, fines and charges for services	3,976,246	3,976,246	2,611,444	(1,364,802)
Interest	600,000	600,000	203,057	(396,943)
Other	<u>200,000</u>	<u>200,000</u>	<u>151,675</u>	<u>(48,325)</u>
Total revenues, including budget carryover	<u>17,319,642</u>	<u>17,649,338</u>	<u>16,548,953</u>	<u>(1,100,385)</u>
EXPENDITURES:				
Current:				
General government	6,064,337	7,028,661	\$ 6,971,393	\$ 57,268
Public safety	2,532,674	2,386,608	2,391,972	(5,364)
Public works and sanitation	6,197,136	6,095,405	6,044,988	50,417
Health	814,489	809,489	809,567	(78)
Culture and recreation	1,052,499	1,026,702	869,138	157,564
Welfare and community development	1,723,507	1,721,063	1,714,730	6,333
Education	<u>35,000</u>	<u>34,220</u>	<u>33,480</u>	<u>740</u>
Total expenditures	<u>18,419,642</u>	<u>19,102,148</u>	<u>18,835,268</u>	<u>266,880</u>
OTHER FINANCING SOURCES (USES):				
Transfer in	1,900,000	2,252,810	2,197,704	(55,106)
Transfer out	<u>(800,000)</u>	<u>(800,000)</u>	<u>(800,000)</u>	<u>-</u>
Total other financing sources (uses):	<u>1,100,000</u>	<u>1,452,810</u>	<u>1,397,704</u>	<u>(55,106)</u>
EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES, ENCUMBRANCES AND OTHER FINANCING SOURCES (USES)				
	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (888,611)</u>	<u>\$ (888,611)</u>
Explanation of Differences Between Budgetary Inflows and Outflows and GAAP Revenues and Expenditures:				
Sources/inflows of resources:				
Actual amounts (budgetary basis)*available for appropriation" from the budgetary comparison schedule				\$18,746,657
Differences-budget to GAAP:				
Revenues recorded in the accrual basis for financial reporting purposes but not in the current year budget				836,878
Transfer-in recorded in the accrual basis for financial reporting purposes but not in the current year budget				<u>117,217</u>
Total revenues and other financing sources as reported on the statement of revenues, expenditures, and changes in fund balances				<u>\$19,700,752</u>
Uses/outflows of resources:				
Actual amounts (budgetary basis)*total charges to appropriations" from the budgetary comparison schedule				\$19,635,268
Differences-budget to GAAP:				
Expenditures recorded in the accrual basis for financial reporting purposes, whose financing sources were not included in the current year budget				2,057,325
Operating transfer out to other funds				(1,000)
Prior year encumbrances recorded as current year expenditures for GAAP basis				(690,791)
Current year encumbrances recorded as expenditures for budgetary purposes				<u>268,820</u>
Total expenditures and other financing uses as reported on the statement of revenues, expenditures, and changes in fund balances				<u>\$ 21,269,622</u>

COMMONWEALTH OF PUERTO RICO
AUTONOMOUS MUNICIPALITY OF CABO ROJO

NOTE TO BUDGETARY COMPARISON SCHEDULE- GENERAL FUND

YEAR ENDED JUNE 30, 2010

NOTE 1. STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY

Budgetary Control

The Municipality's annual budget is prepared on the budgetary basis of accounting, which is not in accordance with 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, 2010 representing original budget. There were no supplemental appropriations for the year ended June 30, 2010.

END OF SECTION

**COMMONWEALTH OF PUERTO RICO
AUTONOMOUS MUNICIPALITY OF CABO ROJO**

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FISCAL YEAR ENDED JUNE 30, 2010**

FEDERAL GRANTOR / PASS THROUGH GRANTOR / PROGRAM OR CLUSTER TITLE	FEDERAL CFDA NUMBER	PASS-THROUGH ENTITY IDENTIFYING NUMBER	FEDERAL EXPENDITURES
U.S. Department of Agriculture:			
Pass-Through: Puerto Rico Department of Education:			
Child and Adult Care Food Program.....	10.558	Not available	<u>\$ 19,964</u>
U.S. Department of Housing and Urban Development:			
Community Development Block Grant/Entitlement Grants (CDBG) - Cluster.....	14.218		1,087,283
ARRA Community Development Block Grant ARRA (CDBG-R) (Recovery Act funded).....	14.253		<u>73,744</u>
Total Community Development Block Grants Cluster			<u>1,161,027</u>
ARRA Homelessness Prevention And Rapid Re-Housing Program (HPRP) (Recovery Act funded).....	14.262		74,128
Section 8 Rental Housing Choice Vouchers	14.871		<u>492,539</u>
Total U.S. Department of Housing and Urban Development:			<u>1,727,694</u>
U.S. Department of Justice:			
Pass-Through: Puerto Rico Department of Justice:			
ARRA Edward Byrne Memorial Justice Assistance Grant (JAG) Program (Recovery Act funded)	16.803	2009-SU-89-053	<u>7,540</u>
U.S. Department of Energy:			
ARRA Energy Efficiency and Conservation Block Grant Program (EECBG) (Recovery Act Funded)	81.128		<u>7,162</u>

Continue

**COMMONWEALTH OF PUERTO RICO
AUTONOMOUS MUNICIPALITY OF CABO ROJO**

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FISCAL YEAR ENDED JUNE 30, 2010**

FEDERAL GRANTOR / PASS THROUGH GRANTOR / PROGRAM OR CLUSTER TITLE	FEDERAL CFDA NUMBER	PASS-THROUGH ENTITY IDENTIFYING NUMBER	FEDERAL EXPENDITURES
U.S. Department of Health and Human Services:			
Pass-Through Programs:			
Pass-Trough: Puerto Rico Office of the Governor – Office for Elderly Persons Affairs:			
Special Program for Aging, Title III, Part B	93.044	Not available	<u>94,582</u>
Pass-Through: Puerto Rico Department of the Family:			
Child Care and Development Block Grant	93.575	Not available	192,830
ARRA Child Care and Development Block Grant (Recovery Act funded)	93.575	241-2010-000286	<u>5,577</u>
Total Child Care and Development Block Grant.....			<u>198,407</u>
Total U.S. Department of Health and Human Services			<u>292,989</u>
U.S. Department of Homeland Security:			
Pass-Through: Puerto Rico Office of the Governor:			
Disaster Grants - Public Assistance.....	97.036	023-99023-00	264,375
Pass-Through: Puerto Rico Department of Justice:			
Homeland Security Program.....	97.067	2004-GE-T4-008	<u>45,428</u>
Total U.S. Department of Homeland Security			<u>309,803</u>
Total Expenditures of Federal Awards			<u>\$2,365,152</u>

See notes to this schedule

**COMMONWEALTH OF PUERTO RICO
AUTONOMOUS MUNICIPALITY OF CABO ROJO**

**NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
JUNE 30, 2010**

NOTE A – BASIS OF PRESENTATION

The accompanying schedule of expenditures of federal awards includes the federal grant activity of the Municipality and is presented on the modified accrual basis of accounting. Expenditures are recognized when the related liability is incurred. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, "Audits of States, Local Governments and Nonprofit Organizations". Therefore, some amounts presented in this schedule may differ from the amounts presented in, or used in the preparation of, the basic financial statements.

NOTE B - FEDERAL CFDA NUMBER

The Catalog of Federal Domestic Assistance (CFDA) Number is a program identification number. The first two digits identify the federal department or agency that administers the program and the last three numbers are assigned by numerical sequence.

NOTE C – PASS-THROUGH ENTITY IDENTIFYING NUMBER

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. OMB Circular A-133 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 D – RECONCILIATION OF EXPENDITURES PRESENTED IN THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS TO THE EXPENDITURES PRESENTED IN THE BASIC FINANCIAL STATEMENTS

Description	Community Development Block Grant Fund	Other Governmental Funds
10.558	\$ -	\$ 19,964
14.218	1,161,027	-
16.803	-	7,540
81.128	-	7,162
93.044	-	94,582
93.575	-	198,407
97.036	-	264,375
97.067	-	45,428
Total federal awards expenditures	1,161,027	637,458
Total nonfederal awards expenditures	147,894	3,134,273
Total expenditures, fund statements	<u>\$ 1,308,921</u>	<u>\$ 3,771,731</u>

END OF SECTION

**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 Mayor and Member of the
Municipal Assembly
Municipality of Cabo Rojo, Puerto Rico

We have audited the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of Municipality of Cabo Rojo, Puerto Rico as of and for the year ended June 30, 2010, which collectively comprise Municipality of Cabo Rojo, Puerto Rico's basic financial statements and have issued our report thereon dated February 1, 2011. The report on governmental activities and general fund was qualified because the Municipality of Cabo Rojo, Puerto Rico excluded its obligation for closure and post-closure care costs in relation to its municipal solid waste landfill. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Municipality of Cabo Rojo, Puerto Rico's internal control over financial reporting as a basis for designing our auditing procedures 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 Cabo Rojo, Puerto Rico's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Municipality of Cabo Rojo, Puerto Rico's internal control over financial reporting.

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

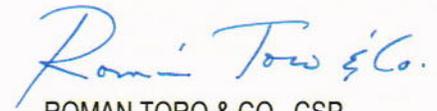
A deficiency in internal control exists when the design or operation of a control does not allow management or employees in a normal course of performing their assigned functions to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of 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. We considered the deficiencies described in the accompanying schedule of finding and questioned costs as items 2010-II-1, 2010-II-2, and 2010-II-3 to be material weaknesses.

Compliance and Other Matters

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

Municipality of Cabo Rojo, Puerto Rico's responses to the findings identified in our audit are described in the accompanying Schedule of Findings and Questioned Costs. We did not audit the Municipality of Cabo Rojo, Puerto Rico's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of management, others within the entity, Municipal Assembly, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.



ROMAN TORO & CO., CSP
LICENSE #35 - IN FORCE

Yauco, Puerto Rico
February 1, 2011

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the original of this report

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

Honorable Mayor and Member of the
Municipal Assembly
Municipality of Cabo Rojo, Puerto Rico

Compliance

We have audited Municipality of Cabo Rojo, Puerto Rico's compliance, with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of Municipality of Cabo Rojo, Puerto Rico's major federal programs for the year ended June 30, 2010. Municipality of Cabo Rojo, Puerto Rico's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of Municipality of Cabo Rojo's management. Our responsibility is to express an opinion on Municipality of Cabo Rojo's compliance based on our audit.

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

In our opinion, Municipality of Cabo Rojo, Puerto Rico, complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2010.

Internal Control Over Compliance

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

Internal Control Over Compliance (continued)

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.

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 deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

This report is intended solely for the information and use of management, Municipal Assembly, others within the entity, federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.



ROMAN TORO & CO., CSP
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Yauco, Puerto Rico
February 1, 2011

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the original of this report

**COMMONWEALTH OF PUERTO RICO
 AUTONOMOUS MUNICIPALITY OF CABO ROJO
 SCHEDULE OF FINDINGS AND QUESTIONED COSTS
 FOR THE YEAR ENDED JUNE 30, 2010**

SECTION I – SUMMARY OF AUDITORS' RESULTS

Financial Statements

Type of auditor's report issued:

- | | |
|---|--|
| <input checked="" type="checkbox"/> Unqualified Opinion on each major fund and the aggregate remaining fund information | <input checked="" type="checkbox"/> Qualified Opinion on governmental activities |
| <input type="checkbox"/> Adverse Opinion | <input type="checkbox"/> Disclaimer Opinion |

Internal control over financial reporting:

- | | | |
|---|---|--|
| • Significant control deficiency identified? | <input checked="" type="checkbox"/> Yes | <input type="checkbox"/> None reported |
| • Material weakness (es) identified? | <input checked="" type="checkbox"/> Yes | <input type="checkbox"/> No |
| Noncompliance material to financial statements noted? | <input type="checkbox"/> Yes | <input checked="" type="checkbox"/> No |

Federal Awards

Internal control over major programs:

- | | | |
|--|------------------------------|---|
| • Significant control deficiency identified? | <input type="checkbox"/> Yes | <input checked="" type="checkbox"/> None reported |
| • Material weakness (es) identified? | <input type="checkbox"/> Yes | <input checked="" type="checkbox"/> No |

Type of auditor's report issued on compliance for Major Programs:

- | | |
|---|---|
| <input checked="" type="checkbox"/> Unqualified Opinion | <input type="checkbox"/> Qualified Opinion |
| <input type="checkbox"/> Adverse Opinion | <input type="checkbox"/> Disclaimer Opinion |

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

- | | |
|------------------------------|--|
| <input type="checkbox"/> Yes | <input checked="" type="checkbox"/> No |
|------------------------------|--|

Identification of Major Programs:

CFDA Number	Name of Federal Program or Cluster
14.218	Community Development Block Grant – Entitlement Grants
14.871	Section 8 – Rental Housing Choice Vouchers

Dollar threshold used to distinguish between Type A and Type B Programs:

\$300,000

Auditee qualified as low-risk auditee?

- | | |
|------------------------------|--|
| <input type="checkbox"/> Yes | <input checked="" type="checkbox"/> No |
|------------------------------|--|

COMMONWEALTH OF PUERTO RICO
AUTONOMOUS MUNICIPALITY OF CABO ROJO
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)
FOR THE YEAR ENDED JUNE 30, 2010

SECTION II – FINANCIAL STATEMENTS FINDINGS

2010-II-1

Type of finding: Financial statement finding.

Situation: Material weakness over financial reporting; Compliance with state and local regulations

Federal Program: N/A

Compliance Requirements: N/A

Prior-Year(s) Audit Finding(s): None.

Questioned Costs: N/A

Condition:

The Municipality's financial reporting system produced the June 30, 2010 financial statements with several material misstatements and missing disclosures.

Context:

While the Municipality invests significant resources in terms of personnel and a third-party accountant firm in order to comply with regulatory financial reporting requirements, the financial reporting process is mostly segregated between various automated and manual records. The Municipality depends on three basic accounting "systems": the locally-mandated OCAM system, a manual accounting system (handwritten records and MS Office documents) used by municipal finance employees, and manual records and documents prepared and accounted by a third-party CPA accounting service provider. The process culminated in providing us with the unaudited financial statements on December 20, 2010 more than five months after the fiscal year closing date at June 30, 2010.

The financial statements and notes to us contained various material misstatements, requiring significant adjustments to current year balances. A total of 8 significant adjustments, reclassifications, and modifications were required to the accounting balances and disclosures, which included the following significant adjustments:

1. Unrecorded and understated expenditures, expenses, and current liabilities, totaling \$1,413,487;
2. Overstatement of capital assets by \$3,000,000;
3. Missing disclosures relating to accounting policies, investments, and construction commitments.

These errors were not detected by the CPA service provider, who subsequently provided for all corrections and adjustments after our suggestions. In all, the Municipality's current year balances required significant adjustments culminating with the net effects of a decrease of \$4,413,487 in its total and current-year change in Net Assets. The Municipality, which had positive balance \$693,959 General Fund's fund balance as of June 30, 2010, actually had a negative balance of \$517,425 after all errors and misstatements were corrected.

Criteria:

Puerto Rico Law #81 of August 30, 1991, otherwise known as the Autonomous Municipalities Law, as amended, requires in Article 8.010(a) and (b) the Municipality to maintain a computer system and accounting procedures designed so as to enable the Municipality to carry out their tasks, to maintain uniform municipal accounting, provide a complete picture of the results of operations, be in accordance with generally accepted accounting principles, and comply with the accounting standards set forth by the Governmental Accounting Standards Board (GASB).

Cause:

The OCAM system, designed over 15 years ago, has technological limitations when compared to currently available resources, and has very limited technical support. The Municipality also has several manual systems which account for different segments of the Municipality's operations. Personnel use these systems to perform budget to actual results analyses, account for receipts and disbursements, for decision-making, and for reports to federal and local agencies.

Continue

COMMONWEALTH OF PUERTO RICO
AUTONOMOUS MUNICIPALITY OF CABO ROJO
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)
FOR THE YEAR ENDED JUNE 30, 2010

SECTION II – FINANCIAL STATEMENTS FINDINGS, continued

2010-II-1, continued

Cause, continued:

While each of these systems provide part of the necessary information to compile a full set of financial statements, the final compilation has to be done manually by the third-party service provider because neither of the systems has comprehensive self-balancing accounts ledgers encompassing all the information of the Municipality, nor an individual process to compile at least basic financial statements on their own. Automatic year-end closing produces are not performed by the OCAM system to account for all transactions in order to produce complete financial statements. The closing procedures and adjustments in order to compile GAAP-oriented trial balances and ledgers are performed manually by the third-party provider, with their work provided to the auditors for auditing. This process takes a significant amount of time and increases the risk of misstatement of accounts, due to the complexity of the Municipality's accounting organization and fund structures and the accessibility of required analysis and documentation.

Effect:

The Municipality could not produce GAAP-compliant financial statements, free from material misstatements, in a timely manner.

Auditor's Recommendation:

The Municipality's financial reporting system should include increased monitoring and review from top management in order to avoid this situation in the future and to improve the timing of the availability of information for the compilation and auditing of the financial statements.

Views of responsible officials and corrective actions:

The Municipality, in its commitment to transparency and accountability, has assigned these responsibilities, which in the past relied entirely in one person, to a team of reliable and capable people, including the creation of the Management and Budget Office to perform these duties in a timely manner from here on.

COMMONWEALTH OF PUERTO RICO
AUTONOMOUS MUNICIPALITY OF CABO ROJO
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)
FOR THE YEAR ENDED JUNE 30, 2010

SECTION II – FINANCIAL STATEMENTS FINDINGS (continued)

2010-II-2

Type of finding: Financial statement.

Situation: Material weakness over financial reporting; Compliance with state and local regulations

Federal Program: Not applicable.

Compliance Requirements: Not applicable.

Prior-Year(s) Audit Finding(s): None.

Questioned Costs: Not applicable.

Condition:

The Municipality of Cabo Rojo did not account \$1,211,384 in costs incurred during the 2009-2010 fiscal year related to the administration of its municipal solid waste landfill (\$959,384) and the collection of solid waste across the Municipality (\$256,000) as of June 30, 2010. These costs, while contracted since 2000 for a continuing and necessary service, were not assigned sufficient budget resources for its payment during the year, while separate costs incurred for the collection of solid waste throughout the Municipality were not allocated sufficient resources, as required by state regulations.

Context:

The Municipality is currently operating a municipal solid waste landfill (MSWLF) as of June 30, 2010, which has been administered by a private contractor since 2000 (through a contract with subsequent amendments). When confirming account payable balances of the Municipality, the private contractor confirmed us a total liability owed by the Municipality to them for the amount of \$1,211,384. Additional investigation revealed that, for the 2009-2010 fiscal year, the Municipality had not provided any budget allocations for the \$959,384 in costs and had not recorded these costs within its records, neither as an encumbrance using purchase orders nor an expenditure and a liability when the service was received and invoiced.

The Municipality's management represented to us that the resources for these costs are from a new bond payable issued on August 2010. When the proceeds were finally available for use on October 2010, the Municipality prepared purchase orders (#11-0862-A and #11-0939) for the services already rendered and costs already incurred in order to record the budget allocation and use, and finally recorded the invoices against the purchase orders and subsequently liquidated the debt.

Criteria:

GASB Interpretation No. 6, Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements, (par. 12) states that "in the absence of an explicit requirement to do otherwise, a government should accrue a governmental fund liability and expenditure in the period in which the government incurs the liability."

Puerto Rico Autonomous Municipalities Law (Law 81 of August 30, 1991) states that Municipalities cannot expend or incur in a liability in the fiscal year any amount that exceeds appropriations and the funds authorized by the Municipal Legislature (article 8.004(b)). The Municipal Administration Manual issued by the Puerto Rico Office of the Commissioner for Municipal Affairs states that Municipalities must budget its estimated expenditures (Ch. II, sec. 4), and not expend its resources or incur liabilities without issuing purchase order (Ch. V, sec. 2).

Cause:

The Municipality's management represented to us that the costs were not recognized until the resources to pay them were available from the emission of the new bond liability.

Effect:

For the fiscal year ended June 30, 2010, the Municipality's financial statements presented to us did not account for expenditures and expenses and related liabilities resulting in material misstatements, which required audit adjustments for the corrections.

COMMONWEALTH OF PUERTO RICO
AUTONOMOUS MUNICIPALITY OF CABO ROJO
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)
FOR THE YEAR ENDED JUNE 30, 2010

SECTION II – FINANCIAL STATEMENTS FINDINGS (continued)

2010-II-2, continued

Auditor's Recommendation:

The Municipality should properly budget its expected costs, and should always account for all costs incurred even when no budget allocations exist in order to avoid presenting financial records with material omissions.

Views of responsible officials and corrective actions:

The Municipality issued a special obligation bond for the current and future funding of this activity, however, the proceeds were delayed in the administrative process by the bank, and therefore, were not received at the end of the fiscal year 2010. As of the date of the auditor's report, the proceeds have been received and the service fully paid.

COMMONWEALTH OF PUERTO RICO
AUTONOMOUS MUNICIPALITY OF CABO ROJO
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)
FOR THE YEAR ENDED JUNE 30, 2010

SECTION II – FINANCIAL STATEMENTS FINDINGS (continued)

2010-II-3

Type of finding: Financial statement.

Situation: Material weakness; Compliance with federal, state and local regulations

Federal Program: Not applicable, only federal regulations relating to municipal solid waste landfills.

Compliance Requirements: Not applicable.

Prior-Year(s) Audit Finding(s): None.

Questioned Costs: Not applicable.

Condition:

The Municipality of Cabo Rojo has not determined and accounted for its municipal solid waste landfills estimated closure and post closure care costs and their respective provisions for financial assurance as of June 30, 2010.

Context:

The Municipality is currently responsible for two municipal solid waste landfills (MSWLFs), one which has ceased to accept solid waste material and another which continues in operation, as of June 30, 2010. The Municipality could not provide us with any documentation or evidence relating to estimates of closure and post-closure care costs related to the two MSWLFs, or any plans or estimates for the required financial assurance for these current and future cost activities.

Criteria:

40 CFR 258, EPA Criteria For Municipal Solid Waste Landfills, requires the Municipality to have a detailed written estimate, in current dollars, of the cost of hiring a third party to (1) close the largest area of all its MSWLF units ever, requiring a final cover at any time during the active life in accordance with the closure plan (40 CFR 258.71), and (2) conduct post-closure care for all its MSWLF units, in compliance with the Municipality's post-closure plan (40 CFR 258.72), which must be conducted for 30 years (40 CFR 258.61).

GASB Statement No. 18, Accounting for Municipal Solid Waste Landfill Closure and Post-closure Care Costs, requires the Municipality to disclose the nature and source of MSWLF closure and post-closure care requirements, the nature of closure and post-closure care estimates, the reported liability at the balance sheet date, the estimated total closure and post-closure care cost remaining to be recognized, the percentage of MSWLF capacity used to date, and the estimated remaining MSWLF life in years. The Municipality is also required to disclose how closure and post-closure care financial assurance requirements are being met.

Cause:

The Municipality's management represented to us that these estimates were unavailable and had not been prepared for the financial statements as of June 30, 2010.

Effect:

For the fiscal year ended June 30, 2010, the Municipality's financial statements did not account or disclose required contingency amounts related to landfill closing and post-closing costs required by generally accepted accounting principles. Therefore, the auditor's opinion on the Municipality's government activities as of June 30, 2010 was qualified.

Auditor's Recommendation:

The Municipality should estimate its landfills' closure and post closure care costs and their respective provisions for financial assurance, and account and disclose in its financial statements in order to comply with federal and local regulations as well as generally accepted accounting principles.

Views of responsible officials and corrective actions:

The Municipality will request the third-party service company currently administering the landfill to conduct a study to determine the estimated closure and post-closure care costs.

END OF SECTION

**COMMONWEALTH OF PUERTO RICO
AUTONOMOUS MUNICIPALITY OF CABO ROJO
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
FOR THE YEAR ENDED JUNE 30, 2010**

Year	Finding Number	Finding	CFDA Number	Questioned Cost(s)	Comments
------	----------------	---------	-------------	--------------------	----------

(1) Prior Audit Findings, fully corrected or not noted during our audit:

2009	2009-III-1	The Municipality's Section 8 had not voided significant amount of checks which had not been cancelled by the payees.	14.871	None.	The Municipality voided the checks in question, and currently reviews for checks left outstanding.
------	------------	--	--------	-------	--

(2) Prior Audit Findings, not corrected or partially corrected:

None.

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

None.

(4) Prior Audit Findings, are no longer valid:

None.

END OF SCHEDULE