

**OFICINA DEL COMISIONADO DE ASUNTOS MUNICIPALES**

**AREA DE ASESORAMIENTO, REGLAMENTACION E INTERVENCION FISCAL**

**AREA DE ARCHIVO DIGITAL**

**MUNICIPIO DE FAJARDO**

**AUDITORIA 2003-2004**

**30 DE JUNIO DE 2004**

Conf No 2-2905

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF FAJARDO, PUERTO RICO**

**BASIC FINANCIAL STATEMENTS**

FISCAL YEAR ENDED JUNE 30, 2004

(WITH THE ADDITIONAL REPORTS AND INFORMATION REQUIRED BY  
THE GOVERNMENT AUDITING STANDARDS AND OMB CIRCULAR A-133)

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF FAJARDO, PUERTO RICO  
BASIC FINANCIAL STATEMENTS  
FISCAL YEAR ENDED JUNE 30, 2004  
(WITH THE ADDITIONAL REPORTS AND INFORMATION  
REQUIRED BY THE GOVERNMENT AUDITING STANDARDS  
AND OMB CIRCULAR A-133)**

TABLE OF CONTENTS

|  | Pages |
|--|-------|
| <b>PART I – Financial:</b>   |       |
| Independent Auditors' Report .....   | 2- 3  |
| Management's Discussion and Analysis .....   | 4-10  |
| Basic Financial Statements:  |       |
| <b>Governmental-Wide Statements:</b>   |       |
| Statement of Net Assets .....  | 11    |
| Statement of Activities .....  | 12    |
| <b>Governmental Funds Statements:</b>  |       |
| Balance Sheet .....  | 13-14 |
| Statement of Revenues, Expenditures and Changes in Fund Balances .....   | 15-16 |
| Notes to the Basic Financial Statements .....  | 17-27 |
| Required Supplementary Information:  |       |
| Budgetary Comparison Schedule – General Funds .....  | 28    |
| Note to Required Supplementary Information .....   | 29    |
| <b>PART II – Schedule of Expenditures of Federal Awards and Reports Required by<br/>Government Auditing Standards and OMB Circular A-133:</b>                              |       |
| Schedule of Expenditures of Federal Awards .....   | 31    |
| Notes to Schedule of Expenditures of Federal Awards .....  | 32    |
| Independent Auditors' Report on Internal Control over Financial Reporting and on<br>Compliance and Other Matters Required by Government Auditing Standards .....           | 33-34 |
| Independent Auditors' Report on Compliance with Requirements Applicable to Each<br>Major Program and Internal Control Over Compliance Required by OMB Circular A-133 ..... | 35-36 |
| <b>PART III – Findings and Questioned Costs:</b>   |       |
| Schedule of Findings and Questioned Costs .....  | 38-49 |
| Schedule of Prior Audits' Findings and Questioned Costs .....  | 50-51 |



## **INDEPENDENT AUDITORS' REPORT**

**To the Honorable Mayor and  
Member of the Municipal Legislature  
Municipality of Fajardo, Puerto Rico**

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the **Municipality of Fajardo, Puerto Rico (Municipality)**, as of and for the fiscal year ended June 30, 2004, which collectively comprise the **Municipality's** basic financial statements as listed in the Table of Contents. These financial statements are the responsibility of the **Municipality's** management. Our responsibility is to express an opinion on these basic combined 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 basic financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the basic financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall basic financial statements presentation. We believe that our audit provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information of the **Municipality**, as of June 30, 2004, and the respective changes in financial position, for the fiscal year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 23, 2004 on our consideration of the **Municipality's** internal control over financial reporting on our test of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis and budgetary comparison information on pages 4 through 10 and 28 and 29, are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

**INDEPENDENT AUDITORS' REPORT**

Page 2

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the **Municipality's** basic financial statements. The accompanying Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis as required by 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 basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

*CPA Diaz-Martinez, PSC*

CPA DIAZ-MARTINEZ, PSC  
Certified Public Accountants & Consultants  
License Number 12, expires on December 1, 2007

Caguas, Puerto Rico  
December 23, 2004



**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF FAJARDO, PUERTO RICO**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
FOR THE FISCAL YEAR ENDED JUNE 30, 2004

As management of the Municipality of Fajardo, we offer readers of the Municipality's financial statements this narrative overview and analysis of the financial activities of the Municipality for the fiscal year ended June 30, 2004. We encourage readers to consider the information presented here in conjunction with additional information that is furnished in the financial statements and notes to the financial statements.

**FINANCIAL HIGHLIGHTS**

- The assets of the Municipality of Fajardo exceeded its liabilities at the close of the most recent fiscal year by \$43,299,894 (*net assets*). Of this amount, \$904,369 (*unrestricted net assets*) may be used to meet the government's ongoing obligations to citizens and creditors.
- The Municipality's net assets increase as a result of this year's operations. Net assets as of June 30, 2004 are \$43,299,894, as compared to \$38,503,233 for the year ended June 30, 2003, for 12% of increase.
- As of the close of the current fiscal year, the Municipality's governmental funds reported combined ending fund balances of \$29,567,370, a decrease of \$514,532 in comparison with the prior year. Approximately 20 percent of this total amount, \$5,812,459, is *available for spending* at the government's discretion (*unreserved fund balance*).
- The investment in capital assets for this year is \$28,460,245.
- The Municipality's total long term debt decreased by \$829,370 (4 percent) during the current fiscal year.

**OVERVIEW OF THE FINANCIAL STATEMENTS**

This discussion and analysis are intended to serve as an introduction to the Municipality's basic financial statements. The Municipality of Fajardo basic financial statements comprise three components: 1) government-wide financial statements, 2) fund financial statements, and 3) notes to the financial statements. This report also contains other supplementary information in addition to the basic financial statements themselves.

**Government-Wide Financial Statements:** The *government-wide financial statements* are designed to provide readers with a broad overview of the Municipality's finances, in a manner similar to a private-sector business.

The *statement of net assets* presents information on all of the Municipality's assets and liabilities, with the difference between the two 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.

The *statement of activities* presents information showing how the government'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 related cash flows*. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods (e.g., earned but unused vacation leave).

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF FAJARDO, PUERTO RICO**

**MANAGEMENT'S DISCUSSION AND ANALYSIS**

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

Page 2

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

**Fund Financial Statements.** A *fund* is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The Municipality, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of the Municipality can be divided into three categories: governmental funds, proprietary funds, and fiduciary funds.

**Governmental funds.** *Governmental funds* are used to account for essentially the same functions reported as *governmental activities* in government-wide financial statements. However, unlike the government-wide financial statements, governmental 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 may be useful in evaluating a government's near-term financing 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, readers may better understand the long-term impact of the government's near-term financing decisions. Both 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*.

The Municipality maintains nine individual governmental funds. Information is presented separately in the governmental fund balance sheet and in the governmental fund statement of revenues, expenditures, and changes in fund balances for the general fund and three other funds that are considered to be major funds. Data from the other governmental funds are combined into a single, aggregated presentation.

The Municipality of Fajardo adopts an annual appropriated budget for its general fund. A supplementary budgetary comparison schedule has been provided for the general fund to demonstrate compliance with this budget.

**Notes to the Financial Statements.** The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF FAJARDO, PUERTO RICO**

**MANAGEMENT'S DISCUSSION AND ANALYSIS**

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

Page 3

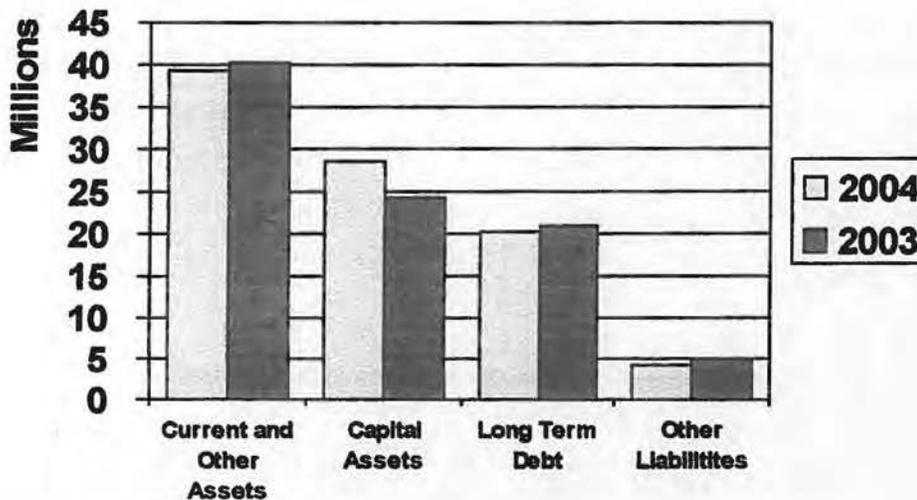
**GOVERNMENTAL-WIDE FINANCIAL ANALYSIS**

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. In the case of the Municipality of Fajardo, assets exceeded liabilities by \$43,299,894 at the close of the most recent fiscal year. (Table 1)

**Table 1  
NET ASSETS  
GOVERNMENTAL ACTIVITIES**

|  | <b>2004</b>         | <b>2003</b>         |
|--|---------------------|---------------------|
| Current and other assets                           | \$39,219,918        | \$40,306,818        |
| Capital assets                                     | 28,460,245          | 24,299,248          |
| <b>Total assets</b>                                | <b>67,680,163</b>   | <b>64,606,066</b>   |
| Long Term Debt outstanding                         | 20,192,856          | 21,022,226          |
| Other liabilities                                  | 4,187,413           | 5,080,607           |
| <b>Total liabilities</b>                           | <b>24,380,269</b>   | <b>26,102,833</b>   |
| Net assets:  |                     |                     |
| Invested in capital assets,<br>net of related debt | 20,965,893          | 12,269,248          |
| Restricted for:                                    |                     |                     |
| Head Start   | 2,888,648           | 3,286,231           |
| Debt Services                                      | 3,921,930           | 2,203,594           |
| Community Development<br>Block Grant Program       | 1,822,859           | 1,891,791           |
| Other purposes                                     | 12,796,195          | 14,660,288          |
| Unrestricted                                       | 904,369             | 4,192,081           |
| <b>Net Assets</b>                                  | <b>\$43,299,894</b> | <b>\$38,503,233</b> |

**Components of Net Assets**



**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF FAJARDO, PUERTO RICO**

**MANAGEMENT'S DISCUSSION AND ANALYSIS**

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

Page 4

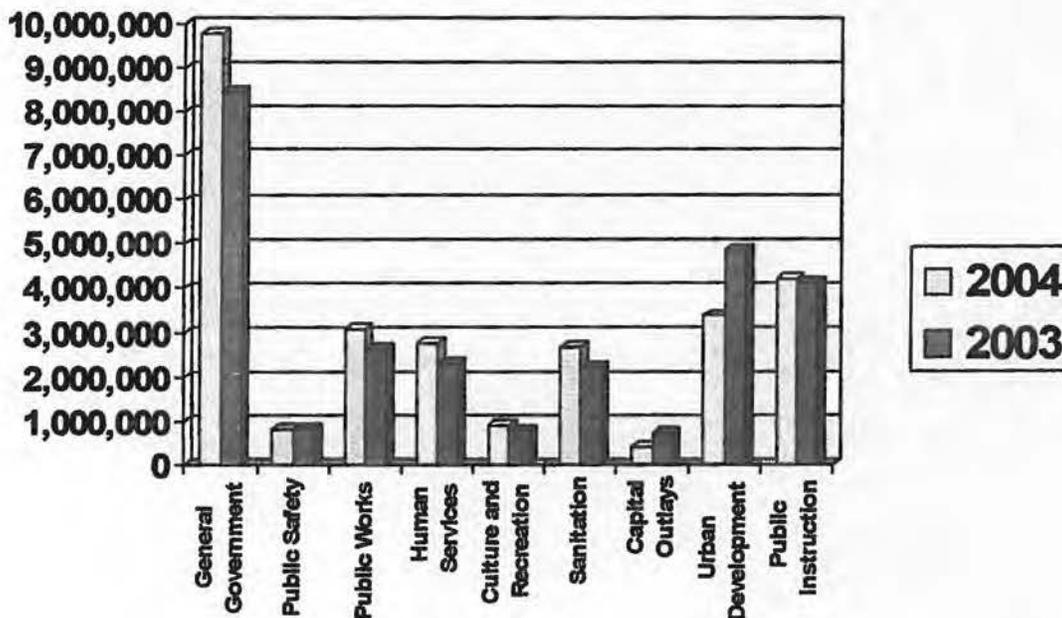
Net assets of the Municipality's governmental activities increase by \$4,796,661. Unrestricted net assets, the part of net assets that can be used to finance operations without constraints established by debt covenants, enabling legislation or other legal requirements, changed from \$4,192,081 at June 30, 2003 to \$904,369 at June 30, 2004. The major cause of this decrease was caused by the transfer of fund for the construction of capital projects.

**FINANCIAL ANALYSIS OF GOVERNMENT'S FUNDS**

The focus of the Municipality's governmental funds is to provide information on near term inflows, outflows, and balances of expendable resources. All activities which are not required to be accounted for in separate funds either by federal or local ordinances are accounted for in the general fund.

As of June 30, 2004, the Municipality's governmental funds reported combined fund balances of \$29,567,370. This represents a decrease of \$514,532 over last year's ending balances.

**Governmental Funds Expenses**



Revenues for the Municipality's general fund decrease by 15% while total expenses increase by 18%. The decrease in the general government expenditures during the fiscal year ended June 30, 2004 was substantially related to the following: (Table 2)

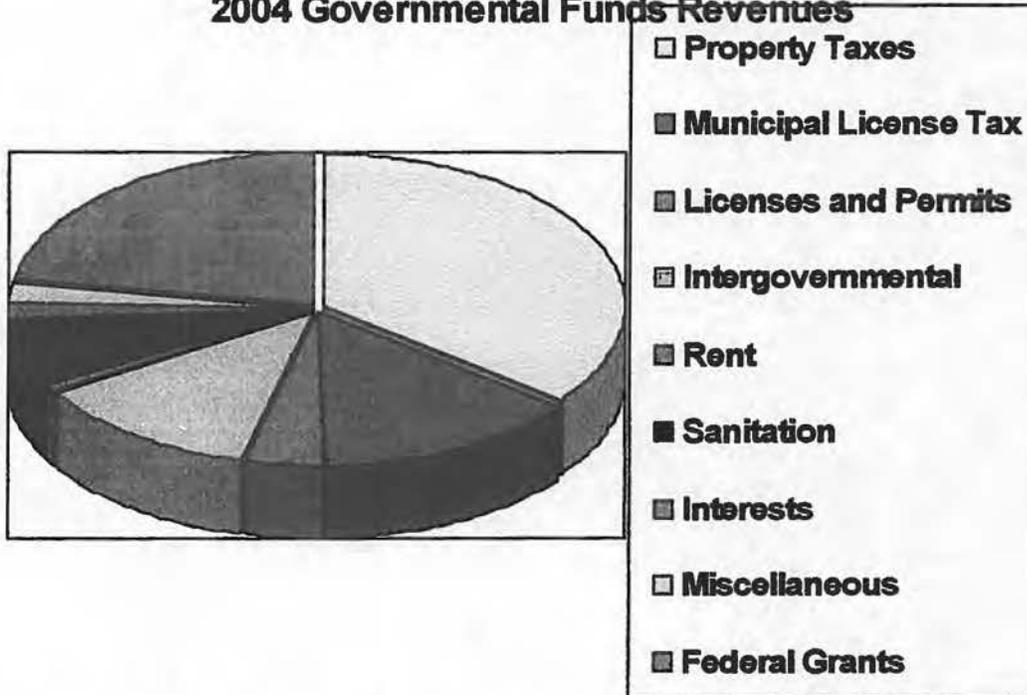
**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF FAJARDO, PUERTO RICO  
MANAGEMENT'S DISCUSSION AND ANALYSIS**

FOR THE FISCAL YEAR ENDED JUNE 30, 2004  
Page 5

**Table 2  
Governmental Activities  
General Fund  
Total cost of services**

|                            | 2004                | 2003                |
|----------------------------|---------------------|---------------------|
| General government         | \$9,594,442         | \$8,321,148         |
| Public safety              | 805,548             | 825,894             |
| Public works               | 3,077,377           | 2,615,837           |
| Human services and welfare | 1,736,283           | 1,411,843           |
| Culture and recreation     | 912,303             | 799,287             |
| Sanitation                 | 2,757,095           | 2,224,823           |
| Capital outlays            | 395,285             | 91,600              |
| <b>Totals</b>              | <b>\$19,278,333</b> | <b>\$16,290,432</b> |

**2004 Governmental Funds Revenues**



Taxes continue to be the largest source of revenue in the general fund and represent approximately a 62% of total general fund revenues. The largest element of taxes is property taxes, it represent 66% of total tax revenues and 41% of total general revenues. This compares with 34% in the prior fiscal year ended June 30, 2003.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF FAJARDO, PUERTO RICO**

**MANAGEMENT'S DISCUSSION AND ANALYSIS**

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

Page 6

The debt service fund has a total fund balance of \$3,051,930, all of which is reserved for the payment of debt services. The net increase in fund balance during the current year was \$848,336.

**GENERAL FUND BUDGETARY HIGHLIGHTS**

Over the course of the year, the Municipal Assembly revised the Municipality of Fajardo budget several times. These budget amendments fall into various categories. The first category includes amendments and supplemental appropriations that were approved shortly after the beginning of the year and reflect the actual balances. The second category includes increases allocated to capital project activities funded out of fund balances.

**CAPITAL ASSET AND DEBT ADMINISTRATION**

**Capital Assets**

As of June 30, 2004, the Municipality of Fajardo had \$28,460,245 invested in capital assets, including buildings, parks, roads, bridges, and equipment. This amount represents a net increase of \$4,160,997 over last year.

Table 3  
Capital Assets at Year End

|                | 2004                | 2003                |
|----------------|---------------------|---------------------|
| Land           | \$2,539,085         | \$524,407           |
| Others         | 758,095             | 726,443             |
| Building       | 21,722,681          | 21,665,191          |
| Infrastructure | 1,244,852           | 266,890             |
| Equipment      | 772,537             | 718,305             |
| Motor vehicles | 1,422,995           | 398,012             |
| <b>Total</b>   | <b>\$28,460,245</b> | <b>\$24,299,248</b> |
|                |                     |                     |
|                |                     |                     |
|                |                     |                     |

**Long Term Debt**

At June 30, 2004 the Municipality had total bonded debt outstanding of \$13,104,553 versus \$13,530,000 last year, a decrease of \$425,447. Other obligations include accrued vacation and sick leave, claims and judgments, and advances of property taxes. More detailed information about the Municipality's long term liabilities is presented in the notes of the financial statements.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF FAJARDO, PUERTO RICO**

**MANAGEMENT'S DISCUSSION AND ANALYSIS**

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

Page 7

**ECONOMIC FACTORS AND NEXT YEAR BUDGET**

The Municipality's elected and appointed officials when setting the fiscal year 2005 budget considered factors such as, the unemployment rate for the region and inflationary trends.

Amounts available for appropriations in the general fund for the fiscal year 2005 are \$31.7 million, an increase of \$14.7 million over the original 2004 budget.

**CONTACTING THE MUNICIPALITY'S FINANCIAL MANAGEMENT**

This financial report is designed to provide our citizens, taxpayers, and creditors with a general overview of the Municipality's finances and to show the accountability of governments funds. If you have questions about this report or need additional financial information, contact us at Municipality of Fajardo, PO Box 865, Fajardo, Puerto Rico 00738.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF FAJARDO, PUERTO RICO**

**STATEMENT OF NET ASSETS**

JUNE 30, 2004

|   | <u>GOVERNMENTAL<br/>ACTIVITIES</u> |
|---|------------------------------------|
| <b>ASSETS:</b>  |                                    |
| Cash and Investments.....                             | \$23,857,708                       |
| Cash with Fiscal Agent.....                           | 9,839,627                          |
| Receivables (net):                                    |                                    |
| Property Taxes.....                                   | 71,860                             |
| Federal Grants.....                                   | 5,070,411                          |
| Interests.....  | 2,710                              |
| Others.....   | <u>377,602</u>                     |
| Capital Assets (Note 1 & 6):                          |                                    |
| Land, Improvements, and Construction in Progress..... | 3,297,180                          |
| Other Capital Assets, [Net of Depreciation].....      | <u>25,163,065</u>                  |
| Total Capital Assets.....                             | <u>28,460,245</u>                  |
| <b>TOTAL ASSETS.....</b>                              | <b><u>67,680,163</u></b>           |
| <b>LIABILITIES:</b>                                   |                                    |
| Accounts Payable and Accrued Expenses.....            | 692,059                            |
| Deferred Revenue.....                                 | 3,161,951                          |
| Matures bonds, notes and Interests Payable.....       | 333,403                            |
| Long-Term Liabilities (Note 7):                       |                                    |
| Due within One Year.....                              | 3,072,654                          |
| Due in More than One Year.....                        | <u>17,120,202</u>                  |
| Total Liabilities.....                                | <u>24,380,269</u>                  |
| <b>NET ASSETS</b>                                     |                                    |
| Invested in Capital Assets, Net of Related Debt.....  | 20,965,893                         |
| Restricted for:                                       |                                    |
| Head Start Program.....                               | 2,888,648                          |
| Debt Service.....                                     | 3,921,930                          |
| Community Development Projects.....                   | 1,822,859                          |
| Other Purposes.....                                   | 12,796,195                         |
| Unrestricted.....                                     | <u>904,369</u>                     |
| <b>TOTAL NET ASSETS.....</b>                          | <b><u>\$43,299,894</u></b>         |

See accompanying Notes to Basic Financial Statements.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF FAJARDO, PUERTO RICO**

**STATEMENT OF ACTIVITIES**

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

| FUNCTIONS/PROGRAMS  | EXPENSES                   | PROGRAM REVENUES           |  |  | NET (EXPENSE)<br>REVENUE   |
|---|----------------------------|----------------------------|--|--|----------------------------|
|   |                            | CHARGES FOR<br>SERVICES    | OPERATING<br>GRANTS AND<br>CONTRIBUTIONS | CAPITAL<br>GRANTS AND<br>CONTRIBUTIONS |                            |
| <b>Governmental Activities:</b>                                   |                            |                            |  |  |                            |
| Mayor and Municipal Legislature.....                              | \$ 3,106,140               | \$ -                       | \$ -                                     | \$ -                                   | (\$ 3,106,140)             |
| General Government.....   | 4,848,854                  | -                          | 706,505                                  | -                                      | (4,142,349)                |
| Public Safety.....  | 888,809                    | -                          | -  | -                                      | (888,809)                  |
| Public Works.....   | 3,932,851                  | -                          | 10,000                                   | -                                      | (3,922,851)                |
| Health and Sanitation.....  | 725,220                    | -                          | -  | -                                      | (725,220)                  |
| Solid Waste Disposal.....   | 2,031,876                  | 2,101,473                  | -  | -                                      | 69,597                     |
| Culture and Recreation.....                                       | 1,003,275                  | -                          | -  | -                                      | (1,003,275)                |
| Human Services and Welfare.....                                   | 2,676,076                  | -                          | 1,020,160                                | -                                      | (1,655,916)                |
| Urban Development.....  | 1,109,115                  | -                          | 774,445                                  | 512,820                                | 178,150                    |
| Education.....  | 4,211,467                  | -                          | 3,813,884                                | -                                      | (397,583)                  |
| Interest on Long-Term Debt.....                                   | 739,810                    | -                          | -  | -                                      | (739,810)                  |
| <b>Total Governmental Activities.....</b>                         | <b><u>\$25,273,493</u></b> | <b><u>\$ 2,101,473</u></b> | <b><u>\$ 6,324,994</u></b>               | <b><u>\$ 512,820</u></b>               | <b><u>(16,334,206)</u></b> |
| <b>General Revenues:</b>  |                            |                            |  |  |                            |
| <b>Taxes:</b>   |                            |                            |  |  |                            |
| Property Taxes, levied for General Purposes.....                  |                            |                            |  |  | 7,885,193                  |
| Property Taxes, levied for Debt Service.....                      |                            |                            |  |  | 2,540,570                  |
| Volume of Business Taxes.....                                     |                            |                            |  |  | 4,139,469                  |
| Construction Taxes.....   |                            |                            |  |  | 1,226,705                  |
| Intergovernmental.....  |                            |                            |  |  | 2,733,155                  |
| Rent.....   |                            |                            |  |  | 249,007                    |
| Miscellaneous.....  |                            |                            |  |  | <u>1,100,840</u>           |
| <b>Total General Revenues.....</b>                                |                            |                            |  |  | <u>19,874,939</u>          |
| <b>CHANGE IN NET ASSETS.....</b>                                  |                            |                            |  |  | <b>3,540,733</b>           |
| <b>Net Assets – Beginning of Year, as Restated (Note 15).....</b> |                            |                            |  |  | <u>39,759,161</u>          |
| <b>NET ASSETS – ENDING OF YEAR.....</b>                           |                            |                            |  |  | <b><u>\$43,299,894</u></b> |

See accompanying Notes to Basic Financial Statements.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF FAJARDO, PUERTO RICO**

**BALANCE SHEET – GOVERNMENTAL FUNDS**

JUNE 30, 2004

|  | GENERAL                    | HEAD START<br>FUND         | DEBT SERVICE<br>FUND       | CDBG<br>FUND               | OTHER<br>GOVERNMENTAL<br>FUNDS | TOTAL<br>GOVERNMENTAL<br>FUNDS |
|--|----------------------------|----------------------------|----------------------------|----------------------------|--------------------------------|--------------------------------|
| <b>ASSETS</b>                                    |                            |                            |                            |                            |                                |                                |
| Cash and Investments (Note 1) .....              | \$14,387,915               | \$ 22,954                  | \$ -                       | \$ 507,042                 | \$ 8,939,796                   | \$23,857,707                   |
| Cash with Fiscal Agent .....                     | -                          | -                          | 4,188,651                  | -                          | 5,650,977                      | 9,839,628                      |
| Receivables:                                     |                            |                            |                            |                            |                                |                                |
| Property Taxes .....                             | -                          | -                          | 71,860                     | -                          | -                              | 71,860                         |
| Federal Grants .....                             | -                          | 3,398,791                  | -                          | 1,386,497                  | 285,123                        | 5,070,411                      |
| Due from Other Funds .....                       | 2,134,640                  | -                          | -                          | -                          | 5,076,347                      | 7,210,987                      |
| Others .....                                     | 310,780                    | -                          | 2,710                      | -                          | 66,824                         | 380,314                        |
| <b>Total Assets .....</b>                        | <b><u>\$16,833,335</u></b> | <b><u>\$ 3,421,745</u></b> | <b><u>\$ 4,263,221</u></b> | <b><u>\$ 1,893,539</u></b> | <b><u>\$20,019,067</u></b>     | <b><u>\$46,430,907</u></b>     |
| <b>LIABILITIES AND FUND BALANCES</b>             |                            |                            |                            |                            |                                |                                |
| Liabilities:                                     |                            |                            |                            |                            |                                |                                |
| Accounts Payable .....                           | \$ 512,134                 | \$ -                       | \$ 870,000                 | \$ 9,958                   | \$ 113,656                     | \$ 1,505,748                   |
| Accrued Interest .....                           | -                          | -                          | 333,403                    | -                          | -                              | 333,403                        |
| Due to Governmental Units .....                  | 45,911                     | -                          | -                          | -                          | 10,402                         | 56,313                         |
| Due to Other Funds .....                         | 5,076,347                  | 533,097                    | 7,888                      | -                          | 1,593,655                      | 7,210,987                      |
| Deferred Revenues:                               |                            |                            |                            |                            |                                |                                |
| Volume of Business Tax .....                     | 2,921,269                  | -                          | -                          | -                          | -                              | 2,921,269                      |
| Local Grants .....                               | 317,562                    | -                          | -                          | -                          | -                              | 317,562                        |
| Federal Grants .....                             | -                          | 2,816,968                  | -                          | 1,285,313                  | 415,974                        | 4,518,255                      |
| <b>Total Liabilities .....</b>                   | <b><u>8,873,223</u></b>    | <b><u>3,350,065</u></b>    | <b><u>1,211,291</u></b>    | <b><u>1,295,271</u></b>    | <b><u>2,133,687</u></b>        | <b><u>16,863,537</u></b>       |
| Fund Balances:                                   |                            |                            |                            |                            |                                |                                |
| Reserve For:                                     |                            |                            |                            |                            |                                |                                |
| Encumbrances .....                               | 2,147,653                  | -                          | -                          | -                          | -                              | 2,147,653                      |
| Debt Service .....                               | -                          | -                          | 3,051,930                  | -                          | -                              | 3,051,930                      |
| Other Purposes .....                             | -                          | 71,680                     | -                          | 598,268                    | 17,885,380                     | 18,555,328                     |
| Unreserved .....                                 | 5,812,459                  | -                          | -                          | -                          | -                              | 5,812,459                      |
| <b>Total Fund Balances .....</b>                 | <b><u>7,960,112</u></b>    | <b><u>71,680</u></b>       | <b><u>3,051,930</u></b>    | <b><u>598,268</u></b>      | <b><u>17,885,380</u></b>       | <b><u>29,567,370</u></b>       |
| <b>TOTAL LIABILITIES AND FUND BALANCES .....</b> | <b><u>\$16,833,335</u></b> | <b><u>\$ 3,421,745</u></b> | <b><u>\$ 4,263,221</u></b> | <b><u>\$ 1,893,539</u></b> | <b><u>\$20,019,067</u></b>     | <b><u>\$46,430,907</u></b>     |

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF FAJARDO, PUERTO RICO**

**RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET  
TO THE STATEMENT OF NET ASSETS**

JUNE 30, 2004

**Total Fund Balances – Governmental Funds (Page 13) ..... \$29,567,370**

Amounts reported for Governmental Activities in the Statement of Net Assets (Page 11) 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 ..... | \$ 3,297,180        |            |
| Depreciable Capital Assets .....     | 37,363,143          |            |
| Infrastructure Assets .....          | 1,275,815           |            |
| Accumulated Depreciation .....       | <u>(13,475,893)</u> |            |
| Total Capital Assets .....           |                     | 28,460,245 |

Some of the **Municipality's** revenues will be collected after year-end but are not available soon enough to pay for the current period's expenditures and therefore are deferred in the funds:

|                               |                |           |
|-------------------------------|----------------|-----------|
| Head Start.....               | 2,816,968      |           |
| CDBG.....                     | 1,285,313      |           |
| Child Care .....              | 210,293        |           |
| Others .....                  | <u>282,561</u> |           |
| Total Deferred Revenues ..... |                | 4,595,135 |

Some liabilities including bonds payable are not due and payable in the current period and therefore are not reported in the funds ..... 870,000

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

|  |                  |                     |
|--|------------------|---------------------|
| Bonds and Notes Payable .....            | 11,804,553       |                     |
| Compensated Absences.....                | 1,807,662        |                     |
| Section 8 Loan .....                     | 1,300,000        |                     |
| Municipal Revenue Collection Agency..... | 280,641          |                     |
| Claims and Assessments.....              | <u>5,000,000</u> |                     |
| Total Long-Term Liabilities.....         |                  | <u>(20,192,856)</u> |

**Total Net Assets of Governmental Activities (Page 11)..... \$43,299,894**

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF FAJARDO, PUERTO RICO**

**STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE –  
GOVERNMENTAL FUNDS**

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

|   | GENERAL             | HEAD START<br>FUND | DEBT SERVICE<br>FUND | CDBG<br>FUND      | OTHER<br>GOVERNMENTAL<br>FUNDS | TOTAL<br>GOVERNMENTAL<br>FUNDS |
|---|---------------------|--------------------|----------------------|-------------------|--------------------------------|--------------------------------|
| <b>REVENUES</b>                                     |                     |                    |                      |                   |                                |                                |
| Property Taxes .....                                | \$ 7,885,193        | \$ -               | \$ 2,540,570         | \$ -              | \$ -                           | \$10,425,763                   |
| Volume of Business Taxes .....                      | 4,139,469           | -                  | -                    | -                 | -                              | 4,139,469                      |
| Federal Assistances .....                           | -                   | 4,283,147          | -                    | 1,455,421         | 803,355                        | 6,541,923                      |
| Intergovernmental .....                             | 2,733,155           | -                  | -                    | -                 | 836,952                        | 3,570,107                      |
| Licenses and Permits .....                          | 1,226,705           | -                  | -                    | -                 | -                              | 1,226,705                      |
| Rent .....  | 249,007             | -                  | -                    | -                 | -                              | 249,007                        |
| Sanitation .....                                    | 2,051,389           | -                  | -                    | -                 | -                              | 2,051,389                      |
| Interests .....                                     | 508,893             | -                  | -                    | -                 | -                              | 508,893                        |
| Miscellaneous .....                                 | 591,946             | -                  | -                    | -                 | -                              | 591,946                        |
| <b>Total Revenues .....</b>                         | <b>19,385,757</b>   | <b>4,283,147</b>   | <b>2,540,570</b>     | <b>1,455,421</b>  | <b>1,640,307</b>               | <b>29,305,202</b>              |
| <b>EXPENDITURES</b>                                 |                     |                    |                      |                   |                                |                                |
| Current:  |                     |                    |                      |                   |                                |                                |
| General Government .....                            | 9,594,442           | -                  | -                    | -                 | 180,519                        | 9,774,961                      |
| Public Safety .....                                 | 805,548             | -                  | -                    | -                 | -                              | 805,548                        |
| Public Works .....                                  | 3,077,377           | -                  | -                    | -                 | 1,885                          | 3,079,262                      |
| Health and Sanitation .....                         | 2,757,095           | -                  | -                    | -                 | -                              | 2,757,095                      |
| Culture and Recreation .....                        | 912,303             | -                  | -                    | -                 | -                              | 912,303                        |
| Human Services and Welfare .....                    | 1,736,283           | -                  | -                    | -                 | 939,792                        | 2,676,075                      |
| Urban Development .....                             | -                   | -                  | -                    | 1,295,476         | 2,071,981                      | 3,367,457                      |
| Education .....                                     | -                   | 4,211,467          | -                    | -                 | -                              | 4,211,467                      |
| Capital Outlay .....                                | 395,285             | -                  | -                    | -                 | 5,024                          | 400,309                        |
| Debt Service:                                       |                     |                    |                      |                   |                                |                                |
| Principal .....                                     | -                   | -                  | 1,095,447            | -                 | -                              | 1,095,447                      |
| Interest and Other Charges .....                    | -                   | -                  | 739,810              | -                 | -                              | 739,810                        |
| <b>Total Expenditures .....</b>                     | <b>19,278,333</b>   | <b>4,211,467</b>   | <b>1,835,257</b>     | <b>1,295,476</b>  | <b>3,199,201</b>               | <b>29,819,734</b>              |
| <b>OTHER FINANCING SOURCES (USES)</b>               |                     |                    |                      |                   |                                |                                |
| Transfers – In .....                                | -                   | -                  | 143,023              | -                 | 6,789,712                      | 6,932,735                      |
| Transfers – Out .....                               | (6,932,735)         | -                  | -                    | -                 | -                              | (6,932,735)                    |
| <b>Total Other Financing Sources and Uses .....</b> | <b>(6,932,735)</b>  | <b>-</b>           | <b>143,023</b>       | <b>-</b>          | <b>6,789,712</b>               | <b>-</b>                       |
| Net Change in Fund Balances .....                   | (6,825,311)         | 71,680             | 848,336              | 159,945           | 5,230,818                      | (514,532)                      |
| Fund Balance – Beginning .....                      | 14,785,423          | -                  | 2,203,594            | 438,323           | 12,654,562                     | 30,081,902                     |
| <b>FUND BALANCES – ENDING .....</b>                 | <b>\$ 7,960,112</b> | <b>\$ 71,680</b>   | <b>\$ 3,051,930</b>  | <b>\$ 598,268</b> | <b>\$17,885,380</b>            | <b>\$29,567,370</b>            |

58,197  
*de forma de \$100.-*

See accompanying Notes to Basic Financial Statements.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF FAJARDO, PUERTO RICO**

**RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES  
IN FUND BALANCE OF GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES**

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

|  |                            |
|--|----------------------------|
| <b>Net Change in Fund Balances – Total Governmental Funds (Page 15) .....</b>  | <b>(\$ 514,532)</b>        |
| Amounts reported for Governmental Activities in the Statement of Activities (Page 12)<br>are different because:  |                            |
| Governmental funds report capital outlays as expenditures. However, in the Statement of<br>Activities the cost of those assets is allocated over their estimated useful lives and reported<br>as depreciation expense. This is the amount of capital assets recorded in the current period. .... | 4,884,494                  |
| Depreciation expense on capital assets is reported in the Government-wide Statement of<br>Activities and Change in Net Assets, but they do not require the use of current<br>financial resources. Therefore, depreciation expense is not reported as expenditures<br>in Governmental Funds ..... | (2,037,622)                |
| Some expenses reported in the Statement of Activities do not require the use of current<br>financial resources and therefore are not reported as expenditures in Governmental Funds .....  | 235,416                    |
| Some revenues in the Governmental Funds that were recorded as revenues in the prior year<br>in the Statement of Activities. ....   | (20,000)                   |
| Intergovernmental receivables in Governmental Funds collected after year-end, but not<br>available soon enough to pay current liabilities, and therefore are not report in the<br>Governmental Funds .....   | (188,854)                  |
| Repayment of long-term principal is expenditure in the Governmental Funds, but the repayment<br>reduces Long-Term Liabilities in the Statement of Net Assets. In the current year the<br>repayments were. ....   | 1,095,447                  |
| Some expenses reported in the Statement of Activities do not require the use of current<br>financial resources and therefore are not reported as expenditures in Governmental Funds.<br>These activities consist of a decrease in Compensated Absences .....                                     | <u>86,384</u>              |
| <b>Change in Net Assets of Governmental Activities (Page 12) .....</b>   | <b><u>\$ 3,540,733</u></b> |

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF FAJARDO, PUERTO RICO

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The **Municipality of Fajardo, Puerto Rico (Municipality)** was founded in the year 1775, and operates as a governmental unit of the Commonwealth of Puerto Rico, under the Law Number 81 of August 30, 1991, known as "Autonomy Municipalities Law of the Commonwealth of Puerto Rico". The governmental system of the **Municipality** is composed of the executive and legislative bodies. The Mayor is the Chief Executive Officer and is elected every four years in the general elections of the Commonwealth of Puerto Rico. The legislative body consists of 14 Legislators also elected in the general elections of Puerto Rico for a four-year period.

The **Municipality** provides services such as: health, public works, sanitation, aids and services to low-income and elderly citizens, public safety, housing and urban development, culture and recreation, planning, zoning and other general and administrative services.

The accounting policies of the **Municipality** conform to accounting principles generally accepted in the United States of America as applicable to governmental units. The following is a summary of the more significant of such policies.

The accompanying basic financial statements of the **Municipality** have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) as prescribed by the Governmental Accounting Standards Board (GASB). The GASB is the standard-setting body for governmental accounting and financial reporting. The GASB periodically updates its codification of the existing Governmental Accounting and Financial Reporting Standards which, along with subsequent GASB pronouncements (Statements and Interpretations) constitutes GAAP for governmental units.

In June 1999, the GASB issued Statement Number 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*. This statement establishes new financial reporting requirements for state and local governments. The **Municipality** adopted the provisions of GASBS No. 34 as well as other statements referred to below as of July 1, 2002. They require new information and restructure much of the information that governments have presented in the past.

With the implementation of GASBS No. 34, the **Municipality** has prepared required supplementary information titled Management's Discussion and Analysis, which precedes the basic financial statements.

The accompanying basic financial statements present the financial position and the results of operations of the **Municipality** and its various funds and fund types. The basic financial statements are presented as of June 30, 2004, and for the fiscal year then ended. The more significant of these accounting policies are described below and, where appropriate, subsequent pronouncements will be referenced.

**A. Financial Reporting Entity**

The accompanying basic financial statements include all departments and organizations units whose funds are under the custody and control of the **Municipality**. In evaluating the **Municipality** as a reporting entity, management has addressed all the potential component units. The decision to include a potential component unit in the reporting entity was

made by applying the provisions of GASBS No. 14, as amended by GASB No. 39.

The basic criteria for including a potential component unit within the reporting entity is if potential component units are financially accountable and other organizations for which the nature and significance of their relationship with the entity are such that exclusion would cause the **Municipality's** financial statements to be misleading or incomplete. The GASB has set forth criteria to be considered in determining financial accountability. These criteria include appointing a voting majority of an organization's governing body and (1) ability of the **Municipality** to impose its will on that organization or (2) the potential for the organization to provide specific financial benefits to, or impose specific financial burdens on the **Municipality**.

The relative importance of each criterion must be evaluated in light of specific circumstances in order to determine which components units are to be included as part of the reporting entity. Our specific evaluations of the criteria applicable to the **Municipality** indicate no organizations meet the criteria to be included as component units. Accordingly, these basic financial statements present only the **Municipality** as the reporting entity.

These financial statements present the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information of the **Municipality**, as of June 30, 2004, and the respective changes in financial position, where applicable, thereof for the fiscal year then ended.

**B. Measurement Focus and Basis of Accounting**

**Government-wide Financial Statements**

The government-wide financial statements (the **Statement of Net Assets** and the **Statement of Activities**) are reported using the economic resources measurement focus and the accrual basis of accounting. Revenue is recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grant and similar items are recognized as revenue as soon as all eligibility requirements have been met.

**Governmental Fund Financial Statements**

The governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recorded when susceptible to accrual; as soon as it is both measurable and available. "Available" means collectible within the current period or soon enough thereafter, normally within sixty (60) days, to be used to pay liabilities of the current period. Expenditures are generally recognized when the related liability is incurred.

The exception to this general rule is the principal and interest on general obligation long-term debt and compensated absences, if any, are recognized when due.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF FAJARDO, PUERTO RICO

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES  
(continuation)

B. Measurement Focus and Basis of Accounting (continuation)

In applying the "susceptible to accrual" concept to intergovernmental revenues (federal grants) pursuant to GASBS No. 33, *Accounting and Financial Reporting for Nonexchange Transactions* (the Municipality may act as either provider or recipient), the provider should recognize liabilities and expenses and the recipient should recognize receivables and revenue when the applicable eligibility requirements including time requirements, are met. Resources transmitted before the eligibility requirements are met should, under most circumstances, be reported as advances by the provider and deferred revenue by the recipient.

There are essentially two types of revenue. For some grants, moneys must be expended by the Municipality on the specific purpose or project before any amounts will be reimbursed. Revenue is, therefore, recognized as expenditures are incurred to the extent available. For the other revenue, moneys are virtually unrestricted and are generally revocable only for failure to comply with prescribed compliance requirements. These resources are reflected as revenue at the time of receipt or earlier if the susceptible to accrual criteria is met. Expenditures are generally recorded when a liability is incurred, as under accrual accounting. Modifications to the accrual basis of accounting include the following:

- Employee's vested annual vacation and sick leave is recorded as expenditure when utilized. The amount of accumulated annual vacation and sick leave unpaid at June 30, 2004, has been reported only in the government-wide financial statements.

C. Financial Statement Presentation

The basic financial statements include both government-wide (based on the Municipality as a whole) and fund financial statements. While the previous financial reporting model emphasized fund types (the total of all funds of a particular type), in the new financial model the focus is on either the Municipality as a whole, or major individual funds (within the basic financial statements). Both the government-wide and fund financial statements (within the basic financial statements) categorize primary activities as either governmental or business type.

Government-wide Financial Statements

The government-wide financial statements (the **Statement of Net Assets** and the **Statement of Activities**) report information of all the activities of the Municipality. For most part, the effect of interfund activity has been removed from these government-wide financial statements. Governmental activities, which normally are supported by taxes and intergovernmental revenues, are reported separately from business-type activities, which rely to a significant extent on fees and charges for support.

The focus of the **Statement of Net Assets** is designed to be similar to bottom line results for the Municipality and its governmental activities. This statement, for the first time, combines and consolidates governmental fund's current financial resources (short-term spendable resources) with capital assets and long-term obligations.

The **Statement of Net Assets** presents the reporting entities' assets and liabilities, with the difference reported as net assets. Net assets are reported in three categories:

- **Invested in Capital Assets, Net of Related Debt** – These consists of capital assets, net of accumulated depreciation and amortization and reduced by outstanding balances for bonds, notes, and other debt that are attributed to the acquisition, construction, or improvement of those assets.
- **Restricted Net Assets** – These result when constraints placed on net assets use are either externally imposed by creditors, grantors, contributors, and the like, or imposed by law through constitutional provisions or enabling legislation.
- **Unrestricted Net Assets** – These consist of net assets which do not meet the definition of the two preceding categories. Unrestricted net assets often are designated, to indicate that management does not consider them to be available for general operations. Unrestricted net assets often have constraints on resources that are imposed by management, but can be removed or modified.

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

The **Statement of Activities** is focused on both the gross and net costs per functional category. The statement reduces gross expenses (including depreciation) by related program revenues, operating and capital grants. This is intended to summarize and simplify the user's analysis of cost of various governmental services.

Governmental Fund Financial Statements

The fund financial statements (the **Balance Sheet**, the **Statement of Revenues, Expenditures, and Changes in Fund Balances**, the **Statement of Net Assets**) are, in substance, very similar to the financial statements presented in the previous financial reporting model. Emphasis here is on the major funds in the governmental category. Non-major funds are summarized into a single column.

Traditional users of governmental financial statements will find the Fund Financial Statements presentation more familiar. The focus is on Major Funds, rather than the previous financial model's fund types. The Governmental Major Fund Statements are presented on current financial resources and modified accrual basis of accounting.

This is the manner in which these funds are normally budgeted. This presentation deemed most appropriate to (a) demonstrate legal and covenant compliance, (b) demonstrate the source and use of liquid resources, and (c) demonstrate how the Municipality's actual experience conforms to the budgeted fiscal plan.

Since the governmental fund statements are presented in different measurement focus and basis of accounting than the government-wide statements, reconciliation is presented and separate explanation for each differences.

continue

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF FAJARDO, PUERTO RICO

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES  
(continuation)

C. Financial Statement Presentation (continuation)

The **Municipality** reports its financial position (**Balance Sheet**) and results of operations (**Statement of Revenues, Expenditures and Changes in Fund Balance**) in funds, which are considered separate accounting entities. The operations of each fund are accounted for within a set of self-balancing accounts. Fund accounting segregates funds according to their intended purpose and is used to aid management in demonstrating compliance with legal, financial, and contractual provisions.

The model as defined in GASBS No. 34 established criteria (percentage of the assets, liabilities, revenues, or expenditures/expenses of either fund category in the governmental fund) for the determination of major funds. The non-major funds are combined in a single column in the fund financial statements. The **Municipality** reports the following major fund:

**General Fund** – This is the general operating fund of the **Municipality**. It is used to account for all financial resources, except those required to be accounted for in another fund.

**Head Start Fund** – This is the fund used to account for all transactions of the Head Start Program. The objectives to this program are to provide comprehensive health, educational, nutritional, social and other developmental services primarily to economically-disadvantaged pre-school children and infants and toddlers so that the children will attain school readiness.

**Debt Service Fund** – This is used to account for the accumulation of resources for, and the payment of long-term debt principal and interests.

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

D. Budgetary Data

The **Municipality** annually adopts the Budget Resolution for all its operating funds except for certain restricted accounts of Proprietary Funds and Special Revenue Funds. Budgetary control is legally maintained at the fund level. The budget is prepared using the modified accrual basis of accounting with encumbrance included as budgetary basis expenditures. The **Municipality's** Budget Resolution provides transfer authority (1) to the Mayor and the Management and Budget Director, within and between departments and funds, as long as the total budget of the **Municipality** (net of interfund transfers) is not increased; (2) to the Management and Budget Director to implement grant budgets as the grant applications are accepted by the **Municipality**; and (3) to the Management and Budget Director to amend (re-appropriate) each new year's budget, to the extent of outstanding encumbrances, and/or unexpended project/grant appropriations at year end. **Municipality's** Legislature action is required for (1) use of the budgeted Legislature

contingency, and (2) the approval of a supplemental appropriation(s). During the year, several supplemental appropriations were necessary.

The budget columns (original and final budgets) of the Budgetary Comparison – General Fund reflect the original budget and the amended budget (which have been adjusted for legally authorized revisions of the annual budgets during the year). Appropriations, except remaining project appropriations, encumbrances, and unexpended grant appropriations, lapse at the end of each fiscal year.

Amendments to the budget, including transfers, require the approval of the Municipal Legislature. Unencumbered appropriations lapse at the end of the next fiscal year. The **Municipality** follows these procedures, in accordance with law, in order to establish the budgetary data reflected in the basic financial statements:

1. Prior of May 15 of each fiscal year, the Mayor submits to the Municipal Legislature a proposed budget for the fiscal year commencing the following July 1 in addition of a budget message.
2. The budget document is available for public inspection prior to its approval by the Municipal Legislature.
3. The Commissioner of Municipal Affairs examines the budget to verify if it complied with the law's standards and sends it to the Mayor for any comments or recommendation before the limited date establishes by the Law.
4. Prior to June 13, the annual budget is legally enacted through passage of the annual appropriation ordinance.
5. If a budget is not adopted prior to the end of the end of the fiscal year, the annual budget for the preceding fiscal year, as approved by the Municipal Legislature and the Mayor, is automatically renewed for the ensuing fiscal year until a new budget is approved. This permits the **Municipality** to continue making payments for its operating and other expenses until the new budget is approved.
6. Subsequent to the enactment of the annual appropriation ordinance, the Municipal Legislature has the authority to make necessary amendments made during the fiscal year and are reflected in the budget information included in the Budgetary Comparison Schedule – General Fund.

Since the budgetary basis differs from accounting principles generally accepted in the United States of America (GAAP), actual amounts for the General Fund in the accompanying Budgetary Comparison Schedule, is presented on the budgetary basis to enhance comparability.

The principal differences between the budgetary and GAAP bases are the following:

1. Encumbrances are recorded as expenditures under the budgetary basis and as a reserve of fund balances under GAAP.

continue

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF FAJARDO, PUERTO RICO**

**NOTES TO THE BASIC FINANCIAL STATEMENTS**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

**NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES  
(continuation)**

**D. Budgetary Data (continuation)**

2. The non-exonerated portion of the property tax advances are presented as revenue in the budgetary basis and as other financing sources under GAAP (See Note 9).
3. Interfund transactions of the General and Special Revenue Funds are not included in the budgetary basis.
4. Certain accrued liabilities and other debts are not included in the budgetary basis.
5. Certain revenues susceptible to accrual, i.e., both measurable and available, are not included in the budgetary data.

All encumbrance appropriations in the operating budget lapse at the end of the fiscal year. Property taxes collected during the current year by the Municipal Revenue Collection Center (Fiscal Agent) are presented as revenues in the accounting basis.

The special funds of the Special Revenue Fund have not been included in the budgetary comparison because balances are not budgeted. Also the budget prepared for the Federal Finance Awards Programs included in the Capital Projects and Special Revenue Funds is based on a program period which is not necessarily a year. Accordingly, it's not practical to present an annual comparison of budget for such programs.

**E. Cash, Cash Equivalent and Investment**

The Director of Finance of the **Municipality** is responsible for investing the available resources in certificates of deposit and other short-term investments. Investments are made from the available combined funds of the **Municipality** and, accordingly, it is not practical to disclose certificates of deposit and other short-term investments individually by fund in the combined financial statements. Interest earned on certificates of deposit and other short-term investments are recognized as revenue in the General Fund. Cash in the Special Revenue, Debt Service and Capital Project Funds are restricted; accordingly, resources available were not used for pool investments.

Under Puerto Rico statutes, public funds deposited in commercial banks must be fully collateralized for the amount deposited in excess of federal depository insurance. All securities pledged as collateral are held by the Secretary of the Treasury of Puerto Rico. In addition, the Municipality maintains deposits with the Government Development Bank for Puerto Rico (GDB). The Municipality's bank balances in commercial banks of approximately \$14.3 million in the general fund were fully collateralized at June 30, 2004. The deposits at GDB of approximately \$5.6 million are restricted principally for capital projects and the \$4.1 million in the debt service fund are unsecured and uncollateralized, as no collateral is required to be carried by governmental banks. The excess is covered by collateral provided by banks and held by the Treasury Department of the Commonwealth of Puerto Rico pursuant to applicable laws and regulations.

**F. Receivable**

Receivable are stated nets of estimated allowances for uncollectible accounts, which are determined upon past collection experience and current economic conditions. Receivable from Federal Government represents amounts owed to the **Municipality** for reimbursement of expenditures incurred pursuant to federally funded programs.

**G. Inventories**

The General, Special Revenue and Capital Project Funds, purchases office and printing supplies, gasoline, oil and other expendable supplies held for consumption. The cost of purchases is recorded as expenditure in the appropriate fund and the inventory is not recorded in the basic financial statements.

**H. Capital Assets**

Property, plant and equipment purchased or acquired is carried at historical cost or estimated historical cost. Contributed assets are recorded at fair market value as of the date received. The **Municipality's** capitalization levels are \$500 on personal property. For improvements other than buildings, the capital outlay must be greater than \$10,000, extend the estimated useful life for ten years, and be greater than 10% of the original cost of the asset. Other costs incurred for repairs and maintenance is expensed as incurred.

Depreciation on all assets is provided on the straight-line basis over the following estimated useful lives: **(See Table 1)**

| TABLE 1                          |       |
|----------------------------------|-------|
| CAPITAL ASSETS                   | YEARS |
| Buildings                        | 50    |
| Improvement Other Than Buildings | 50    |
| Infrastructure                   | 10-50 |
| Motor Vehicles                   | 5     |
| Machinery and Equipments         | 5-10  |

**I. Compensated Absences**

The **Municipality** accrues accumulated unpaid vacation and sick leave and associated employee-related costs when earned (or estimated to be earned) by the employee. The **Municipality's** employees are granted 30 days of vacations and 18 days of sick leave annually. Vacations may be accumulated up to a maximum of sixty (60) days and sick leave up to a maximum of ninety (90) days. In the event of employee resignation, the employee is paid for accumulated vacation days up to the maximum allowed. Separation from employment prior to use of all or part of the sick leave terminates all rights for compensation, except for employees with ten years of service who are entitled to sick leave pay up to the maximum allowed. The **Municipality** accrued a liability for compensated absences, which meet the following criteria:

1. The **Municipality's** obligation relating to employee's rights to receive compensation for future absences is attributable to employee's services already rendered.
2. The obligation relates to rights that vest or accumulate.

continue

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF FAJARDO, PUERTO RICO**

**NOTES TO THE BASIC FINANCIAL STATEMENTS**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

**NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES  
(continuation)**

**I. Compensated Absences (continuation)**

3. Payment of the compensation is probable.
4. The amount can be reasonably estimated.

In accordance with the above criteria and requirements as established by GASBS No. 16; the **Municipality** has accrued a liability for compensated absences, which has been earned but not taken by **Municipality's** employees. For the government-wide statements, the current portion is the amount estimated to be used in the following year. For the governmental funds statements, all of the compensated absences are considered long-term and therefore, are not a fund liability and represents a reconciling item between the fund level and government-wide presentations (see Note 7 on page 24).

The following is a summary of changes in the balance of Compensated Absences for the fiscal year ended June 30, 2004 (**Table 2**).

| BALANCE<br>JULY 1,<br>2003 | NEW<br>ISSUES | RETIREMENTS<br>AND CURRENT<br>MATURATES | BALANCE<br>JUNE 30,<br>2004 | CURRENT<br>PORTION | LONG-TERM<br>PORTION |
|----------------------------|---------------|---|-----------------------------|--------------------|----------------------|
| \$1,894,046                | \$ -          | \$ 86,384                               | \$1,807,662                 | \$1,317,101        | \$ 490,561           |

**J. Insurance**

The **Municipality** has insurance coverage for its public facilities, primarily to provide protection from catastrophic losses. Also, principal officials of the **Municipality** are covered under various surety bonds. The Secretary of the Treasury Department of the Commonwealth of Puerto Rico is the agent commissioned to place all of the **Municipality's** insurance coverage. Corresponding premiums payable are withheld by the Municipal Revenue Collection Center from quarterly advances of annual property tax and subsidy send to the **Municipality**.

**K. Interfund Transactions**

Interfund transactions are reflected as loans, reimbursements or transfers. Loans are reported as receivables and payables as appropriate and are subject to elimination upon consolidation. Reimbursements occur when one fund incurs a cost, charges the appropriate benefiting fund and reduces its related cost as a reimbursement. All other interfund transactions are treated as transfers. Transfers between governmental or proprietary funds are netted as part of the reconciliation to the government-wide columnar presentation. The **Municipality** has the following types of transactions among funds:

*Interfund Transfers* - Legally required transfers that are reported when incurred as transfers-in by the recipient fund and as transfers-out by the disbursing fund, with receivables and payables presented as amounts due to and due from other funds. Advances between funds are also presented as amounts due to and due from other funds. However, these transfers and related amounts receivables and payables are

considered internal balances and activities that have been eliminated in the government-wide financial statements.

**L. Reservations of Fund Balance - Governmental Funds**

The governmental fund financial statements present fund balance reserves for those portions of fund balance (1) not available for appropriation for expenditures or (2) legally segregated for a specific future use. The reserves for related assets such as inventories and prepayments are examples of the former. Reserves for debt service and other specific purposes are examples of the latter.

**M. Claims and Judgments**

The estimated amount of the liability for claims and judgments, if any, which is due on demand, such as from adjudicated or settled claims, is recorded in the General Fund. The Long-Term Liabilities includes an amount estimated as a contingent liability or liabilities with a fixed or expected due date, which will require future available financial resources for its payment.

**N. Use of Estimates**

The preparation of the basic 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 and disclosures of contingent assets and liabilities at the date of the basic financial statements and the reported revenue and expenses during the reporting period. Actual result could differ from those estimates.

**NOTE 2 CASH, CASH EQUIVALENTS AND INVESTMENTS**

Investments consist of certificates of deposit. The **Municipality's** cash, cash equivalent and investments at year-end were entirely covered by the Federal Deposit Insurance Corporation (FDIC) coverage, up to a maximum of \$100,000 in each bank, and the excess by collateral provided by the banks and held by the Department of the Treasury pursuant the applicable laws and regulations. Cash with fiscal agent is maintained in interest bearing accounts in the Government Development Bank of Puerto Rico and is not collateralized.

Puerto Rico laws authorize governmental entities to invest in direct obligations or obligations guaranteed by the federal government or the Commonwealth of Puerto Rico. 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 Commonwealth laws.

continue

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF FAJARDO, PUERTO RICO**

**NOTES TO THE BASIC FINANCIAL STATEMENTS**

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

**NOTE 2 CASH, CASH EQUIVALENTS AND INVESTMENTS**  
(continuation)

During the year, the Municipality invested its funds in interest bearing bank accounts and short-term certificates of deposit. As June 30, 2004, the market value of investments recorded in Special Revenue Fund approximated its carrying value as follow: (See Table 3)

| CERTIFICATE OF DEPOSIT ISSUED BY | PRINCIPAL NUMBER | INTEREST AMOUNT     | RATE  | TABLE 3 EXPIRATION DATE |
|----------------------------------|------------------|---------------------|-------|-------------------------|
| Popular Bank of Puerto Rico ...  | 111000020        | \$ 1,000,000        | 1.75% | 09-01-04                |
| Popular Bank of Puerto Rico ...  | 111000021        | 500,000             | 1.75% | 07-03-04                |
| Popular Bank of Puerto Rico ...  | 111000025        | 1,000,000           | 1.75% | 09-24-04                |
| Popular Bank of Puerto Rico ...  | 111000026        | 500,000             | 1.80% | 07-27-04                |
| Popular Bank of Puerto Rico ...  | 111000028        | 1,000,000           | 1.75% | 09-03-04                |
| Popular Bank of Puerto Rico ...  | 111000030        | 3,000,000           | 1.75% | 09-13-04                |
| Popular Bank of Puerto Rico ...  | 111000031        | 2,000,000           | 1.75% | 09-13-04                |
| Popular Bank of Puerto Rico ...  | 111000039        | 500,000             | 1.75% | 09-11-04                |
| Popular Bank of Puerto Rico ...  | 111000041        | 1,500,000           | 1.75% | 09-11-04                |
| Popular Bank of Puerto Rico ...  | 111000040        | 1,000,000           | 1.75% | 09-11-04                |
| <b>TOTAL</b> .....               |                  | <b>\$12,000,000</b> |       |                         |

The investments are distributed by the amounts of \$10,000,000 to the General Fund and \$2,000,000 to the Special Revenue Fund.

**NOTE 3 OTHERS RECEIVABLES AND DUE FROM AGENCIES**

As of June 30, 2004, the amount of \$310,780 corresponds to the Solid Waste Disposal.

The following is a summary of due from other agencies for the fiscal year ended June 30, 2004 (Table 4).

|  | AMOUNT             |
|--|--------------------|
| Health and Human Services Head Start.....    | \$3,398,791        |
| Health and Human Services Child Care.....    | 285,123            |
| Municipal Revenue Collection Center .....    | 71,860             |
| Housing and Urban Development - CDBG.....    | 1,386,497          |
| Municipality of San Juan.....                | 18,529             |
| Department of Labor - Law 52 .....           | 44,422             |
| Other Agencies - Voucher Portability.....    | 3,873              |
| <b>Total Due to Governmental Units .....</b> | <b>\$5,209,095</b> |

**NOTE 4 INTERFUND TRANSFER AND BALANCES**

**A. INTERFUND TRANSFERS**

Transfers are indicative of funding for capital projects or debt service, and subsidies of various operations. (See Table 5)

| INTERFUND TRANSFERS WITHIN THE GOVERNMENTAL FUNDS |                   |                    |                          |
|---|-------------------|--------------------|--------------------------|
| TABLE 5   |                   |                    |                          |
| SOURCES   | TRANSFER TO       | AMOUNT             | PURPOSE                  |
| General Fund                                      | Debt Service Fund | \$ 143,023         | Debt payment             |
| General Fund                                      | Other Fund        | 6,789,712          | Specific project funding |
| <b>Total</b>                                      |                   | <b>\$6,932,735</b> |                          |

**B. INTERFUND RECEIVABLE AND PAYABLE BALANCES**

Interfund receivables and payables at June 30, 2004 are summarized as follows: (See Table 6)

| INTERFUND RECEIVABLE | INTERFUND PAYABLE | TABLE 6 AMOUNT     |
|----------------------|-------------------|--------------------|
| General Fund         | Debt Service Fund | \$ 7,888           |
| Other Fund           | General Fund      | 5,076,347          |
| General Fund         | Other Fund        | 1,593,655          |
| General Fund         | Head Start Fund   | 533,097            |
| <b>TOTAL</b>         |                   | <b>\$7,210,987</b> |

Inter-fund receivables between the General and Debt Service Fund represent the interest income received from the Municipal Revenue Collection Center.

**NOTE 5 DUE TO OTHER GOVERNMENTAL UNITS**

As of June 30, 2004, balance due to other governmental units of the General Fund for services rendered to the Municipality, consists of the following: (See Table 7)

|  | AMOUNT          |
|--|-----------------|
| TABLE 7                                      |                 |
| Water Company .....                          | \$15,133        |
| General Service Administration .....         | 5,090           |
| Retirement System Administration .....       | 25,525          |
| AEELA .....                                  | 163             |
| <b>Total Due to Governmental Units .....</b> | <b>\$45,911</b> |

continue

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF FAJARDO, PUERTO RICO**

**NOTES TO THE BASIC FINANCIAL STATEMENTS**

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

**NOTE 6 CAPITAL ASSETS**

Capital Assets activities for the fiscal year ended June 30, 2004 was as follows (See Table 8)

| TABLE 8                                | DESCRIPTION  | BALANCE<br>JULY 1,<br>2003 | ADDITIONS           | ADJUSTMENTS         | BALANCE<br>JUNE 30,<br>2004 |
|--|--|----------------------------|---------------------|---------------------|-----------------------------|
| <b>Non-Depreciable Capital Assets:</b> |  |                            |                     |                     |                             |
|  | Land .....   | \$ 524,407                 | \$ 700,453          | \$ 1,314,225        | \$ 2,539,085                |
|  | Others .....                                       | <u>726,443</u>             | <u>31,652</u>       | -                   | <u>758,095</u>              |
|  | <b>Total Non-Depreciable Capital Assets.....</b>   | <u>1,250,850</u>           | <u>732,105</u>      | <u>1,314,225</u>    | <u>3,297,180</u>            |
| <b>Depreciable Capital Assets:</b>     |  |                            |                     |                     |                             |
|  | Buildings .....                                    | 30,683,064                 | 1,132,747           | -                   | 31,815,811                  |
|  | Infrastructure.....                                | 272,337                    | 1,003,478           | -                   | 1,275,815                   |
|  | Machinery and Equipment.....                       | 1,633,631                  | 387,276             | -                   | 2,020,907                   |
|  | Motor Vehicles .....                               | <u>1,897,537</u>           | <u>1,628,888</u>    | -                   | <u>3,526,425</u>            |
|  | <b>Total Depreciable Capital Assets.....</b>       | <u>34,486,569</u>          | <u>4,152,389</u>    | -                   | <u>38,638,958</u>           |
| <b>Less Accumulated Depreciation:</b>  |  |                            |                     |                     |                             |
|  | Buildings .....                                    | (9,017,873)                | (1,075,257)         | -                   | (10,093,130)                |
|  | Infrastructure.....                                | (5,447)                    | (25,516)            | -                   | (30,963)                    |
|  | Machinery and Equipment.....                       | (915,326)                  | (333,044)           | -                   | (1,248,370)                 |
|  | Motor Vehicles .....                               | <u>(1,499,625)</u>         | <u>(603,805)</u>    | -                   | <u>(2,103,430)</u>          |
|  | <b>Total Accumulated Depreciation.....</b>         | <u>(11,438,271)</u>        | <u>(2,037,622)</u>  | -                   | <u>(13,475,893)</u>         |
|  | <b>Total Depreciable Capital Assets (Net).....</b> | <u>23,048,298</u>          | <u>2,114,767</u>    | -                   | <u>25,163,065</u>           |
|  | <b>CAPITAL ASSETS, NET .....</b>                   | <u>\$24,299,148</u>        | <u>\$ 2,846,872</u> | <u>\$ 1,314,225</u> | <u>\$28,460,245</u>         |

Depreciation expenses were charged to governmental functions/programs as follows: (See Table 9)

| TABLE 9                                 | AMOUNT             |
|---|--------------------|
| General Government .....                | \$ 736,988         |
| Public Safety .....                     | 83,261             |
| Public Works .....                      | 853,588            |
| Culture and Recreation.....             | 90,971             |
| Urban Development.....                  | <u>272,814</u>     |
| <b>Total Depreciation Expenses.....</b> | <u>\$2,037,622</u> |

**NOTE 7 GENERAL LONG-TERM DEBTS**

**A. GENERAL OBLIGATIONS BONDS AND SPECIAL NOTES PAYABLE**

The principal long-term obligations of the **Municipality** are general obligations bonds and special notes issued to finance the construction and improvements of public facilities and purchase of equipment. The **Municipality's** obligations long-term debt retirements are appropriated and paid from resources accumulated in the Debt Service Fund (See Note 8). The special obligations long-term notes retirements are paid through retention made by the Municipal Revenue Collection Center from monthly advance of annual property tax and subsidy send to the **Municipality**.

General obligations bonds and notes payable as of June 30, 2004, are comprised of the following individual issues:

| DESCRIPTION  | AMOUNT           |
|--|------------------|
| <b>General Obligations Bonds:</b>  |                  |
| \$11,435,000, Series 1999-98, for construction purposes, payable in annual installments ranging from \$305,000 to \$1,130,000, excluding variable interests from 5.190% to 6.340% until July 1, 2016 ..... | \$ 9,645,000     |
| <b>Total General Obligations Bonds .....</b>   | <u>9,645,000</u> |

**Special Obligations Notes:**

|   |         |
|---|---------|
| \$1,496,000, Series 1983-84, for construction purposes, payable in annual installments ranging from \$18,000 to \$143,000, excluding interests at 9.125%, until January 1, 2008.....                  | 504,553 |
| \$865,000, Series 1989-90, for construction purposes, payable in annual installments ranging from \$20,000 to \$105,000, excluding variable interest from 3.263% to 8.600%, until July 1, 2004.....   | 105,000 |
| \$3,270,000 Series 1991-92, for construction purposes, payable in annual installments ranging from \$120,000 to \$355,000, excluding variable interest from 4.163% to 6.363%, until July 1, 2006..... | 990,000 |

continue

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF FAJARDO, PUERTO RICO**

**NOTES TO THE BASIC FINANCIAL STATEMENTS**

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

**NOTE 7 GENERAL LONG-TERM DEBTS (continuation)**

| DESCRIPTION   | AMOUNT              |
|---|---------------------|
| <b>Special Obligations Notes:</b>   |                     |
| \$370,000 Series 1994-95, for construction purposes, payable in annual installments ranging from \$5,000 to \$35,000, excluding variable interests from 6.106% to 8.206%, until July 1, 2019.....         | \$ 310,000          |
| \$2,500,000, Series 1986-87, for operational purposes, payable in annual installments of \$125,000, excluding variable interests from 5.000% to 8.500%, until July 1, 2006.....                           | 250,000             |
| \$2,500,000, Series 1996, for construction purposes, payable in annual installments ranging to \$140,000 to \$650,000, excluding interests at 3.00%, until August 1, 2005; (paid through CDBG funds)..... | 1,300,000           |
| Total Special Obligations Notes.....  | 3,459,553           |
| <b>Total General and Special Obligations.....</b>   | <b>\$13,104,553</b> |

The **Municipality's** general obligations long-term note retirements are appropriated and paid from resources accumulated in the Debt Service Fund (see Note 8). The special obligations long-term notes retirements are paid through retention made by the Municipal Revenue Collection Center from monthly advance of annual property tax and subsidy sent to the **Municipality**, except for the Section 108 Loan that was paid through CDBG Program Fund.

The annual requirements to amortize the general and special obligations outstanding as of June 30, 2004 are as follows (See Table 10):

| YEAR ENDING<br>JUNE 30, | PRINCIPAL<br>PAYMENT | INTEREST<br>PAYMENT | TABLE 10<br>TOTAL<br>PAYMENT |
|-------------------------|----------------------|---------------------|------------------------------|
| 2005                    | \$ 1,755,553         | \$ 772,066          | \$ 2,527,619                 |
| 2006                    | 1,720,000            | 661,940             | 2,381,940                    |
| 2007                    | 1,021,000            | 567,600             | 1,588,600                    |
| 2008                    | 723,000              | 513,052             | 1,236,052                    |
| 2009                    | 625,000              | 465,639             | 1,090,639                    |
| 2010-2014               | 3,950,000            | 1,689,178           | 5,639,178                    |
| 2015-2019               | 3,275,000            | 350,754             | 3,625,754                    |
| 2020-2024               | 35,000               | 1,436               | 36,436                       |
| <b>TOTAL</b>            | <b>\$13,104,553</b>  | <b>\$ 5,021,665</b> | <b>\$18,126,218</b>          |

**B. OTHER LONG-TERM DEBTS**

Following are the Other Long-Term Debts (See Table 11):

| TABLE 11<br>DESCRIPTION     | BALANCE<br>JULY 1,<br>2003 | NEW<br>ISSUES | RETIREMENTS<br>AND<br>ADJUSTMENT | BALANCE<br>JUNE 30,<br>2004 |
|-----------------------------|----------------------------|---------------|----------------------------------|-----------------------------|
| Property Taxes – MRCC.....  | \$ 316,058                 | \$ -          | \$ 35,417                        | \$ 280,641                  |
| Claims and Assessments..... | 5,282,122                  | -             | 282,122                          | 5,000,000                   |
| Compensated Absences.....   | 1,894,046                  | -             | 86,384                           | 1,807,662                   |
| <b>TOTAL.....</b>           | <b>\$7,492,226</b>         | <b>\$ -</b>   | <b>\$ 403,923</b>                | <b>\$ 7,088,303</b>         |

**C. CHANGES IN GENERAL LONG-TERM DEBTS**

The following is a summary of changes in long-term debts for the year ended June 30, 2004: (See Table 12)

| TABLE 12<br>DESCRIPTION | BALANCE<br>JULY 1,<br>2003 | NEW<br>ISSUES | RETIREMENTS<br>AND<br>ADJUSTMENT | BALANCE<br>JUNE 30,<br>2004 | AMOUNTS<br>DUE WITHIN<br>ONE YEAR | AMOUNTS<br>DUE AFTER<br>NEXT YEAR |
|-------------------------|----------------------------|---------------|----------------------------------|-----------------------------|-----------------------------------|-----------------------------------|
| General.....            | \$ 9,645,000               | \$ -          | \$ -                             | \$ 9,645,000                | \$ 450,000                        | \$ 9,195,000                      |
| Special.....            | 3,885,000                  | -             | 425,447                          | 3,459,553                   | 1,305,553                         | 2,154,000                         |
| Others Debts..          | 7,492,226                  | -             | 403,923                          | 7,088,303                   | 1,317,101                         | 490,561                           |
| <b>TOTAL.....</b>       | <b>\$21,022,226</b>        | <b>\$ -</b>   | <b>\$ 829,370</b>                | <b>\$20,192,856</b>         | <b>\$ 3,072,654</b>               | <b>\$17,120,202</b>               |

**NOTE 8 DEBT RETIREMENT**

Revenues of the debt service fund consists of the ad-valorem property taxes which are recognized as revenue when collected from taxpayers and reported by the Municipal Revenue Collection Center of the Commonwealth of Puerto Rico to the **Municipality** (See Note 9).

These property taxes are accumulated by the Municipal Revenue Collection Center in costs of the general obligations bonds issued by the **Municipality** (See Note 7). Payments are made to the Government Development Bank of the Commonwealth of Puerto Rico from such accumulated funds by the Municipal Revenue Collection Center of Puerto Rico.

**NOTE 9 PROPERTY TAXES**

The Municipal Revenue Collection Center of the Commonwealth of Puerto Rico is responsible for the assessment of all real and personal property located within the **Municipality** and for the levy, administration and collection of the corresponding tax contribution.

The property tax contribution is levied each year over the appraised value of the property at the beginning of the calendar year. The real property assessment is based on the current value existing in the year 1957 and the personal property at the current value at the date of the assessment.

The tax rate per annum is 8.53% for real property and 6.53% for personal property of which 1.03% of both belong to the Commonwealth of Puerto Rico and 7.50% and 5.50%, respectively, belongs to the **Municipality**. From the portion belonging to the **Municipality**, 6.00% and 4.00%, respectively, represents the **Municipality's** basic tax rate that is appropriated for general purposes and therefore accounted for through the general fund.

The remaining portion belonging to the **Municipality** of 1.50% represents the ad-valorem property taxes withheld by the Municipal Revenue Collection Center of the Commonwealth of Puerto Rico and restricted for debt service, which is accounted for through the debt service fund (See Note 8). The **Municipality** has reached the maximum statutory tax rate limit for the basic tax while there is no limitation for the ad-valorem tax rate.

continue

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF FAJARDO, PUERTO RICO**

**NOTES TO THE BASIC FINANCIAL STATEMENTS**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

---

**NOTE 9 PROPERTY TAXES (continuation)**

The Commonwealth of Puerto Rico grants complete real property tax exoneration on the first \$15,000 has assessed valuation on residential units occupied by their owners. However, the **Municipality** receives the full amount levied, except for residential units assessed at less than \$3,500 on which a complete exemption is granted. The Municipal Revenue Collection Center, instead of the property taxpayer, becomes the source of payment in these cases.

The **Municipality** grants a complete exemption from personal property taxes up to an assessment value of \$50,000, to retailers with an annual net sales volume of less than \$150,000. The Municipal Revenue Collection Center advances to the **Municipality**, on monthly payments, 100% of the contribution assessed over property for each fiscal year. In accordance to Law, these advances will be contributions by the Municipal Revenue Collection Center from taxpayers. The Municipal Revenue Collection Center periodically informs to the **Municipality** the amounts collected from taxpayers and applied to outstanding advances.

The **Municipality** records as revenue in the general fund the property tax contribution when received from monthly advances from Municipal Revenue Collection Center.

Due to the fact that collections of property tax are applied to the advances of property tax paid by the Municipality Revenue Collection Center, the amortization of the advance at end of year was not available due to that is in process of verification by external auditors. As of June 30, 2004, the Debt Service Fund presented a receivable of \$68,004 for the collection of additional property taxes during the next 60 days after end of year.

**NOTE 10 VOLUME OF BUSINESS TAX**

Volume of Business Tax is recorded in the fiscal year in which payments is due and, accordingly, represents taxes which are due and uncollected at June 30, 2004. The Volume of Business Tax is determined based on the gross income of all commerce and industrial organizations that have operations in the Municipality, and are not totally or partially exempt under the Industrial Incentive Law of Puerto Rico.

An annual return of business volume should be filed on or before April 15 of each year and payable in two equal installments due on July 1 and January 1. A discount of 5% is allowed when full payment is made on or before April 15. The rates of municipal license in the Municipality are as follow:

- a. 1.50% for financial institutions and savings and loan associations.
- b. 0.40% for all other organizations.

Taxes are payable in two equal semi-annual installments on July 1 and January 1 following the date of levy. If they are paid with declaration, the taxpayer is granted a 5% of discount. Collections of taxes during current fiscal year, applicable to the next fiscal year, are recorded as deferred revenues in the General Fund.

**NOTE 11 INTERGOVERNMENTAL REVENUES**

Intergovernmental revenues consist primarily of funds received from the Commonwealth of Puerto Rico, "in lieu of tax" payments from the quasi-public corporation, Puerto Rico Electric Power Authority, and federal financial assistance received from federal government.

Grants and subsidies received from the Commonwealth of Puerto Rico and federal agencies include, among others, a general subsidy for urban development and capital improvements. Intergovernmental revenues are accounted for through the General Fund except for those directly related to urban development and capital improvements, which are accounted for through the Special Revenue and the Capital Project Funds. Federal Financial Assistance is recorded in the Special Revenue Fund.

**NOTE 12 EMPLOYEE'S RETIREMENT PLAN**

The Employee's Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS) is the administrator of a cost-sharing multiple-employer retirement system established by the Commonwealth of Puerto Rico. The ERS was created under the Act 447, approved on May 15, 1951, as amended, and became effective on January 1, 1952. ERS covers all regular employees of the Commonwealth of Puerto Rico and its instrumentalities and of certain municipalities and components units not covered by their own retirement systems.

Participation is mandatory except for members of the Legislature, Government Secretaries, Head of Agencies and Public Instrumentalities, Assistants to the Governor, the Comptroller of the Puerto Rico, Gubernatorial Board and Committee appointees and Experimental Service Station employees. ERS provides retirement, death and disability benefits. Disability retirement benefits are available to members for occupational and non-occupational disabilities. Retirement benefits depend upon age at retirement and number of years of credited service. Benefits vest after ten years of plan participation.

The **Municipality** adopted the requirements of GASBS No. 25 for all the career employees that are covered under the Commonwealth of Puerto Rico Employee's Retirement System, a multiple-employer public employee retirement system, established by State Laws.

Under the plan, the employees and employer portions are contributed, for which, the employee amount is withheld from salaries. Covered employees are required by Commonwealth statute to contribute 5.775% for the first \$550 of monthly salary plus 8.275% for the excess of this amount, or on the alternative, 8.275% of all salary. The **Municipality** contributes to the system 9.275% of the participating employee's salaries.

Law Number 305 of September 24, 1999, amends the Act Number 447 that establish a savings program. All employees active in the system as of December 31, 1999 may elect to transfer from defined contribution programs to the new savings program (a defined contribution plan). Employees in the savings program may now contribute from a minimum of 8.275% up to a maximum of 10% of their monthly salary, and will invested in an account which will either: (a) earn a fixed rate based on the two-year Constant Maturity Treasury Note or, (b) earn a rate equal to 75% of the return of the System's investment portfolio (net of management fees), or (c) earn a combination of both alternatives.

continue

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF FAJARDO, PUERTO RICO**

**NOTES TO THE BASIC FINANCIAL STATEMENTS**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

**NOTE 12 EMPLOYEE'S RETIREMENT PLAN (continuation)**

If at time of retirement accumulated benefits amount to \$10,000 or less may elect to receive a lump sum distribution up to the accumulated benefits. Under the new program the retirement age is reduced from 65 to 60 for those employees who joined the current plan on or after April 1, 1990.

The pension benefit for participants who retire with less than 30 years of service is computed at the rate of 1½% of their average compensation of each year of credit service for the remaining years. The System also provides for death and disability benefits and the assets of the System pertaining to the participant employees.

A variety of significant actuarial assumptions are used to determine the standard measure of the pension benefit obligation and these assumptions are summarized below:

- a. The present value of the future pension payments was computed by using a discount of 9%.
- b. Future pension payments reflect an assumption of a 6% salary increase.

All employees that do not elect to transfer for the new program and who at the time of employment are 55 years old or less are eligible to participate in the System. Pension benefits for participants with 30 years of service are as follows (See Table 13)

| YEARS OF SERVICE | PARTICIPANT'S AGE | PENSION BENEFITS  | TABLE 13 |
|------------------|-------------------|---|----------|
| 30 or more       | 55 or less        | 65% of the average of the three years of highest salary during the employee's service period.   |          |
| 30 or more       | 58 or more        | 75% of the average of the three years of highest salary during the employee's service period.   |          |
| 30 or more       | 65 or more        | 75% of the average of the three years of highest salary during the employee's service period (employees started working after April 1, 1990). |          |

The amount of the total pension benefit obligation is based on a standardized measurement established by GASBS No. 27, *Financial Reporting for Defined Benefit Pension Plans and Notes Disclosure for Defined Contributions Plans*. The standardized measurement is the actuarial present value of estimated defined pension benefits, adjusted for the effects of projected salary increases and step-rate benefits, estimated to be payable in the future as a result of employee services performed to date. The measure is intended to help users assess the System's funding status on a going-concern basis, assess progress made in accumulating sufficient assets to pay benefits when due, and make comparisons among other public retirement systems. The measure is independent of the actuarial funding method used to determine contributions to the plan.

The membership of retirees and beneficiaries currently receiving benefits and terminated employees entitled to benefits, but not yet receiving benefits, and active employees and the distribution of active employees between vested and non-vested is not readily available.

Contributions in 2004 and prior years were made based on percentages established by the law. Such percentage has not been based on actuarial studies, as required by accounting principles generally accepted in the United States of America. An actuarial compilation of the annual contribution applicable to the **Municipality** has not been prepared. Accordingly, the accounts by which the actual contributions differ from the required actuarial contributions are not known.

The total pension expenditures recorded in the category of administration for the Fiscal Year Ended June 30, 2004 was approximately \$370,505. All employees who at the time of employment are 55 years old or less are eligible to participate in the System. No benefit is payable if the participant receives a refund of his accumulated contributions.

The historical trend information regarding the accumulation of assets and pension benefit obligation in the ERS is not available. For the ten-year trend information, refer to the separately issued financial statements of the ERS as of and for the fiscal year ended June 30, 2004. The P.R. Retirement Plan Administration provides additional information of the ERS. They issue a publicly available financial report that includes financial statements and required supplementary information for ERS, as a component unit of the Commonwealth of Puerto Rico. That report may be obtained by writing to the Administration at PO Box 42003, Minillas Station, San Juan, PR 00940.

**NOTE 13 ESTIMATED MUNICIPAL SOLID WASTE LANDFILL CLOSING COSTS**

State and Federal laws and regulations require the **Municipality** to place a final cover on its landfill when closed and perform certain maintenance and monitoring function at the landfill site for thirty years after closure. In addition to the operating expenditures related to current activities of the landfill, an expense

provision and related liability are being recognized based on futures closure and post-closure care costs that will be incurred near or after the date the landfill no longer accepts waste. The **Municipality** has performed a study of the activities that need to be implemented at the **Municipality's** landfill to comply with applicable laws and regulations. As result of this study, the **Municipality** has decided to privatize the solid waste disposal service. The Municipality is entitled, under the agreement, to certain revenues resulting from the use of the landfill. As part of the agreement the contractor will assume the closure and post-closure costs during the next thirty years, releasing the **Municipality** of the estimated liability for future closure and post-closure care costs.

Accordingly, as of June 30, 2004 the **Municipality** has not made contributions to finance closure and post-closure care costs.

continue

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF FAJARDO, PUERTO RICO**

**NOTES TO THE BASIC FINANCIAL STATEMENTS**

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

**NOTE 14 CONTINGENCIES**

**A. CLAIMS AND JUDGMENTS**

The **Municipality** is, at present, a defendant in a number of legal matters that arise from alleged improper application of policies and negligence in the ordinary course of the **Municipality's** activities. The legal counsel of the **Municipality** has advised that at this stage in the proceedings of lawsuits he cannot offer an opinion as to the probable outcome.

In addition, the **Municipality** is a defendant or co-defendant in several legal proceedings, which are in discovery stage. Certain of these claims are covered by insurance. Legal counsel with the information currently available can not determine the final outcome of these claims, with the exception of one (1) lawsuit related to excessive use of force, to which the legal counsel has estimate a potential loss of \$5,000,000. These lawsuits are in appeal in other Courts. Accordingly, the financial statements include this provision in the Long-Term Liabilities because will be paid with future resources if the Courts decided in against of the **Municipality**.

**B. FEDERAL GRANTS**

In the normal course of operations, the **Municipality** receives grants from various Federal and State agencies. The grant programs are subject to audit by agents of the granting authority, the purpose of which is to ensure compliance with conditions precedent to the granting of funds. Any liability for reimbursement which may arise as the result of these audits is not believed to be material.

The **Municipality** is, at present, a defendant in a number of legal matters that arise from alleged improper application of policies and negligence in the ordinary course of the **Municipality's** activities. The legal counsels of the **Municipality** have advised that at this stage in the proceedings of lawsuits he cannot offer an opinion as to the probable outcome.

**NOTE 15 FUND BALANCE – NET ASSETS RESTATEMENTS**

Impact of the restatements on fund/balance net assets as previously reported is as follows:

| TABLE 14   | NET ASSETS          |
|--|---------------------|
| Net Assets, as Previously Reported,<br>June 30, 2003 ..... | \$38,503,233        |
| Adjustment to Account Payable.....                         | (58,297)            |
| Adjustment to Capital Assets .....                         | 1,314,225           |
| Net Assets, as Restated, June 30, 2003 .....               | <u>\$39,759,161</u> |

**NOTE 16 FUTURE ADOPTION OF ACCOUNTING PRONOUNCEMENT**

The Governmental Accounting Standards Board (GASB) issued GASBS No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*, which is effective for fiscal year beginning after December 15, 2004. Early application is encouraged. The **Municipality** has not adopted the requirement of this statement. Other two pronouncements are issued (GASBS Nos. 43 and 44), but do not apply to the **Municipality**.

**END OF NOTES**

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF FAJARDO, PUERTO RICO**

**REQUIRED SUPPLEMENTARY INFORMATION  
BUDGETARY COMPARISON SCHEDULE – GENERAL FUND**

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

|   | BUDGET AMOUNTS             |                            | ACTUAL AMOUNTS<br>(BUDGETARY BASIS)<br>(SEE NOTE A) | VARIANCE WITH<br>FINAL BUDGET<br>POSITIVE (NEGATIVE) |
|---|----------------------------|----------------------------|---|--|
|   | ORIGINAL                   | FINAL                      |   |  |
| <b>BUDGETARY FUND BALANCE, JULY 1, 2003.....</b>  | <b><u>\$12,347,055</u></b> | <b><u>\$12,347,055</u></b> | <b><u>\$12,347,055</u></b>                          | <b><u>\$ -</u></b>                                   |
| Resources (Inflows):                              |                            |                            |   |  |
| Property Taxes.....                               | 7,297,126                  | 7,297,126                  | 7,885,193   | 588,067  |
| Municipal License Taxes.....                      | 3,770,279                  | 3,770,279                  | 4,139,469   | 369,190  |
| License and Permits and Other Local Taxes.....    | 2,056,876                  | 2,056,876                  | 1,226,705   | (830,171)  |
| Intergovernmental Revenues.....                   | 2,546,861                  | 2,546,861                  | 2,733,155   | 186,294  |
| Rent.....   | 59,000                     | 59,000                     | 249,007   | 190,007  |
| Sanitation.....                                   | 200,000                    | 200,000                    | 2,031,389   | 1,831,389  |
| Interest.....                                     | 400,000                    | 400,000                    | 508,487   | 108,487  |
| Miscellaneous.....                                | <u>690,000</u>             | <u>690,000</u>             | <u>591,946</u>                                      | <u>(98,054)</u>                                      |
| Total Resources (Inflows).....                    | <u>17,020,142</u>          | <u>17,020,142</u>          | <u>19,365,851</u>                                   | <u>2,345,209</u>                                     |
| Amounts Available for Appropriation.....          | <u>29,367,197</u>          | <u>29,367,197</u>          | <u>31,712,406</u>                                   | <u>2,345,209</u>                                     |
| Charges to Appropriations (Outflows):             |                            |                            |   |  |
| General Government.....                           | 8,772,755                  | 10,783,204                 | 8,875,156   | 1,908,048  |
| Public Safety.....                                | 1,166,347                  | 1,161,424                  | 811,630   | 349,794  |
| Public Works.....                                 | 3,336,732                  | 3,993,661                  | 3,465,931   | 527,730  |
| Human Services and Welfare.....                   | 1,991,086                  | 1,991,460                  | 1,741,524   | 249,936  |
| Culture and Recreation.....                       | 1,078,770                  | 1,145,092                  | 940,997   | 204,095  |
| Sanitation.....                                   | 517,577                    | 2,918,685                  | 2,757,095   | 161,590  |
| Capital Outlays.....                              | -                          | 562,497                    | 395,285   | 167,212  |
| Transfer to Other Funds.....                      | <u>156,875</u>             | <u>6,946,587</u>           | <u>6,932,735</u>                                    | <u>13,852</u>  |
| Total Charges to Appropriations.....              | <u>17,020,142</u>          | <u>29,502,610</u>          | <u>25,920,353</u>                                   | <u>3,582,256</u>                                     |
| <b>BUDGETARY FUND BALANCE, JUNE 30, 2004.....</b> | <b><u>\$12,347,055</u></b> | <b><u>(\$ 135,413)</u></b> | <b><u>\$ 5,792,053</u></b>                          | <b><u>\$ 5,927,466</u></b>                           |

See accompanying Notes to Required Supplementary Information.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF FAJARDO, PUERTO RICO**

**BUDGETARY COMPARISON SCHEDULE – GENERAL FUND  
NOTE TO REQUIRED SUPPLEMENTARY INFORMATION**

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

**NOTE A Explanation of Differences between Budgetary Inflows and Outflows and GAAP Revenues and Expenditures**

|  | <u>GENERAL FUND</u> |
|--|---------------------|
| <b>Sources/Inflows of Resources:</b>   |                     |
| Actual Amounts (Budgetary Basis) "Available for Appropriation" from the Budgetary Comparison Schedule (See Page 28).....                     | \$31,712,406        |
| Difference – Budget to GAAP:   |                     |
| The Fund Balance at the Beginning of Year is a budgetary resource but is not a Current-Year Revenue for financial reporting purposes. ....   | (12,347,055)        |
| Prior-Year Revenue is not inflows of budgetary resources but are <i>revenues</i> for financial reporting purposes. ....                      | <u>20,406</u>       |
| Total Revenues as Reported on the Statement of Governmental Funds Revenues, Expenditures and Changes in Fund Balance (See Page 15) .....     | <u>\$19,385,757</u> |
| <b>Uses/Outflows of Resources:</b>   |                     |
| Actual Amounts (Budgetary Basis) "Total Charges to Appropriation" from the Budgetary Comparison Schedule (See Page 28).....                  | \$25,920,353        |
| Difference – Budget to GAAP:   |                     |
| Transfers to other funds are outflows of budgetary resources but are not expenditures For financial reporting purposes:                      |                     |
| Designated as special revenues funds.....  | (6,789,712)         |
| Payment of bonds.....  | (143,023)           |
| Prior-Year Encumbrances recorded as current year expenditures for GAAP basis.....  | 1,048,359           |
| Current Year Encumbrances recorded as expenditures for budgetary basis.....  | <u>(757,644)</u>    |
| Total Expenditures as Reported on the Statement of Governmental Funds Revenues, Expenditures and Changes in Fund Balance (See Page 15) ..... | <u>\$19,278,333</u> |

**NOTE B Explanation of Differences between Budgetary Fund Balance and GAAP Fund Balance**

|  |                     |
|--|---------------------|
| Budgetary Fund Balance, June 30, 2004 (See Page 28).....     | \$ 5,792,053        |
| Timing Differences:  |                     |
| Non-budgetary Items .....                                    | <u>20,406</u>       |
| Unrestricted Fund Balance, June 30, 2004 (See Page 13) ..... | <u>\$ 5,812,459</u> |

**END OF THIS SECTION**

**PART II**

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
AND REPORTS REQUIRED BY GOVERNMENT AUDITING  
STANDARDS AND OMB CIRCULAR A-133**

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF FAJARDO, PUERTO RICO  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

| FEDERAL GRANTOR / PASS THROUGH<br>GRANTOR / PROGRAM OR CLUSTER TITLE                | FEDERAL<br>CFDA<br>NUMBER | PASS-THROUGH<br>ENTITY IDENTIFYING<br>NUMBER | FEDERAL<br>EXPENDITURES   |
|---|---------------------------|--|---------------------------|
| U.S. Department of Agriculture:   |                           |  |                           |
| Pass-Through Administration of Families and Children:                               |                           |  |                           |
| Child and Adult Care Food Program (USDA) .....                                      | 10.558                    | N/AV   | <u>\$ 254,089</u>         |
| U.S. Department of Housing and Urban Development:                                   |                           |  |                           |
| Community Development Block Grant (CDBG).....                                       | 14.218                    |  | 1,100,795                 |
| Lower Income Housing Assistance Program –<br>Section 8 Moderate Rehabilitation..... | 14.856                    |  | 111,676                   |
| Section 8 Housing Choice Voucher Program .....                                      | 14.871                    |  | <u>303,508</u>            |
| Total U.S. Department of Housing and Urban Development ...                          |                           |  | <u>1,515,979</u>          |
| U.S. Department of Justice:   |                           |  |                           |
| Pass-Through Puerto Rico Department of Justice:                                     |                           |  |                           |
| Local Law Enforcement Block Grant .....   | 16.592                    | 2000-LB-BX-0726                              | <u>18,660</u>             |
| U.S. Federal Emergency Management Agency (FEMA):                                    |                           |  |                           |
| Pass-Through Office of the Governor:  |                           |  |                           |
| Emergency Management Performance Grant (EMPG).....                                  | 83.552                    | N/AV   | <u>3,490</u>              |
| U. S. Department of Health and Human Services:                                      |                           |  |                           |
| Pass-Through Administration for the Childhood Care<br>and Integral Development:     |                           |  |                           |
| Child Care and Development Block Grant.....   | 93.575                    | N/AV   | 168,097                   |
| Head Start Program.....   | 93.600                    | N/AV   | <u>4,105,796</u>          |
| Total U.S. Department of Health and Human Services.....                             |                           |  | <u>4,273,893</u>          |
| <b>TOTAL EXPENDITURES OF FEDERAL AWARDS .....</b>                                   |                           |  | <b><u>\$6,066,111</u></b> |

See accompanying Notes to Schedule of Expenditures of Federal Awards.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF FAJARDO, PUERTO RICO**

**NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

---

**NOTE 1 GENERAL**

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activities of the **Municipality of Fajardo, Puerto Rico**. The information in this Schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this Schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements. The **Municipality** reporting entity is defined in Note (1) (A) to the basic financial statements. All federal financial awards received directly from federal agency as well as federal financial awards passed-through other government agencies are included on the Schedule.

**NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

- A. The accompanying Schedule of Expenditures of Federal Awards is prepared from **Municipality's** accounting records and is not intended to present financial position or the results of operations.
- B. The **Municipality** in accordance with the terms records the financial transactions and conditions of the grants, which are consistent with accounting principles generally accepted in the United States of America.
- C. Expenditures are recognized in the accounting period in which the liability is incurred, if measurable or when actually paid, whichever occurs first.

**NOTE 3 FEDERAL CFDA NUMBER**

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

**NOTE 4 PASS-THROUGH GRANTOR'S NUMBER**

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

**NOTE 5 LOAN OUTSTANDING**

In determining the value of total noncash awards expended for loans and loan guarantees, the balances of loans from previous years must be included if the federal government imposes continuing compliance requirements. OMB Circular A-133 does not specifically define the term continuing compliance requirements. Therefore, it is a matter of judgment as to whether continuing compliance requirements are significant enough to require inclusion of prior-year loan or loan guarantee balances. The **Municipality** had the following outstanding balance at June 30, 2004: Section 108 Loans for the amount of \$1,300,000 included in the Long-Term Liabilities of the Statement of Net Assets, for which Grantor do not imposes continuing compliance requirements.

**NOTE 6 MAJOR PROGRAMS**

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

**END OF NOTES**



## **INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS REQUIRED BY GOVERNMENT AUDITING STANDARDS**

**To the Honorable Mayor and  
Members of the Municipal Legislature  
Municipality of Fajardo, Puerto Rico**

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of **Municipality of Fajardo, Puerto Rico (Municipality)**, as of and for the fiscal year ended June 30, 2004, which collectively comprise the **Municipality's** basic financial statements and has issued our report thereon dated December 23, 2004. 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 the **Municipality's** internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted certain matter involving the internal control over financial reporting and its operation that we consider to be reportable condition. Reportable condition involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect **Municipality's** ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Reportable condition is described in the accompanying Schedule of Findings and Questioned Costs as item 04-II-01.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe none of the reportable condition described above is a material weakness. We also noted no matters involving the internal control over financial reporting that we have reported to management of **Municipality** in a separate letter dated December 23, 2004.

### **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the **Municipality's** basic 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 *Government Auditing Standards*.

**INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS REQUIRED BY GOVERNMENT AUDITING STANDARDS**

Page 2

This report is intended solely for the information and use of the management, Office of the Commissioner of Municipal Affairs, 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. However, this report is a matter of public record and its distribution is not limited.

*CPA Diaz-Martinez PSC*

CPA DIAZ-MARTINEZ, PSC  
Certified Public Accountants & Consultants  
License Number 12, expires on December 1, 2007

Caguas, Puerto Rico  
December 23, 2004





**CPA DIAZ-MARTINEZ, PSC**  
*Certified Public Accountants & Consultants*

PO BOX 8369  
CAGUAS, P R 00726-8369

TEL (787) 746-0510  
FAX (787) 746-0525

**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM AND INTERNAL CONTROL OVER COMPLIANCE REQUIRED BY OMB CIRCULAR A-133**

**To the Honorable Mayor and  
Members of the Municipal Legislature  
Municipality of Fajardo, Puerto Rico**

**Compliance**

We have audited the compliance of the **Municipality of Fajardo, Puerto Rico (Municipality)**, with the types of compliance requirements described in the *U. S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the fiscal year ended June 30, 2004. The **Municipality's** major federal programs are identified in the summary of auditors' result 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 the **Municipality's** management. Our responsibility is to express an opinion on the **Municipality's** compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the **Municipality's** compliance with those requirements and performing such 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 on the **Municipality's** compliance with those requirements.

In our opinion, the **Municipality** complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the fiscal year ended June 30, 2004. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying Schedule of Findings and Questioned Costs as items 04-III-01 through 04-III-10.

**Internal Control Over Compliance**

The management of the **Municipality** is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered the **Municipality's** internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on the internal control over compliance in accordance with OMB Circular A-133.

**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM AND INTERNAL CONTROL OVER COMPLIANCE REQUIRED BY OMB CIRCULAR A-133**

Page 2

We noted certain matter involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect the **Municipality's** ability to administer a major federal program in accordance with applicable requirements of laws, regulations, contracts and grants. Reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs as items 04-III-01 through 04-III-05.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that none of the reportable conditions described above is a material weakness.

This report is intended solely for the information and use of the management, Office of the Commissioner of Municipal Affairs, 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. However, this report is a matter of public record and its distribution is not limited.

*CPA Diaz-Martinez PSC*

CPA DIAZ-MARTINEZ, PSC  
Certified Public Accountants & Consultants  
License Number 12, expires on December 1, 2007

Caguas, Puerto Rico  
December 23, 2004



**PART III**  
**FINDINGS AND QUESTIONED COSTS**

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF FAJARDO, PUERTO RICO**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**  
FOR THE FISCAL YEAR ENDED JUNE 30, 2004

SECTION I – SUMMARY OF AUDITORS' RESULTS

**Financial Statements**

Type of auditors' report issued:  Unqualified Opinion  Qualified Opinion  
 Adverse Opinion  Disclaimer Opinion

Internal control over financial reporting:

● Reportable condition(s) identified?  Yes  None Reported

● Material weakness(es) identified?  Yes  No

Noncompliance material to financial statements noted?  Yes  No

**Federal Awards**

Internal control over major programs:

● Reportable condition(s) identified?  Yes  None Reported

● Material weakness (es) identified?  Yes  No

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

Unqualified Opinion  Qualified Opinion  
 Adverse Opinion  Disclaimer Opinion

Any audit finding disclosed that are required to be reported in accordance with Section 510 (a) of Circular A-133?  Yes  No

Identification of Major Programs:

| CFDA Number | Name of Federal Program or Cluster       |
|-------------|--|
| 14.871      | Section 8 Housing Choice Voucher Program |
| 93.600      | Head Start Program                       |

Dollar threshold used to distinguish between Type A and Type B Programs: \$300,000

Auditee qualified as low-risk auditee?  Yes  No

continue

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF FAJARDO, PUERTO RICO**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

---

SECTION II – FINANCIAL STATEMENT FINDINGS

---

|                            |   |
|----------------------------|---|
| <b>FINDING</b>             | <b>NUMBER 04-II-01</b>  |
| <b>REQUIREMENT</b>         | <b>REPORTABLE CONDITION</b>   |
| <b>CONDITION</b>           | During our examination of <b>Municipality's</b> annual budget transactions we noticed that prior year allocations were made without the authorization of the Municipal Legislature. |
| <b>CRITERIA</b>            | Article 7.009, Chapter VII, of State Act Number 81 of August 30, 1991, states that the Municipal Legislature must authorize prior year allocations.                                 |
| <b>CAUSE</b>               | There is evidence that <b>Municipality</b> did not assure that prior year allocations were authorized by the Municipal Legislature before funds were transferred.                   |
| <b>EFFECT</b>              | <b>Municipality</b> did not maintain an adequate control of the accountability of budgetary transactions.   |
| <b>RECOMMENDATION</b>      | We recommend to the <b>Municipality</b> to obtain authorization from the Municipal Legislature for this type of transaction as required by Law.                                     |
| <b>MANAGEMENT RESPONSE</b> | Pending the Corrective Action Plan.   |

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF FAJARDO, PUERTO RICO**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

---

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

---

|                            |  |
|----------------------------|--|
| <b>FINDING</b>             | <b>NUMBER 04-III-01</b>  |
| <b>FEDERAL PROGRAM</b>     | <b>HEAD START PROGRAM (CFDA 93.600)<br/>U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES<br/>PASS-THROUGH STATE – ADMINISTRATION FOR THE CHILDHOOD CARE AND<br/>INTEGRAL DEVELOPMENT</b>   |
| <b>REQUIREMENT</b>         | <b>COMPLIANCE AND INTERNAL CONTROL</b>   |
| <b>NONCOMPLIANCE</b>       | <b>DAVIS-BACON ACT</b>   |
| <b>CONDITION</b>           | <b>Municipality</b> did not develop a monitoring system to ensure that contractors paid prevailing wages according to the Department of Labor's requirements.  |
| <b>CRITERIA</b>            | Davis-Bacon Act, as amended (40 USC 276a – 276a-7), which establishes that the <b>Municipality</b> must interview employees at the beginning, at a middle stage and at the end of the project.   |
| <b>CAUSE</b>               | <b>Municipality</b> did not develop an adequate monitoring system to ensure contractors and subcontractors comply with the Act.  |
| <b>EFFECT</b>              | <b>Municipality</b> is not in compliance with Davis-Bacon Act (40 USC 276a – 276a-7).  |
| <b>RECOMMENDATION</b>      | We recommend management to develop a monitoring system that includes obtaining prevailing wage rates from the Department of Labor, the assignment of specific responsibility to a municipal employee to monitor contractors and subcontractors for compliance, obtaining contractor's payrolls and performing interviews to contractor's and subcontractor's laborers according to the established requirements. |
| <b>QUESTIONED COSTS</b>    | None   |
| <b>MANAGEMENT RESPONSE</b> | Pending the Corrective Action Plan.  |

---

continue

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF FAJARDO, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

---

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

---

|                            |   |
|----------------------------|---|
| <b>FINDING</b>             | <b>NUMBER 04-III-02</b>   |
| <b>FEDERAL PROGRAM</b>     | <b>SECTION 8 HOUSING CHOICE VOUCHER PROGRAM (CFDA NO. 14.871)<br/>U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT</b>  |
| <b>REQUIREMENT</b>         | <b>COMPLIANCE AND INTERNAL CONTROL</b>  |
| <b>NONCOMPLIANCE</b>       | <b>ELIGIBILITY TEST</b>   |
| <b>CONDITION</b>           | During our Participant's Files Test we noticed that three (3) participant's files did not have evidence of the HUD-approved release and consent forms submitted by the family as required by federal regulation. <b>This is a prior year audit finding.</b>   |
| <b>CRITERIA</b>            | Code of Federal Regulations, 24 CFR, Subpart F, Section 5.617 (b) states that as a condition of admission to, or continued occupancy of, any assisted unit, the <b>Municipality</b> shall require the family head and other such family members as it designated, on 24 CFR, Subpart B, Section 5.230 (a), to execute a HUD-approved release and consent form authorizing any depository or private source of income, or any federal, state or local agency, to furnish or release to the <b>Municipality</b> and to HUD such information as the <b>Municipality</b> and HUD determines to be necessary. It is also stated on 24 CFR, Subpart K, Section 982.516 (g). |
| <b>CAUSE</b>               | <b>Municipality</b> did not have consent forms that authorize the collection of income information from State Wages Information Collection Agencies (SWICA), wages, net earnings from self-employment, payments of retirement income, and unearned income as referenced at 26 U.S.C. 6103. In addition the consent form may authorize the collection of other information from applicants and participants to determine eligibility or level of benefits.   |
| <b>EFFECT</b>              | <b>Municipality</b> is not in compliance with 24 CFR, Subpart F, Section 5.617(b); Subpart B, Section 5.230(a); and Subpart K, Section 982.516 (g).   |
| <b>RECOMMENDATION</b>      | We recommend management to require each member of the family of an assistance applicant or participant who is at least 18 years of age, and each family head and spouse regardless of age, to sign a release form.  |
| <b>QUESTIONED COSTS</b>    | None  |
| <b>MANAGEMENT RESPONSE</b> | Pending the Corrective Action Plan.   |

---

continue

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF FAJARDO, PUERTO RICO**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

---

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

---

|                            |   |
|----------------------------|---|
| <b>FINDING</b>             | <b>NUMBER 04-III-03</b>   |
| <b>FEDERAL PROGRAM</b>     | <b>SECTION 8 HOUSING CHOICE VOUCHER PROGRAM (CFDA NO. 14.871)<br/>U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT</b>  |
| <b>REQUIREMENT</b>         | <b>COMPLIANCE AND INTERNAL CONTROL</b>  |
| <b>NONCOMPLIANCE</b>       | <b>ELIGIBILITY TEST</b>   |
| <b>CONDITION</b>           | During our Participant's Files Test we noticed that one (1) tenant's file, did not contain evidence of the unit's property deeds.   |
| <b>CRITERIA</b>            | Code of Federal Regulations, 24 CFR, Subpart G, Section 982.306 (d) states that the <b>Municipality</b> must not approve a unit if the owner is the parent, child, grandparent, grandchild, sister, or brother of any member of the family. |
| <b>CAUSE</b>               | <b>Municipality</b> did not implement procedures to guarantee that the family does not own or has any interest in the unit.   |
| <b>EFFECT</b>              | <b>Municipality</b> is not in compliance with 24 CFR, Subpart G, Section 982.306 (d).   |
| <b>RECOMMENDATION</b>      | We recommend management to implement the necessary procedures in order to comply with program regulations.  |
| <b>QUESTIONED COSTS</b>    | None  |
| <b>MANAGEMENT RESPONSE</b> | Pending the Corrective Action Plan.   |

---

continue

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF FAJARDO, PUERTO RICO**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

---

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

---

|                            |   |
|----------------------------|---|
| <b>FINDING</b>             | <b>NUMBER 04-III-04</b>   |
| <b>FEDERAL PROGRAM</b>     | <b>HEAD START PROGRAM (CFDA 93.600)<br/>U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES<br/>PASS-THROUGH STATE – ADMINISTRATION FOR THE CHILDHOOD CARE AND<br/>INTEGRAL DEVELOPMENT</b>  |
| <b>REQUIREMENT</b>         | <b>COMPLIANCE AND INTERNAL CONTROL</b>  |
| <b>NONCOMPLIANCE</b>       | <b>PROCUREMENT STANDARDS</b>  |
| <b>CONDITION</b>           | The model for construction contracts over \$10,000.00 used by the <b>Municipality</b> did not contain the clauses detailed for compliance with the provisions for Davis Bacon, contract Work hours and safety standards, granting access to GAO or other federal agency to books, documents, etc., and Energy Policy and Conservation Act as required by the program's regulation. <b>This is a prior year audit finding.</b> |
| <b>CRITERIA</b>            | Code of Federal Regulations, 45 CFR, Subpart C, Section 92.36 (h) (3) (i) (1-13) states that subgrantee's contracts must contain provisions in paragraph (i) of this Section. Federal agencies are permitted to require changes, remedies, changed conditions, access and records retention, suspension of work, and other clauses approved by the Office of Procurement Policy.  |
| <b>CAUSE</b>               | Federal Program and Finance Departments did not maintain appropriate procurement standard procedures, in order to assure that contractors comply with some requirements.  |
| <b>EFFECT</b>              | <b>Municipality</b> is not in compliance with 45 CFR, Subpart C, Section 92.36 (3) (i) (1-13) of OMB Common Rules.  |
| <b>RECOMMENDATION</b>      | We recommend management to update the contract model according with the federal requirements.   |
| <b>QUESTIONED COSTS</b>    | None  |
| <b>MANAGEMENT RESPONSE</b> | Pending the Corrective Action Plan.   |

---

continue

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF FAJARDO, PUERTO RICO**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

---

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

---

|                            |   |
|----------------------------|---|
| <b>FINDING</b>             | <b>NUMBER 04-III-05</b>   |
| <b>FEDERAL PROGRAM</b>     | <b>SECTION 8 HOUSING CHOICE VOUCHER PROGRAM (CFDA NO. 14.871)<br/>U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT</b>  |
| <b>REQUIREMENT</b>         | <b>COMPLIANCE AND INTERNAL CONTROL</b>  |
| <b>NONCOMPLIANCE</b>       | <b>REPORTING</b>  |
| <b>CONDITION</b>           | During our Participant's Files Test we noticed that in one (1) tenant's file, the Family Reports (HUD-50058) was not updated annually.  |
| <b>CRITERIA</b>            | Code of Federal Regulations, 24 CFR, Subpart D, Section 982.516 (a), states that the <b>Municipality</b> must conduct a reexamination of family income and composition at least annually. |
| <b>CAUSE</b>               | <b>Municipality</b> did not implement procedures that guarantee the timeliness of the Family Report form HUD 50058.   |
| <b>EFFECT</b>              | <b>Municipality</b> is not in compliance with 24 CFR, Subpart D, Section 982.516 (a).   |
| <b>RECOMMENDATION</b>      | We recommend management to implement adequate procedures to prepare the Family Reports adequately.  |
| <b>QUESTIONED COSTS</b>    | None  |
| <b>MANAGEMENT RESPONSE</b> | Pending the Corrective Action Plan.   |

---

continue

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF FAJARDO, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

---

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

---

|                            |  |
|----------------------------|--|
| <b>FINDING</b>             | <b>NUMBER 04-III-06</b>  |
| <b>FEDERAL PROGRAM</b>     | <b>HEAD START PROGRAM (CFDA 93.600)<br/>U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES<br/>PASS-THROUGH STATE – ADMINISTRATION FOR THE CHILDHOOD CARE AND<br/>INTEGRAL DEVELOPMENT</b>   |
| <b>REQUIREMENT</b>         | <b>COMPLIANCE</b>  |
| <b>NONCOMPLIANCE</b>       | <b>SPECIAL TESTS AND PROVISIONS</b>  |
| <b>CONDITION</b>           | The Head Start Program did not obtain, for various Centers, the required licenses issued by Puerto Rico Administration for Permits and Regulations. <b>This is a prior year audit finding.</b>   |
| <b>CRITERIA</b>            | Code of Federal Regulations, 45 CFR, Part 1306, Subpart C, Section 1306.30 (c) and OMB Circular A-133 - Compliance Supplement, state that the facilities used by Head Start grantees must comply with applicable State and local requirements concerning license. The State requirement for the operation of Head Start center include a license granted by the Puerto Rico Fire Department, Health Department and Administration of Families and Children of the Puerto Rico Family Department. |
| <b>CAUSE</b>               | The Head Start Centers failed to obtain or renew the required license issued by the Puerto Rico Administration for Permits and Regulations.  |
| <b>EFFECT</b>              | <b>Municipality</b> is not in compliance with 45 CFR, Part 1306, Subpart C, Section 1306.30 (c) and OMB Circular A-133 – Compliance Supplement.  |
| <b>RECOMMENDATION</b>      | We recommend management to perform the required improvements and obtain the required licenses from the state agencies.   |
| <b>QUESTIONED COSTS</b>    | None   |
| <b>MANAGEMENT RESPONSE</b> | Pending the Corrective Action Plan.  |

---

continue

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF FAJARDO, PUERTO RICO**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

---

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

---

|                            |  |
|----------------------------|--|
| <b>FINDING</b>             | <b>NUMBER 04-III-07</b>  |
| <b>FEDERAL PROGRAM</b>     | <b>SECTION 8 HOUSING CHOICE VOUCHER PROGRAM (CFDA NO. 14.871)<br/>U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT</b>   |
| <b>REQUIREMENT</b>         | <b>COMPLIANCE</b>  |
| <b>NONCOMPLIANCE</b>       | <b>SPECIAL TESTS AND PROVISIONS</b>  |
| <b>CONDITION</b>           | During our waiting list test, we noticed that the order of applicants in the waiting list was based on the family unit size for which the family qualifies under the PHA occupancy policy. <b>This is a prior year audit finding.</b>                        |
| <b>CRITERIA</b>            | Code of Federal Regulations, 24 CFR, Subpart E, Section 982.204 (d) (1) states that the order of administration from the waiting list may not be based on family size, or on family unit size for which the family qualifies under the PHA occupancy policy. |
| <b>CAUSE</b>               | <b>Municipality</b> did not administrate the waiting list in accordance to the federal regulation and does not guarantee the correct selection of the applicants.  |
| <b>EFFECT</b>              | <b>Municipality</b> is not in compliance with 24 CFR, Subpart E, Section 982.204 (d) (1).  |
| <b>RECOMMENDATION</b>      | We recommend management to revise the waiting list and administrate it according to regulation.  |
| <b>QUESTIONED COSTS</b>    | None   |
| <b>MANAGEMENT RESPONSE</b> | Pending the Corrective Action Plan.  |

---

continue

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF FAJARDO, PUERTO RICO**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

---

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

---

|                            |   |
|----------------------------|---|
| <b>FINDING</b>             | <b>NUMBER 04-III-08</b>   |
| <b>FEDERAL PROGRAM</b>     | <b>SECTION 8 HOUSING CHOICE VOUCHER PROGRAM (CFDA NO. 14.871)<br/>U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT</b>  |
| <b>REQUIREMENT</b>         | <b>COMPLIANCE</b>   |
| <b>NONCOMPLIANCE</b>       | <b>SPECIAL TESTS AND PROVISIONS</b>   |
| <b>CONDITION</b>           | During our Participant's Files Test we noticed that three (3) participant's files did not have a unit inspection report.  |
| <b>CRITERIA</b>            | Code of Federal Regulations, 24 CFR, Subpart D, Section 982.158 (a) states that the <b>Municipality</b> must maintain complete and accurate accounts and other records for the program in accordance with HUD requirements. Also 24 CFR, Subpart D, Section 982.158 (d) states that the <b>Municipality</b> must prepare unit inspection reports. |
| <b>CAUSE</b>               | <b>Municipality</b> did not prepare an inspection report in order to document the required annual Housing Quality Standards Inspections and quality control re-inspections.   |
| <b>EFFECT</b>              | <b>Municipality</b> is not in compliance with 24 CFR, Subpart D, Section 982.158 (a) and Section 982.158 (d).   |
| <b>RECOMMENDATION</b>      | We recommend management to document the Housing Quality Standards inspections as established under federal regulation.  |
| <b>QUESTIONED COSTS</b>    | None  |
| <b>MANAGEMENT RESPONSE</b> | Pending the Corrective Action Plan.   |

---

continue

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF FAJARDO, PUERTO RICO**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

---

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

---

|                            |   |
|----------------------------|---|
| <b>FINDING</b>             | <b>NUMBER 04-III-09</b>   |
| <b>FEDERAL PROGRAM</b>     | <b>SECTION 8 HOUSING CHOICE VOUCHER PROGRAM (CFDA NO. 14.871)<br/>U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT</b>  |
| <b>REQUIREMENT</b>         | <b>COMPLIANCE</b>   |
| <b>NONCOMPLIANCE</b>       | <b>SPECIAL TESTS AND PROVISIONS</b>   |
| <b>CONDITION</b>           | During our verification of units which failed Housing Quality Standards inspections, we noticed that the <b>Municipality</b> does not establish the correction period in the document submitted to the person responsible for the repairs in three (3) participant's files. Also, there was no unit inspection report or other verification documenting that any PHA required repairs were completed in five (5) participant's files. |
| <b>CRITERIA</b>            | Code of Federal Regulations, 24 CFR, Subpart I, Section 982.404 states that the <b>Municipality</b> must not make any housing assistance payments for a dwelling unit that fails to meet the Housing Quality Standards, unless the responsible person (owner and/or participant) corrects the defect within the period specified by the <b>Municipality</b> and the <b>Municipality</b> verifies the correction.                      |
| <b>CAUSE</b>               | <b>Municipality</b> does not specify the time frames for the correction of the deficiencies, also the entity does not verify the correction of the Housing Quality Standards deficiencies; therefore, the <b>Municipality</b> failed to take prompt and vigorous action to enforce the owner and/or participant's obligations.  |
| <b>EFFECT</b>              | <b>Municipality</b> is not in compliance with 24 CFR, Subpart I, Section 982.404.   |
| <b>RECOMMENDATION</b>      | We recommend management to implement internal control procedures to establish a correction time period to assure that the unit's Housing Quality Standards deficiencies were corrected during the specified period established by the federal regulation.   |
| <b>QUESTIONED COSTS</b>    | None  |
| <b>MANAGEMENT RESPONSE</b> | Pending the Corrective Action Plan.   |

---

continue

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF FAJARDO, PUERTO RICO  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

---

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

---

|                            |  |
|----------------------------|--|
| <b>FINDING</b>             | <b>NUMBER 04-III-10</b>  |
| <b>FEDERAL PROGRAM</b>     | <b>SECTION 8 HOUSING CHOICE VOUCHER PROGRAM (CFDA NO. 14.871)<br/>U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT</b>   |
| <b>REQUIREMENT</b>         | <b>COMPLIANCE</b>  |
| <b>NONCOMPLIANCE</b>       | <b>SPECIAL TESTS AND PROVISIONS</b>  |
| <b>CONDITION</b>           | During our Participant's Files Test we noticed that seventeen (17) tenant's files did not have any evidence of the determination that the rent paid to the owner was reasonable, initially and during the contract's term, in accordance with the <b>Municipality's</b> administrative plan.         |
| <b>CRITERIA</b>            | Code of Federal Regulations, 24 CFR, Subpart D, Section 982.158 (f) (7) states that the <b>Municipality</b> must maintain records to document the basis for the <b>Municipality's</b> determination that the rent to owner is a reasonable rent (initially and during the term of the HAP contract). |
| <b>CAUSE</b>               | <b>Municipality</b> did not implement procedures in order to document the reasonableness of the rent paid to the owner.  |
| <b>EFFECT</b>              | <b>Municipality</b> is not in compliance with 24 CFR, Subpart D, Section 982.158 (f) (7).  |
| <b>RECOMMENDATION</b>      | We recommend management to document the basis for the determination that the rent to owner is a reasonable rent (initially and during the term of the HAP contract).   |
| <b>QUESTIONED COSTS</b>    | None   |
| <b>MANAGEMENT RESPONSE</b> | Pending the Corrective Action Plan.  |

**END OF SCHEDULE**

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF FAJARDO, PUERTO RICO**

**SCHEDULE OF PRIOR AUDITS' FINDINGS AND QUESTIONED COSTS**

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

**(1) Audit Findings that have been Fully Corrected:**

NONE

**(2) Audit Findings not Corrected or Partially Corrected:**

**FISCAL YEAR 2003**

**Finding Number**      03-III-01      **Activities Allowed and Unallowed**  
Municipality made unallowed loans between funds.

**CFDA Number**      14.871

**Questioned Cost**      None

**Auditee Comments**      The restitution of funds is pending to the results of a revision of the debt.

**Finding Number**      03-III-02      **Eligibility**  
HUD- approved release and consent forms submitted by the family.

**CFDA Number**      14.871

**Questioned Cost**      None

**Auditee Comments**      All required release and consent form were obtained in order to comply with the federal regulation.

**Finding Number**      03-III-03      **Procurement Standards**  
Missing contracts' clauses.

**CFDA Number**      93.600

**Questioned Cost**      None

**Auditee Comments**      Contracts granted during the fiscal year 2004-2005 contained all the clauses required by federal regulation.

**Finding Number**      03-III-04      **Special Test and Provisions**  
The waiting list did not contain the required information to assure compliance with selection policies.

**CFDA Number**      14.871

**Questioned Cost**      None

**Auditee Comments**      The lists were integrated into one in order to comply with federal requirements.

**Finding Number**      03-III-05      **Special Test and Provisions**  
Required licenses from the state agencies.

**CFDA Number**      93.600

**Questioned Cost**      None

**Auditee Comments**      All licenses were obtained in order to comply with federal regulation.

continue

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF FAJARDO, PUERTO RICO**

**SCHEDULE OF PRIOR AUDITS' FINDINGS AND QUESTIONED COSTS**

FOR THE FISCALYEAR ENDED JUNE 30, 2004

---

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

NONE

(4) Audit findings is no longer valid:

NONE

**END OF SCHEDULE**