

**OFICINA DEL COMISIONADO DE ASUNTOS MUNICIPALES**  
**AREA DE ASESORAMIENTO, REGLAMENTACION E INTERVENCION FISCAL**  
**AREA DE ARCHIVO DIGITAL**

**MUNICIPIO DE FAJARDO**  
**AUDITORIA 2005-2006**  
**30 DE JUNIO DE 2006**

OFICINA DEL COMISIONADO  
DE ASUNTOS MUNICIPALES

2007 JAN 23 AM 10: 50

RECIBIDO  
UNIDAD DE CORREO

*Carta No. 7. 1090*

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

**BASIC FINANCIAL STATEMENTS**

FISCAL YEAR ENDED JUNE 30, 2006

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

*cec  
cm*

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF FAJARDO, PUERTO RICO  
**BASIC FINANCIAL STATEMENTS**  
FISCAL YEAR ENDED JUNE 30, 2006  
(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 .....	17-28
Required Supplementary Information:	
Budgetary Comparison Schedule – General Funds .....	29
Note to Required Supplementary Information .....	30
<b>PART II – Schedule of Expenditures of Federal Awards and Reports Required by Government Auditing Standards and OMB Circular A-133:</b>	
Schedule of Expenditures of Federal Awards .....	32
Notes to Schedule of Expenditures of Federal Awards .....	33
Independent Auditors' Report on Internal Control over Financial Reporting and on Compliance and Other Matters Required by Government Auditing Standards .....	34-35
Independent Auditors' Report on Compliance with Requirements Applicable to Each Major Program and Internal Control Over Compliance Required by OMB Circular A-133 .....	36-37
<b>PART III – Findings and Questioned Costs:</b>	
Schedule of Findings and Questioned Costs .....	38-44
Schedule of Prior Audits' Findings and Questioned Costs .....	45-46

**PART I**  
**FINANCIAL**



201 Gautier Benitez Ave.  
Consolidated Mall C-31  
PO Box 8369  
Caguas, PR 00726-8369  
Phones: (787) 746-0510 / 746-1185 / 746-1370  
Fax: (787) 746-0525  
cpadiazmartinez@hotmail.com

## 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, 2006, 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, 2006, 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 11, 2006 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 11, 2006



## MANAGEMENT DISCUSSION AND ANALYSIS

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, 2006. 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 \$56,573,957 (*net assets*). Of this amount, \$3,842,652 (*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, 2006 are \$56,573,957 as compared to \$52,482,808 for the year ended June 30, 2005, for 3.0% of increase.
- ↓ As of the close of the current fiscal year, the Municipality's governmental funds reported combined ending fund balances of \$27,610,000, an increase of \$232,562 in comparison with the prior year. Approximately 11 percent of this total amount, \$3,139,332 is *available for spending* at the government's discretion (*unreserved fund balance*).
- ↓ The investment in capital assets for this year is \$31,215,023.
- ↓ The Municipality's total long term debt decreased by \$1,871,424 (6 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).

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*).

MUNICIPALITY OF FAJARDO, PUERTO RICO  
MANAGEMENT DISCUSSION AND ANALYSIS  
FOR THE YEAR ENDED JUNE 30, 2006

---

**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.

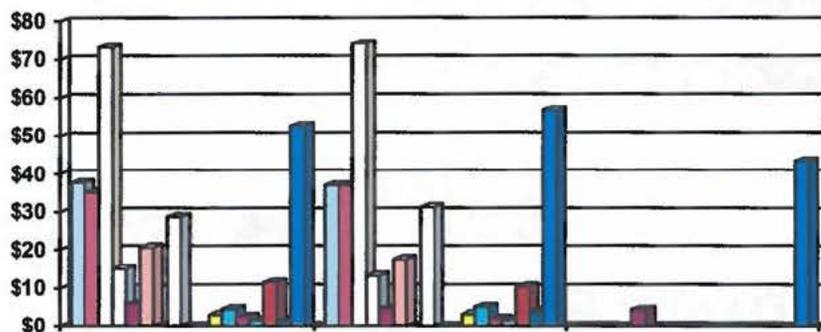
MUNICIPALITY OF FAJARDO, PUERTO RICO  
 MANAGEMENT DISCUSSION AND ANALYSIS  
 FOR THE YEAR ENDED JUNE 30, 2006

**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 \$56,573,957 at the close of the most recent fiscal year. (Table 1)

Table 1  
 NET ASSETS  
 GOVERNMENTAL ACTIVITIES

	2006	2005
Current and other assets	\$37,128,200	\$37,767,427
Capital assets	36,965,473	35,300,606
<b>Total assets</b>	<b>74,093,673</b>	<b>73,068,033</b>
Long Term Debt outstanding	13,159,314	15,030,738
Other liabilities	4,360,402	5,529,770
<b>Total liabilities</b>	<b>17,519,716</b>	<b>20,560,508</b>
<b>Net assets:</b>		
Invested in capital assets, net of related debt	31,215,023	28,747,621
<b>Restricted for:</b>		
Head Start	2,934,872	2,844,411
Debt Services	4,866,789	4,290,618
Community Development Block Grant Program	1,872,622	2,409,772
Capital Projects	1,511,460	1,396,763
Other purposes	10,330,539	11,415,509
Unrestricted	3,842,652	1,402,831
<b>Net Assets</b>	<b>\$56,573,957</b>	<b>\$52,507,525</b>



□ Current and other assets	■ Capital assets
□ Total assets	□ Long Term Debt outstanding
■ Other liabilities	■ Total liabilities
■ Net assets:	□ Invested in capital assets,
■ net of related debt	Restricted for:
■ Head Start	■ Debt Services
■ Community Development Block Grant Program	■ Capital Project
■ Other purposes	■ Unrestricted
■ Net Assets	

MUNICIPALITY OF FAJARDO, PUERTO RICO  
 MANAGEMENT DISCUSSION AND ANALYSIS  
 FOR THE YEAR ENDED JUNE 30, 2006

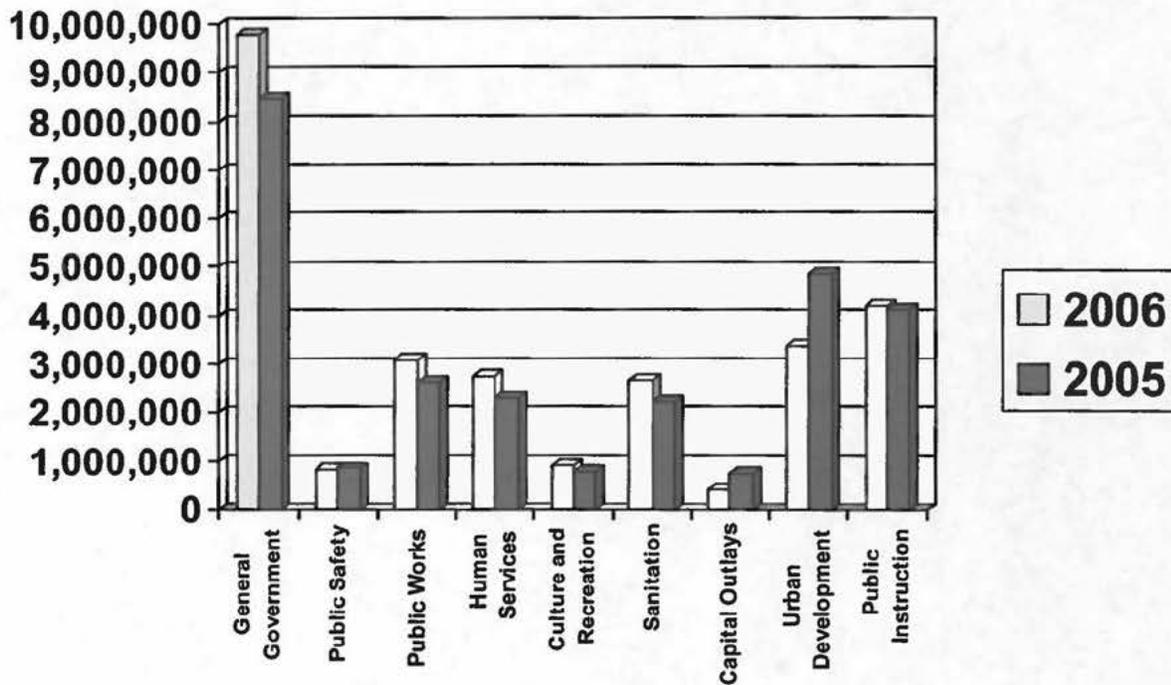
Net assets of the Municipality's governmental activities increase by \$4,066,432. Unrestricted net assets, the part of net assets that can be used to finance operations without constraints established by debt covenants, enabling legislation or other legal requirements, changed from \$1,402,831 at June 30, 2005 to \$3,842,652 at June 30, 2006. The major cause of this increase 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, 2006, the Municipality's governmental funds reported combined fund balances of \$27,610,001. This represents an increase of \$232,562 over last year's ending balances.

**Governmental Funds Expenses**

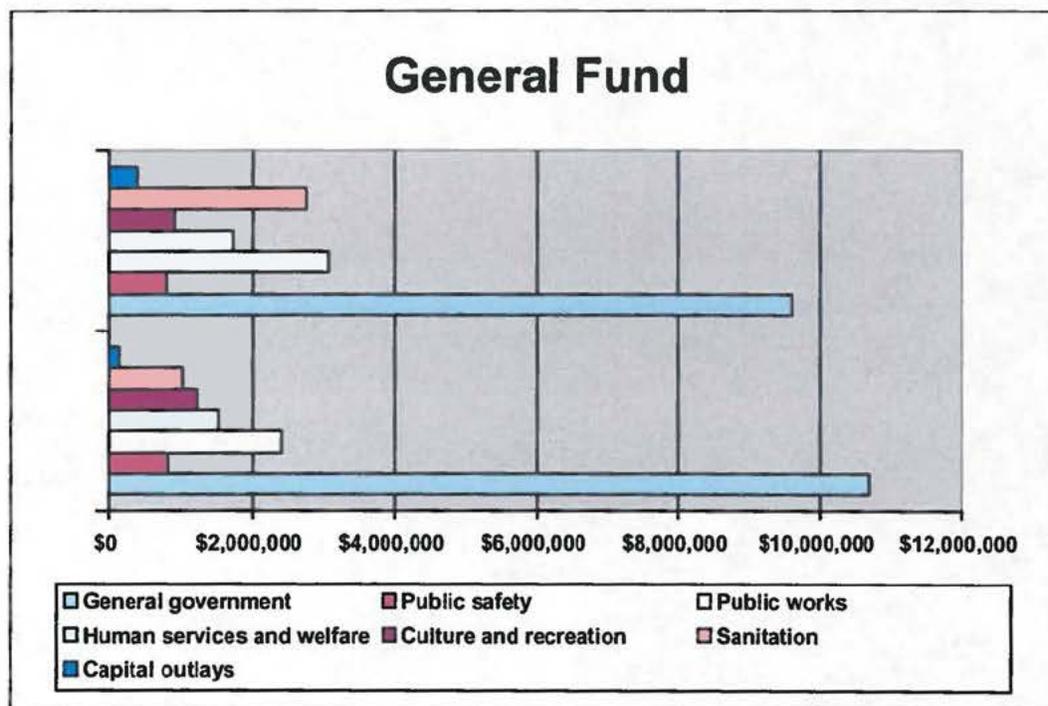


MUNICIPALITY OF FAJARDO, PUERTO RICO  
 MANAGEMENT DISCUSSION AND ANALYSIS  
 FOR THE YEAR ENDED JUNE 30, 2006

Revenues for the Municipality's general fund decrease by 2% while total expenses decrease 7%. The decrease in the general government expenditures during the fiscal year ended June 30, 2006 was substantially related to the following: (Table 2)

Table 2  
 Governmental Activities  
 General Fund  
 Total cost of services

	2006	2005
General government	8,130,518	\$10,702,316
Public safety	823,626	824,110
Public works	2,548,562	2,405,237
Human services and welfare	1,294,794	1,517,292
Culture and recreation	1,137,695	1,229,301
Sanitation	1,365,336	1,021,584
Capital outlays	122,192	138,456
<b>Totals</b>	<b>15,422,723</b>	<b>17,838,296</b>



MUNICIPALITY OF FAJARDO, PUERTO RICO  
 MANAGEMENT DISCUSSION AND ANALYSIS  
 FOR THE YEAR ENDED JUNE 30, 2006

Taxes continue to be the largest source of revenue in the general fund and represent approximately a 68% of total general fund revenues. The largest element of taxes is property taxes, it represent 61% of total tax revenues and 42% of total general revenues. This compares with 41% in the prior fiscal year ended June 30, 2005.

The debt service fund has a total fund balance of \$3,976,789, all of which is reserved for the payment of debt services. The net increase in fund balance during the current year was \$511,170.

**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, 2006, the Municipality of Fajardo had \$36,965,473 invested in capital assets, including buildings, parks, roads, bridges, and equipment. This amount represents a net increase of \$1,664,867 over last year.

Table 3  
 Capital Assets at Year End

	2006	2005
Land	7,820,439	7,795,987
Others	1,917,466	765,615
Building	24,205,767	23,574,187
Infrastructure	1,511,214	1,327,851
Equipment	1,126,242	1,456,572
Motor vehicles	384,345	380,394
<b>Total</b>	<b>\$36,965,473</b>	<b>\$35,300,606</b>

**Long Term Debt**

At June 30, 2006 the Municipality had total bonded debt outstanding of \$9,754,000 versus \$11,499,000 last year, an increase of \$1,745,000. 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.

### **ECONOMIC FACTORS AND NEXT YEAR BUDGET**

The Municipality's elected and appointed officials when setting the fiscal year 2007 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 2007 are \$28.9 million, an increase of \$2.0 millions over the original 2006 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 government 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, 2006

	<u>GOVERNMENTAL ACTIVITIES</u>
<b>ASSETS:</b>	
Cash and Investments.....	\$21,603,850
Cash with Fiscal Agent.....	10,537,736
Receivables (net):	
Federal Grants.....	4,523,163
Due from Government.....	307,806
Others.....	<u>109,457</u>
Deferred Charges.....	46,188
Capital Assets (Notes 1 & 8):	
Land, Improvements, and Construction in Progress.....	9,737,905
Other Capital Assets, [Net of Depreciation].....	<u>27,227,568</u>
Total Capital Assets.....	<u>36,965,473</u>
<b>TOTAL ASSETS.....</b>	<b><u>74,093,673</u></b>
<b>LIABILITIES:</b>	
Accounts Payable and Accrued Expenses.....	362,834
Accrued Interest.....	284,376
Christmas Bonus.....	337,334
Deferred Revenues.....	3,375,858
Long-Term Liabilities (Note 9):	
Due within One Year.....	2,593,121
Due in More than One Year.....	<u>10,566,193</u>
<b>Total Liabilities.....</b>	<b><u>17,519,716</u></b>
<b>NET ASSETS</b>	
Invested in Capital Assets, Net of Related Debt.....	31,215,023
Restricted for:	
Head Start Program.....	2,934,872
Debt Service.....	4,866,789
Community Development Projects.....	1,872,622
Capital Projects.....	1,511,460
Other Purposes.....	10,330,539
Unrestricted.....	<u>3,842,652</u>
<b>TOTAL NET ASSETS.....</b>	<b><u>\$56,573,957</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, 2006

FUNCTIONS/PROGRAMS	EXPENSES	PROGRAM REVENUES			NET (EXPENSE) REVENUE
		CHARGES FOR SERVICES	OPERATING GRANTS AND CONTRIBUTIONS	CAPITAL GRANTS AND CONTRIBUTIONS	
<b>Governmental Activities:</b>					
Mayor and Municipal Legislature.....	\$ 2,086,335	\$ -	\$ -	\$ -	(\$ 2,086,335)
General Government.....	8,494,970	-	1,130,352	-	(7,364,618)
Public Safety.....	823,651	-	4,282	-	(819,369)
Public Works.....	2,594,194	-	-	-	(2,594,194)
Health and Sanitation.....	1,365,336	-	-	-	(1,365,336)
Culture and Recreation.....	515,299	-	-	-	(515,299)
Human Services and Welfare.....	3,158,303	-	1,592,991	-	(1,565,312)
Urban Development.....	1,068,033	-	214,884	914,231	61,082
Education.....	3,760,030	-	3,794,444	-	34,414
Interest on Long-Term Debt.....	<u>720,359</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(720,359)</u>
<b>Total Governmental Activities.....</b>	<b><u>\$24,586,510</u></b>	<b><u>\$ -</u></b>	<b><u>\$ 6,736,953</u></b>	<b><u>\$ 914,231</u></b>	<b><u>(16,935,326)</u></b>
<b>General Revenues:</b>					
Taxes:					
Property Taxes, levied for General Purposes.....					8,037,360
Property Taxes, levied for Debt Service.....					2,125,700
Volume of Business Taxes.....					4,899,753 x
Construction Taxes.....					1,378,390
Intergovernmental.....					3,356,947
Rent.....					63,121
Miscellaneous.....					<u>1,140,487</u>
Total General Revenues.....					<u>21,001,758</u>
<b>CHANGE IN NET ASSETS.....</b>					<b>4,066,432</b>
Net Assets – Beginning of Year, as Restated (Note 18).....					<u>52,507,525</u>
<b>NET ASSETS – ENDING OF YEAR.....</b>					<b><u>\$56,573,957</u></b>

See accompanying Notes to Basic Financial Statements.

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

**BALANCE SHEET – GOVERNMENTAL FUNDS**

JUNE 30, 2006

	GENERAL	HEAD START FUND	DEBT SERVICE FUND	OTHER GOVERNMENTAL FUNDS	TOTAL GOVERNMENTAL FUNDS
<b>ASSETS</b>					
Cash and Investments (Notes 1 and 2).....	\$ 8,670,799	\$ 23,984	\$ -	\$12,909,067	\$21,603,850
Cash with Fiscal Agent .....	-	-	5,183,882	5,353,854	10,537,736
Receivables:					
Federal Grants.....	-	3,199,249	-	1,323,914	4,523,163
Due from Other Funds.....	1,373,513	-	-	2,688,739	4,062,252
Due from Government.....	283,320	-	-	24,486	307,806
Others.....	92,162	-	17,295	-	109,457
<b>Total Assets .....</b>	<b><u>\$10,419,794</u></b>	<b><u>\$ 3,223,233</u></b>	<b><u>\$ 5,201,177</u></b>	<b><u>\$22,300,060</u></b>	<b><u>\$41,144,264</u></b>
<b>LIABILITIES AND FUND BALANCES</b>					
Liabilities:					
Accounts Payable and Accrued Liabilities.....	\$ 161,043	\$ 21,646	\$ 890,000	\$ 165,977	\$ 1,238,666
Accrued Interest.....	-	-	284,376	-	284,376
Due to Governmental Units .....	14,168	-	-	-	14,168
Due to Other Funds .....	2,688,739	266,715	50,012	1,056,786	4,062,252
Deferred Revenues:					
Volume of Business Tax.....	3,375,858	-	-	-	3,375,858
Intergovernmental.....	283,320	-	-	-	283,320
Federal Grants.....	-	2,612,464	-	1,663,159	4,275,623
<b>Total Liabilities .....</b>	<b><u>6,523,128</u></b>	<b><u>2,900,825</u></b>	<b><u>1,224,388</u></b>	<b><u>2,885,922</u></b>	<b><u>13,534,263</u></b>
Fund Balances:					
Reserve For:					
Encumbrances.....	757,334	-	-	-	757,334
Debt Service.....	-	-	3,976,789	-	3,976,789
Future Expenditures .....	-	322,408	-	19,414,138	19,736,546
Unreserved .....	3,139,332	-	-	-	3,139,332
<b>Total Fund Balances.....</b>	<b><u>3,896,666</u></b>	<b><u>322,408</u></b>	<b><u>3,976,789</u></b>	<b><u>19,414,138</u></b>	<b><u>27,610,001</u></b>
<b>TOTAL LIABILITIES AND FUND BALANCES .....</b>	<b><u>\$10,419,794</u></b>	<b><u>\$ 3,223,233</u></b>	<b><u>\$ 5,201,177</u></b>	<b><u>\$22,300,060</u></b>	<b><u>\$41,144,264</u></b>

See accompanying Notes to Basic Financial Statements.

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

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

JUNE 30, 2006

<b>Total Fund Balances – Governmental Funds (Page 13) .....</b>		<b>\$27,610,001</b>
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 .....	\$ 9,737,905	
Depreciable Capital Assets .....	42,068,955	
Infrastructure Assets .....	1,587,291	
Accumulated Depreciation .....	<u>(16,428,678)</u>	
Total Capital Assets .....		36,965,473
Other Assets used in Governmental Activities are not Financial Resources and therefore are not reported in the funds		
Deferred Charges .....		46,188
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 .....	2,612,464	
Child Care Food Program .....	269,309	
Child Care Development Block Grant .....	178,531	
CDBG .....	1,156,831	
Intergovernmental .....	283,320	
Housing Choice Vouchers Program .....	<u>58,488</u>	
Total Deferred Revenues .....		4,558,943
Some liabilities are not due and payable in the current period and therefore are not reported in the funds. Those liabilities consist of:		
General Bonds and Notes Payable .....	(8,864,000)	
LIMS Debt .....	(554,857)	
Compensated Absences .....	(2,133,361)	
Christmas Bonus .....	(337,334)	
Law 42 .....	(224,990)	
Law 146 .....	(488,212)	
Claims and Judgments .....	-	
Property Tax Advances-Treasury .....	<u>(3,894)</u>	
Total Long-Term Liabilities .....		<u>(12,606,648)</u>
<b>Total Net Assets of Governmental Activities (Page 11) .....</b>		<b><u>\$56,573,957</u></b>

See accompanying Notes to Basic Financial Statements.

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, 2006

	GENERAL	HEAD START FUND	DEBT SERVICE FUND	OTHER GOVERNMENTAL FUNDS	TOTAL GOVERNMENTAL FUNDS
<b>REVENUES</b>					
Property Taxes .....	\$ 7,922,707	\$ -	\$ 2,125,700	\$ -	\$10,048,407
Volume of Business Taxes .....	4,899,753	-	-	-	4,899,753
Federal Assistances .....	-	4,063,037	-	2,241,044	6,304,081
Intergovernmental .....	3,368,256	-	-	1,237,582	4,605,838
Licenses and Permits .....	1,378,390	-	-	-	1,378,390
Rent .....	63,121	-	-	-	63,121
Miscellaneous .....	1,140,487	-	-	-	1,140,487
<b>Total Revenues .....</b>	<b>18,772,714</b>	<b>4,063,037</b>	<b>2,125,700</b>	<b>3,478,626</b>	<b>28,440,077</b>
<b>EXPENDITURES</b>					
Current:					
Mayor and Municipal Legislature .....	2,255,436	-	-	-	2,255,436
General Government .....	5,795,804	-	-	1,240,891	7,036,695
Public Safety .....	823,626	-	-	1,515	825,141
Public Works .....	2,548,562	-	-	-	2,548,562
Culture and Recreation .....	1,137,695	-	-	-	1,137,695
Sanitation .....	1,365,336	-	-	-	1,365,336
Education .....	-	3,758,689	-	1,341	3,760,030
Human Services and Welfare .....	1,294,794	-	-	889,850	2,184,644
Urban Development .....	79,278	-	-	794,009	873,287
Capital Outlay .....	122,192	-	-	2,961,238	3,083,430
Debt Service:					
Principal .....	-	-	2,416,900	-	2,416,900
Interest and Other Charges .....	-	-	720,359	-	720,359
<b>Total Expenditures .....</b>	<b>15,422,723</b>	<b>3,758,689</b>	<b>3,137,259</b>	<b>5,888,844</b>	<b>28,207,515</b>
<b>OTHER FINANCING SOURCES (USES)</b>					
Transfers – In .....	-	-	1,522,729	3,763,758	5,286,487
Transfers – Out .....	(4,613,802)	-	-	(672,685)	(5,286,487)
<b>Total Other Financing Sources and Uses .....</b>	<b>(4,613,802)</b>	<b>-</b>	<b>1,522,729</b>	<b>3,091,073</b>	<b>-</b>
Net Change in Fund Balances .....	(1,263,811)	304,348	511,170	680,855	232,562
Fund Balance – Beginning, as Restated (Note 18) .....	5,180,477	18,060	3,465,619	18,733,263	27,377,439
<b>FUND BALANCES – ENDING .....</b>	<b>\$ 3,896,666</b>	<b>\$ 322,408</b>	<b>\$ 3,976,789</b>	<b>\$19,414,138</b>	<b>\$27,610,001</b>

*Handwritten signature and date:*  
15/06/07

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, 2006

**Net Change in Fund Balances – Total Governmental Funds (Page 15) ..... \$ 232,562**

Amounts reported for Governmental Activities in the Statement of Activities (Page 12)  
are different because:

Governmental funds report capital outlays as expenditures. However, in the Statement of  
Activities the cost of those assets is allocated over their estimated useful lives and reported  
as depreciation expense. In the current period, these amounts are:

Urban Development and Capital Outlay .....	\$ 3,083,430	
Depreciation Expense .....	<u>(1,418,563)</u>	
Excess of Capital Outlay over Depreciation Expense .....		1,664,867

Revenues in the Statement of Activities that do not provide current financial resources are not reported as revenues in the funds. ....		789,648
--	--	---------

Revenues in the Statement of Revenues that correspond to prior year resources are not reported as revenues in the Statement of Activities .....		(576,783)
--	--	-----------

Governmental funds report capital outlays as expenditures. However, in the Statement of

Repayment of long-term principal is expenditure in the Governmental Funds, but the repayment reduces Long-Term Liabilities in the Statement of Net Assets. In the current year the repayments were. ....		1,927,301
--	--	-----------

Governmental funds report the effect of Bond Issuance Costs as Expenditures when debt  
is first issued, whereas these amounts are deferred and amortized in the Statement of  
activities. This amounts is the effect of the Differences:

Amortization of Deferred Charges .....		(2,904)
--	--	---------

Some expenses reported in the Statement of Activities do not require the use of current  
financial resources and therefore are not reported as expenditures in Governmental Funds.  
These activities consist of:

Decrease Christmas Bonus .....	22,618	
Decrease in Compensated Absences.....	<u>9,123</u>	
Total Long-Term Liabilities.....		<u>31,741</u>

**Change in Net Assets of Governmental Activities (Page 12) ..... \$ 4,066,432**

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF FAJARDO, PUERTO RICO

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2006

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 (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. The following is a summary of the more significant of such policies.

**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 GASBS No. 39, *Determining Whether Certain Organizations Are Component Units – an amendment of GASB Statement No. 14*.

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**.

GASBS No. 39 provided additional guidance to determine whether certain organization for which the primary government is not financially accountable should be reported as components units. A legally separate, tax-exempt organization should be discretely presented as a component unit if all of the following criteria are met: (a) the economic resources received or held by the separate organization are entirely or almost entirely for the direct benefit of the primary government, its component units, or its constituents; (b) the primary government, or its component

units, is entitled to, or has the ability to otherwise access, a majority of the economic resources received or held by the separate organization, and; (c) the economic resources received or held by an individual organization that the specific primary government, or its component units, is entitled to, or has the ability to otherwise access, are significant to the primary government.

There are two methods of presentation of the component unit in the financial statements: blending – the financial data of the component unit's balances and transactions in a manner similar to the presentation of the **Municipality's** balance; and discrete – presentation of the component unit's financial data in column separate from the **Municipality's** balances and transactions.

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, 2005, and the respective changes in financial position, where applicable, thereof for the fiscal year then ended.

**B. 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 are normally supported by taxes and intergovernmental revenues.

Business-type activities, which rely to a significant extent on fees and charges for support, are not reported seen the **Municipality** don't have such activities.

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.

continue

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF FAJARDO, PUERTO RICO

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2006

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES  
(continuation)

B. Financial Statement Presentation (continuation)

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 consist 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* demonstrates the degree to which the direct expenses of a given function or segment is offset by program revenues. *Direct expenses* are those that are clearly identifiable with a specific function or segment. *Program revenues* include 1) charges to customers or applicants who purchase, use or directly benefit from goods, services, or privileges provided by a given function or segment, and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items not properly included among program revenues are reported instead as *general revenues*.

**Governmental Fund Financial Statements**

The fund financial statements (the *Balance Sheet*, the *Statement of Revenues, Expenditures, and Changes in Fund Balance 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. 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.

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.

**Required Supplementary Information**

Required supplementary information consists of the Management Discussion and Analysis – a narrative introduction and analytical overview of the **Municipality's** financial activities. Also consists of the Budgetary Comparison Schedule – General Fund (see Section D of Note 1) as required by GASB.

C. 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 imposed by the provider 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 enough thereafter to pay liabilities of the current period. For this purposes, the government considers revenues to be available if they are collected within sixty (60) days of the end of the current period.

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.

continue

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF FAJARDO, PUERTO RICO

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2006

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES  
(continuation)

C. Measurement Focus and Basis of Accounting (continuation)

There are essentially two types of revenue. For the majority of grants, money 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 recognized when the related liability is incurred, as under accrual accounting. The exceptions to this general rule are the compensated absences and claims and judgments, if any, that are recorded only when payment is due.

Property taxes, volume of business taxes, licenses and permits, and interest associated with the current fiscal period are all considered to be susceptible to accrual and so have been recognized as revenues of the current fiscal period. All other revenue items are considered to be measurable and available only when cash is received by the **Municipality**.

The **Municipality** reports the following major funds:

**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.

The non-major funds are combined in a single column in the fund financial statements.

D. Budgetary Data

The **Municipality's** annually adopts the Budget Resolution for all operating funds of the **Municipality** except for certain restricted accounts 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. All encumbrance appropriations in the operating budget lapse at the end of the fiscal year.

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.
2. Payments of encumbrances of prior year are recorded as expenditures under GAAP but not under the budgetary basis.
3. Interfund transactions of the General 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.

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 Financial Awards Programs included in the Capital Projects and Special Revenue Funds is based on a program period which is not necessarily the same fiscal year. Accordingly, it's not practical to present an annual comparison of budget for such programs.

continue

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

**NOTES TO THE BASIC FINANCIAL STATEMENTS**

FOR THE FISCAL YEAR ENDED JUNE 30, 2006

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

**E. Cash 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 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.

Cash with fiscal agent represents property tax collections retained by the Municipal Revenues Collection Center and undisbursed proceeds of certain bonds, loans or grants which are maintained in a cash custodian account by the Government Development Bank of the Commonwealth of Puerto Rico and is not collateralized.

Cash balance recognized in the Debt Service Fund is restricted for the payment of the **Municipality's** obligations, and others are restricted for specific projects, such as the acquisition or construction of permanent improvements. This sinking fund is maintained by the Governmental Development Bank of Puerto Rico, agency which acts as the insurer and payer of the **Municipality's** bonds and notes issued in accordance with law.

**F. Receivables and Payables**

Activity between funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as either "due to/from other funds" (i.e., the current portion of interfund loans) or "advances to/from other funds" (i.e., the non-current portion of interfund loans). All other outstanding balances between funds are reported as "due to/from other funds." Any residual balances outstanding between the governmental activities and business-type activities are reported in the government-wide financial statement as "interfund balances".

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

All trade and property tax receivable are shown net of an allowances for uncollectible, 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 \$1 on personal property. Infrastructure assets are capitalized based on a percentage of the estimated useful life. Other costs incurred for repairs and maintenance is expensed as incurred. Major outlays for capital assets and improvements are capitalized as projects are constructed.

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.
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 represent a reconciling item between the fund level and government-wide presentations (see Note 9).

continue

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

**NOTES TO THE BASIC FINANCIAL STATEMENTS**

FOR THE FISCAL YEAR ENDED JUNE 30, 2006

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

The following is a summary of changes in the balance of Compensated Absences for the fiscal year ended June 30, 2006. (See Table 2)

BALANCE JULY 1, 2005	NEW ISSUES	RETIREMENTS AND CURRENT MATURATES	BALANCE JUNE 30, 2006	CURRENT PORTION	LONG-TERM PORTION
\$2,142,484	\$ -	\$ (9,123)	\$2,133,361	\$1,380,566	\$ 752,795

**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 sent 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:

*Operating 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. Transfer includes interest earned on restricted cash with fiscal agent in the Debt Service Fund and operating and capital improvement in other governmental funds which is transferred to the General Fund; and principal and interest payments of general long-term debt transferred from the General Fund to the Debt Service Fund. 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.

**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 AND INVESTMENTS**

The **Municipality** maintains its cash deposits in commercial banks located in Puerto Rico. Under Commonwealth of Puerto Rico statutes, public funds deposited in commercial banks must be fully collateralized for the amount deposited in excess of federal deposit insurance. All securities pledged as collateral by the **Municipality** are held by the Secretary of Treasury of Puerto Rico in the **Municipality's** name. The **Table 3** presented below discloses the level of custody risk assumed by the **Municipality** based upon how its deposits were insured or secured with collateral at June 30, 2006:

Category 1: Insured or collateralized with securities held by the Secretary of Treasury agent's in the **Municipality's** name.

Category 2: Collateralized with securities held by the pledging financial institution's trust department or its agents in the **Municipality's** name.

Category 3: Uncollateralized, including any bank balance that is collateralized with securities held by the pledging financial institution or by its trust department or agent by not in the **Municipality's** name.

	CATEGORY			CARRYING AMOUNT	BANK BALANCE
	1	2	3		
Deposits in Commercial Banks.....	\$21,603,850	\$ -	\$ -	\$21,603,850	\$22,121,794
Deposits in Governmental Bank.....	-	-	10,537,736	10,537,736	10,541,860
Total.....	\$21,603,850	\$ -	\$10,537,736	\$32,141,586	\$32,663,654
<b>Reconciliation to Government-Wide Statement of Net Assets:</b>					
		UNRESTRICTED	RESTRICTED	TOTAL	
Carrying amount of deposits in Commercial Banks .....		\$ 4,570,799	\$17,033,051	\$21,603,850	
Carrying amount of deposits in Government Bank .....		-	10,537,736	10,537,736	
Total.....		\$ 4,570,799	\$27,570,787	\$32,141,586	

continue

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

**NOTES TO THE BASIC FINANCIAL STATEMENTS**

FOR THE FISCAL YEAR ENDED JUNE 30, 2006

**NOTE 2 CASH 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, 2006, the market value of investments recorded approximated its carrying value as follow: (See Table 4)

CERTIFICATE OF DEPOSIT ISSUED BY	PRINCIPAL NUMBER	INTEREST AMOUNT	RATE	TABLE 4 EXPIRATION DATE
Popular Bank of Puerto Rico ...	1110000043	\$ 1,500,000	5.20%	07-08-06
Popular Bank of Puerto Rico ...	1110000048	2,600,000	5.00%	07-16-06
Popular Bank of Puerto Rico ...	1110000049	<u>6,000,000</u>	5.00%	07-16-06
TOTAL .....		<u>\$10,100,000</u>		

The investments are distributed by the amounts of \$4,100,000 to the General Fund and \$6,000,000 to the Special Revenue Fund.

**NOTE 3 CUSTODIAL CREDIT RISK RELATED TO DEPOSITS**

As of June 30, 2006, the **Municipality's** custodial credit risk was approximately \$10.5 million, which is the bank balance of cash deposited at the Government Development Bank of Puerto Rico (GDB). These deposits are exempt from the collateral requirement established by the Commonwealth.

Pursuant to the Investment Guidelines for the Commonwealth adopted by GDB, the **Municipality** may invest in obligations of the Commonwealth, obligations of the United States, certificates of deposit, commercial paper, banker's acceptance, or in pools of obligations of the municipalities of Puerto Rico, among others.

**NOTE 4 OTHERS RECEIVABLES AND DUE FROM AGENCIES**

The following is a summary of due from other agencies for the fiscal year ended June 30, 2006. (Table 5)

TABLE 5 DUE FROM GOVERNMENTAL UNITS		AMOUNT
Municipal Revenue Collection Center (CRIM).....		\$114,653
Puerto Rico Treasury Department (Christmas Bonus)....		<u>168,667</u>
Total Due from to Governmental Units.....		<u>\$283,320</u>

Governmental funds report *deferred revenue* in connection with receivables for revenue that are not considered to be available to liquidate liabilities of the current period. Governmental funds also defer revenue recognition in connection with resources that have been received, but not yet earned. At the end of the current fiscal year, the various components of *deferred revenues* and *unearned revenue* reported in the governmental funds were as follow:

	Unavailable	Unearned
Volume of Business Taxes .....	\$ -	\$3,375,858
Other Major Funds .....	-	1,663,159
SBGP .....	2,612,464	-
Intergovernmental.....	114,653	-
Christmas Bonus.....	<u>168,667</u>	-
Total Deferred/Unearned Revenue.....	<u>\$2,895,784</u>	<u>\$5,039,017</u>

**NOTE 5 INTERFUND TRANSFER AND BALANCES**

Transfers are indicative of funding for capital projects or debt service, and subsidies of various operations. (See Table 6)

INTERFUND TRANSFERS WITHIN THE GOVERNMENTAL FUNDS TABLE 6			
SOURCES	TRANSFER TO	AMOUNT	PURPOSE
General Fund	Debt Service Fund	\$1,522,729	Debt payment
General Fund	Other Fund	<u>3,763,758</u>	Specific project funding
Total		<u>\$5,286,487</u>	

**NOTE 6 INTERFUND RECEIVABLE AND PAYABLE BALANCES**

Interfund receivables and payables at June 30, 2006 are summarized as follows: (See Table 7)

INTERFUND RECEIVABLE	INTERFUND PAYABLE	TABLE 7 AMOUNT
General Fund	Debt Service Fund	\$ 50,012
General	Head Start Fund	266,715
General Fund	Other Fund	1,056,786
Other Fund	General Fund	<u>2,688,739</u>
TOTAL		<u>\$4,062,252</u>

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

**NOTE 7 DUE TO OTHER GOVERNMENTAL UNITS**

As of June 30, 2006, balance due to other governmental units of the General Fund for services rendered to the **Municipality**, consists of the following: (See Table 8)

TABLE 8	AMOUNT
Water Company .....	\$10,445
AEELA.....	283
General Service Administration .....	<u>3,440</u>
Total Due to Governmental Units.....	<u>\$14,168</u>

continue

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

**NOTES TO THE BASIC FINANCIAL STATEMENTS**

FOR THE FISCAL YEAR ENDED JUNE 30, 2006

**NOTE 8 CAPITAL ASSETS**

Capital Assets activities for the fiscal year ended June 30, 2006 was as follows (See Table 9)

TABLE 9	BALANCE JULY 1, 2005	ADJUSTMENTS	INCREASES	BALANCE JUNE 30, 2006
<b>Non-Depreciable Capital Assets:</b>				
Land.....	\$ 7,795,987	\$ -	\$ 24,452	\$ 7,820,439
Construction in Progress .....	-	-	1,151,851	1,151,851
Others.....	<u>765,615</u>	-	-	<u>765,615</u>
<b>Total Non-Depreciable Capital Assets .....</b>	<b><u>8,561,602</u></b>	<b>-</b>	<b><u>1,176,303</u></b>	<b><u>9,737,905</u></b>
<b>Depreciable Capital Assets:</b>				
Buildings.....	33,798,267	630,020	1,274,225	35,702,512
Infrastructure .....	718,801	649,157	219,333	1,587,291
Machinery and Equipment.....	3,415,312	174,451	235,742	3,825,505
Motor Vehicles.....	<u>2,512,998</u>	<u>(149,887)</u>	<u>177,827</u>	<u>2,540,938</u>
<b>Total Depreciable Capital Assets .....</b>	<b><u>40,445,378</u></b>	<b><u>1,303,741</u></b>	<b><u>1,907,127</u></b>	<b><u>43,656,246</u></b>
<b>Less Accumulated Depreciation:</b>				
Buildings.....	(11,393,660)	539,560	(642,645)	(11,496,745)
Infrastructure .....	-	(40,107)	(35,970)	(76,077)
Machinery and Equipment.....	(2,144,084)	10,893	(566,072)	(2,699,263)
Motor Vehicles.....	<u>(1,982,810)</u>	<u>93</u>	<u>(173,876)</u>	<u>(2,156,593)</u>
<b>Total Accumulated Depreciation .....</b>	<b><u>(15,520,554)</u></b>	<b><u>510,439</u></b>	<b><u>(1,418,563)</u></b>	<b><u>(16,428,678)</u></b>
<b>Total Depreciable Capital Assets (Net) .....</b>	<b><u>24,924,824</u></b>	<b><u>1,814,180</u></b>	<b><u>488,564</u></b>	<b><u>27,227,568</u></b>
<b>CAPITAL ASSETS, NET .....</b>	<b><u>\$33,486,426</u></b>	<b><u>\$ 1,814,180</u></b>	<b><u>\$ 1,664,867</u></b>	<b><u>\$36,965,473</u></b>

Depreciation expenses were charged to governmental functions/programs as follows: (See Table 10)

TABLE 10	AMOUNT
General Government .....	\$ 510,683
Public Safety.....	56,742
Public Works.....	581,611
Culture and Recreation.....	70,928
Urban Development.....	<u>198,599</u>
<b>Total Depreciation Expenses .....</b>	<b><u>\$1,418,563</u></b>

continue

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

**NOTES TO THE BASIC FINANCIAL STATEMENTS**

FOR THE FISCAL YEAR ENDED JUNE 30, 2006

**NOTE 9 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 10). 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.

General obligations bonds and notes payable as of June 30, 2006, are comprised of the following individual issues:

DESCRIPTION	AMOUNT
<b>General Obligations Bonds:</b>	
\$11,435,000, Series 1997-98, 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.....	<u>\$8,710,000</u>
Total General Obligations Bonds.....	<u>8,710,000</u>
<b>Special Obligations Notes:</b>	
\$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.....	274,000
\$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.....	355,000
\$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.....	290,000
\$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.....	<u>125,000</u>
Total Special Obligations Notes.....	<u>1,044,000</u>
Total General and Special Obligations.....	<u>\$9,754,000</u>

The Municipality's general obligations long-term note retirements are appropriated and paid from resources accumulated in the Debt Service Fund (see Note 10). 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.

The annual requirements to amortize the general and special obligations outstanding as of June 30, 2006 are as follows (See Table 11):

YEAR ENDING JUNE 30,	PRINCIPAL PAYMENT	INTEREST PAYMENT	TABLE 11 TOTAL PAYMENT
2007	\$ 1,146,000	\$ 572,912	\$ 1,718,912
2008	723,000	513,052	1,236,052
2009	625,000	465,639	1,090,639
2010	675,000	428,062	1,103,062
2011	725,000	387,029	1,112,029
2012-2016	4,610,000	1,169,531	5,779,531
2017-2021	<u>1,250,000</u>	<u>56,746</u>	<u>1,306,746</u>
TOTAL	<u>\$ 9,754,000</u>	<u>\$ 3,592,971</u>	<u>\$13,346,971</u>

**B. OTHER LONG-TERM DEBTS**

Following are the Other Long-Term Debts (See Table 12):

TABLE 12 DESCRIPTION	BALANCE JULY 1, 2005	NEW ISSUES	RETIREMENTS AND ADJUSTMENT	BALANCE JUNE 30, 2006
Property Taxes - Law 42....	\$ 228,293	\$ -	(\$ 3,303)	\$ 224,990
Property Taxes-Treasury....	4,865	-	(971)	3,894
Property Taxes-Law 146....	518,207	-	(29,995)	488,212
Property Taxes-MRCC.....	-	514,599	(514,599)	-
LIMS.....	637,889	-	(83,032)	554,857
Claims and Assessments...	5,000,000	-	(5,000,000)	-
Compensated Absences....	<u>2,142,484</u>	-	<u>(9,123)</u>	<u>2,133,361</u>
TOTAL.....	<u>\$8,531,738</u>	<u>\$ 514,599</u>	<u>(\$5,641,023)</u>	<u>\$3,405,314</u>

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

The following is a summary of changes in long-term debts for the year ended June 30, 2006: (See Table 13)

TABLE 13 DESCRIPTION	BALANCE JULY 1, 2005	NEW ISSUES	RETIREMENTS AND ADJUSTMENT	BALANCE JUNE 30, 2006	AMOUNTS DUE WITHIN ONE YEAR	AMOUNTS DUE AFTER NEXT YEAR
General.....	\$ 9,195,000	\$ -	(\$ 485,000)	\$ 8,710,000	\$ 525,000	\$ 8,185,000
Special.....	2,279,000	-	(1,235,000)	1,044,000	596,000	448,000
Others Debts.....	<u>8,531,738</u>	<u>514,599</u>	<u>(5,641,023)</u>	<u>3,405,314</u>	<u>1,472,121</u>	<u>1,933,193</u>
TOTAL.....	<u>\$20,005,738</u>	<u>\$ 514,599</u>	<u>(\$ 7,361,023)</u>	<u>\$13,159,314</u>	<u>\$ 2,593,121</u>	<u>\$10,566,193</u>

**NOTE 10 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 11).

These property taxes are accumulated by the Municipal Revenue Collection Center in costs of the general obligations bonds issued by the Municipality. 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.

continue

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

**NOTES TO THE BASIC FINANCIAL STATEMENTS**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

---

**NOTE 11 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.

As per Ordinance Number 28, Series 2005-2006, enacted on February 6, 2006, the new tax rates per annum are 10.43% for real property and 8.43% for personal property for which 1.03% of both belong to the Commonwealth of Puerto Rico and 9.40% and 7.40%, 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 3.40% 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 10). 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.

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.

**NOTE 12 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, 2005. 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 13 CONSTRUCTION TAX**

Construction Tax is recorded in the fiscal year in which payments are due and, accordingly, represents taxes which are due and uncollected at June 30, 2006. The Construction Tax is determined based on the total amount of the construction cost of the project.

Any construction project, which doesn't qualify for any of the exceptions presented below, will pay a tax of 4% of the total cost amount of the project. The exceptions for the 4% Construction Tax imposed by the **Municipality** are as follow:

- a. 5.00% of the total cost of the project for any construction involving movement of land.
- b. 2.00% for all low income housing projects, and educational institutions of primary and secondary level.
- c. When construction is for a residence, made of at least 50% concrete, and said residence is not part of a housing project, urbanization, condominium, or any project of a similar nature; a fixed rate of \$25.00 will be collected up to a maximum total construction cost of \$50,000. In addition, for every \$1,000 in excess of the \$50,000 in total construction costs, a \$5.00 rate will be collected.

Taxes are payable before beginning construction or any activity related to the construction. Collections of taxes during current fiscal year, applicable to the next fiscal year, are recorded as deferred revenues in the General Fund.

continue

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

**NOTES TO THE BASIC FINANCIAL STATEMENTS**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

**NOTE 14 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 15 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 define 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.

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 14)

YEARS OF SERVICE	PARTICIPANT'S AGE	PENSION BENEFITS	TABLE 14
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.

continue

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

**NOTES TO THE BASIC FINANCIAL STATEMENTS**

FOR THE FISCAL YEAR ENDED JUNE 30, 2006

**NOTE 15 EMPLOYEE'S RETIREMENT PLAN (continuation)**

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 2006 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.

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 total pension expenditures recorded in the category of administration for the current and the previous years are as follows: (See Table 15)

FISCAL YEAR	LAW No. 447	SYSTEM 2000
2006	<u>\$298,369</u>	<u>\$172,374</u>
2005	<u>\$304,338</u>	<u>\$151,422</u>
2004	<u>\$312,270</u>	<u>\$104,035</u>

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, 2005. 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 16 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, 2006 the **Municipality** has not made contributions to finance closure and post-closure care costs.

**NOTE 17 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. Accordingly, the financial statements do not include adjustment, if any, that could result from the resolution of this legal proceeding. However, it has been the **Municipality's** experience that such actions are settled for amounts substantially less than the claimed amounts.

**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.

continue

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

**NOTES TO THE BASIC FINANCIAL STATEMENTS**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

**NOTE 18 FUND BALANCE – NET ASSETS RESTATEMENTS**

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

<b>FUND BALANCE RESTATEMENT</b>	
<b>Other Governmental Funds</b>	
Fund Balance, as Previously Reported, At June 30, 2005.....	\$26,760,377
Adjustments to Cash Balance.....	(272,999)
Adjustment to Expenditures.....	<u>890,061</u>
Beginning Net Assets, as Restated, At July 1, 2005 .....	<u>\$27,377,439</u>
<b>NET ASSETS RESTATEMENT</b>	
Net Assets, as Previously Reported, June 30, 2005 .....	\$45,304,825
Adjustment to Expenses Other major .....	890,061
Adjustments to Long-term Debt.....	4,975,000
Deferred Charges .....	49,092
Adjustment to Revenues-CDBG.....	102,894
Adjustment to Revenue-Head Start.....	44,703
Adjustment to Revenue-Other major .....	(400,231)
Adjustment to Cash Balances.....	(272,999)
Adjustment to Capital Assets.....	<u>1,814,180</u>
Net Assets, as Restated, July 1, 2005.....	<u>\$52,507,525</u>

GASBS No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefit Other Than Pension* (Period beginning after December 15, 2007)

GASBS No. 47, *Accounting for Termination Benefit* (Period beginning after June 15, 2005)

**END OF NOTES**

**NOTE 19 SUBSEQUENT EVENTS**

On November 7, 2006, the Municipality Legislature, by means of Ordinance Number 9, Series 2006-2007, approved the issuance of \$14,440,000 in general obligation bonds, for construction projects.

**NOTE 20 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; and GASBS No. 46, *Net Assets Restricted by Enabling Legislation*, which is effective for period beginning after June 15, 2005. Early application is encouraged. The Municipality has not adopted the requirement of these statements. The following are other pronouncements issued that does not apply to the Municipality:

GASBS No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans* (Period beginning after December 15, 2006)

GASBS No. 44, *Economic Condition Reporting: The Statistical Section* (Period beginning after June 15, 2005)

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

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

FOR THE FISCAL YEAR ENDED JUNE 30, 2006

	BUDGET AMOUNTS		ACTUAL AMOUNTS (BUDGETARY BASIS) (SEE NOTE A)	VARIANCE WITH FINAL BUDGET
	ORIGINAL	FINAL		
<b>BUDGETARY FUND BALANCE, JULY 1, 2005.....</b>	<b><u>\$ 4,094,872</u></b>	<b><u>\$ 4,094,872</u></b>	<b><u>\$ 4,094,872</u></b>	<b><u>\$ -</u></b>
Resources (Inflows):				
Property Taxes.....	7,421,029	7,421,029	7,922,707	501,678
Volume of Business Taxes.....	4,079,306	4,079,306	4,899,753	820,447
License and Permits and Other Local Taxes.....	2,516,200	2,516,200	1,378,390	(1,137,810)
Intergovernmental Revenues.....	3,457,951	3,491,188	3,368,256	(122,932)
Rent.....	252,100	252,100	63,121	(188,979)
Miscellaneous.....	<u>1,836,134</u>	<u>1,836,134</u>	<u>1,140,487</u>	<u>(695,647)</u>
Total Resources (Inflows).....	<u>19,562,720</u>	<u>19,595,957</u>	<u>18,772,714</u>	<u>(823,243)</u>
Amounts Available for Appropriation.....	<u>23,657,592</u>	<u>23,690,829</u>	<u>22,867,586</u>	<u>(823,243)</u>
Charges to Appropriations (Outflows):				
Mayor and Municipal Legislature.....	2,653,533	3,475,687	2,704,542	771,145
General Government.....	7,429,023	8,177,299	5,773,683	2,403,616
Public Safety.....	1,248,653	1,260,698	839,702	420,996
Public Works.....	2,776,258	2,724,063	2,609,088	114,975
Human Services and Welfare.....	1,946,216	2,010,034	1,305,809	704,225
Culture and Recreation.....	1,030,464	1,040,937	1,177,780	(136,843)
Sanitation.....	1,298,933	1,300,839	1,365,336	(64,497)
Urban Development.....	164,143	193,528	79,278	114,250
Capital Outlays.....	194,400	177,073	122,192	54,881
Transfer to Other Funds.....	<u>821,097</u>	<u>3,943,968</u>	<u>4,613,802</u>	<u>(669,834)</u>
Total Charges to Appropriations.....	<u>19,562,720</u>	<u>24,304,126</u>	<u>20,591,212</u>	<u>3,712,914</u>
<b>BUDGETARY FUND BALANCE, JUNE 30, 2006.....</b>	<b><u>\$ 4,094,872</u></b>	<b><u>(\$ 613,297)</u></b>	<b><u>\$ 2,276,374</u></b>	<b><u>\$ 2,889,671</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, 2006

**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 29).....	\$22,867,586
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. ....	<u>(4,094,872)</u>
Total Revenues as Reported on the Statement of Governmental Funds Revenues, Expenditures and Changes in Fund Balance (See Page 15) .....	<u>\$18,772,714</u>
<b>Uses/Outflows of Resources:</b>	
Actual Amounts (Budgetary Basis) "Total Charges to Appropriation" from the Budgetary Comparison Schedule (See Page 29).....	\$20,591,212
Difference – Budget to GAAP:	
Prior-Year Expenditures are not outflows of budgetary resources but are expenditures for financial reporting purposes.....	202,647
Encumbrances for supplies and equipment ordered but not received are reported in the year the order is placed for budgetary purposes .....	(757,334)
Transfers to other funds are outflows of budgetary resources but are not expenditures for financial reporting purposes. ....	<u>(4,613,802)</u>
Total Expenditures as Reported on the Statement of Governmental Funds Revenues, expenditures and Changes in Fund Balance (See Page 15) .....	<u>\$15,422,723</u>

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

Budgetary Fund Balance, June 30, 2006 (See Page 29).....	\$ 2,276,374
Timing Differences:	
Net Changes in Encumbrances .....	244,634
Non-budgetary Items .....	<u>618,324</u>
Unrestricted Fund Balance, June 30, 2006 (See Page 13) .....	<u>\$ 3,139,332</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, 2006**

FEDERAL GRANTOR / PASS THROUGH GRANTOR / PROGRAM OR CLUSTER TITLE	FEDERAL CFDA NUMBER	PASS-THROUGH ENTITY IDENTIFYING NUMBER	FEDERAL EXPENDITURES
U.S. Department of Agriculture:			
Pass-Through Administration of Families and Children:			
Child and Adult Care Food Program (USDA) .....	10.558	N/AV	<u>\$ 205,416</u>
U.S. Department of Homeland Security:			
Pass-Through Governor Authorized Representative:			
Public Assistance Grants.....	97.036	DR-PR-1552	<u>919,207</u>
U.S. Department of Housing and Urban Development:			
Community Development Block Grant (CDBG).....	14.218		834,778
Lower Income Housing Assistance Program – Section 8 Moderate Rehabilitation.....	14.856		3,491
Section 8 Housing Choice Voucher Program .....	14.871		<u>383,740</u>
Total U.S. Department of Housing and Urban Development ...			<u>1,222,009</u>
U. S. Department of Health and Human Services:			
Pass-Through Administration for the Childhood Care and Integral Development:			
Child Care and Development Block Grant.....	93.575	N/AV	160,017
Head Start Program.....	93.600	N/AV	<u>3,758,689</u>
Total U.S. Department of Health and Human Services .....			<u>3,918,706</u>
<b>TOTAL EXPENDITURES OF FEDERAL AWARDS .....</b>			<b><u>\$6,265,338</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, 2006

---

**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 non-cash 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, 2006: Section 108 Loans for the amount of \$650,000 included in the Long-Term Liabilities of the Statement of Net Assets, for which Grantor do not imposes continuing compliance requirements.

**NOTE 6 RELATIONSHIP TO FEDERAL FINANCIAL REPORTS**

Expenditures of federal awards are reported in the Municipality's Statement of Revenues, Expenditures and Changes in Fund Balances- Governmental Fund as follows: Head Start \$ 3,758,689 and Other Governmental Funds \$2,506,649.

**NOTE 7 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**

---



201 Gautier Benítez Ave.  
Consolidated Mall C-31  
PO Box 8369  
Caguas, PR 00726-8369  
Phones: (787) 746-0510 / 746-1185 / 746-1370  
Fax: (787) 746-0525  
cpadiazmartinez@hotmail.com

## 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, 2006, which collectively comprise the **Municipality's** basic financial statements and has issued our report thereon dated December 11, 2006. 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. Our consideration of the internal control would not necessarily disclose all matters in the internal control over financial reporting that might be material weakness. 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. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

### 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 11, 2006





201 Gautier Benítez Ave.  
Consolidated Mall C-31  
PO Box 8369  
Caguas, PR 00726-8369  
Phones: (787) 746-0510 / 746-1185 / 746-1370  
Fax: (787) 746-0525  
cpadiazmartinez@hotmail.com

## 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, 2006. 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, 2006. 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 06-III-01 through 06-III-04.

### 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 06-III-01 through 06-III-03.

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, of the reportable conditions described above we consider item 06-III-01 to be 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 11, 2006



**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, 2006

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
14.218	Community Development Block Grants/Entitlement Grants
93.600	Head Start Program
97.036	Public Assistance Grants

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, 2006

---

**SECTION II – FINANCIAL STATEMENT FINDINGS**

---

**NO MATTER IS REPORTED.**

---

continue

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF FAJARDO, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2006

---

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

---

<b>FINDING</b>	<b>NUMBER 06-III-01 (see Finding Number 06-III-04)</b>
<b>FEDERAL PROGRAM</b>	<b>PUBLIC ASSISTANT GRANTS (CFDA NO. 97.036) FEDERAL U.S. DEPARTMENT OF HOMELAND SECURITY EMERGENCY MANAGEMENT ADMINISTRATION PASS-THROUGH STATE – OFFICE OF THE GOVERNOR</b>
<b>REQUIREMENTS</b>	<b>COMPLIANCE AND INTERNAL CONTROL</b>
<b>NONCOMPLIANCE</b>	<b>ALLOWABLE COSTS AND COST PRINCIPLES</b>
<b>CONDITION</b>	During our disbursements test, we noted that two (2) vouchers reimbursing to the <b>Municipality</b> the costs incurred by them, did not have all supporting documentation for the payment. A similar situation was detected by the auditors of the GAR in a final determination for the audit of the Project DR-PR-1552 (Jeanne Storm).
<b>CRITERIA</b>	Code of Federal Regulations, 44 CFR, Part 13, Subpart C, Section 13.20 (b) (5) establish that the terms of grant and subgrant agreements will be followed in determining the reasonableness, allowability, and allocability of costs; (6) accounting records must be supported by such source documentation as cancelled checks, paid bills, payrolls, time and attendance records, contract and subgrant award documents, etc.
<b>CAUSE</b>	<b>Municipality</b> failed to maintain an adequate control over the recordkeeping of documents that justify the disbursements.
<b>EFFECT</b>	<b>Municipality</b> may pay for services not performed or goods not received.
<b>RECOMMENDATION</b>	We recommend the implementation of an adequate control over the recordkeeping of document that justifies the disbursements.
<b>QUESTIONED COSTS</b>	NONE
<b>MANAGEMENT RESPOSE</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, 2006

---

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

---

<b>FINDING</b>	<b>NUMBER 06-III-02</b>
<b>FEDERAL PROGRAM</b>	<b>PUBLIC ASSISTANT GRANTS (CFDA NO. 97.036) FEDERAL U.S. DEPARTMENT OF HOMELAND SECURITY EMERGENCY MANAGEMENT ADMINISTRATION PASS-THROUGH STATE – OFFICE OF THE GOVERNOR</b>
<b>REQUIREMENTS</b>	<b>COMPLIANCE AND INTERNAL CONTROL</b>
<b>NONCOMPLIANCE</b>	<b>EARMARKING</b>
<b>CONDITION</b>	During our earmarking tests, we noted that the <b>Municipality</b> exceeded the limits on administrative costs per Grant Award. A similar situation was detected by the auditors of the GAR in a final determination for the audit of the Project DR-PR-1552 (Jeanne Storm).
<b>CRITERIA</b>	Code of Federal Regulations, 44 CFR, Part 206, Subpart G, Section 206.228 (a) (2) (ii), establish that subgrantees pursuant to Section 406 (f)(1) of the Stafford Act, necessary costs of requesting, obtaining, and administering Federal disaster assistance subgrants will be covered by an allowance which is based on the following percentages of net eligible costs: (A) For the first \$100,000, three percent of such costs; (B) For next \$900,000, two percent of such costs; (C) For the next \$4,000,000, one percent of such costs; (D) For those costs over \$5,000,000, one-half percent of such costs.
<b>CAUSE</b>	<b>Municipality</b> failed to implement procedures to ensure that administration costs did not exceed the limits established by the grant agreement.
<b>EFFECT</b>	<b>Municipality</b> is not in compliance with Subpart G, 44 CFR 206.228 (a) (2) (ii), which requires the recipient of funds to comply with all the items and dispositions set forth by the Grant Agreement.
<b>RECOMMENDATION</b>	We recommend management to implement the necessary procedures in order to comply with the limits on administrative costs per Grant Award.
<b>QUESTIONED COSTS</b>	NONE
<b>MANAGEMENT RESPOSE</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, 2006

---

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

---

<b>FINDING</b>	<b>NUMBER 06-III-03</b>
<b>FEDERAL PROGRAM</b>	<b>PUBLIC ASSISTANT GRANTS (CFDA NO. 97.036) FEDERAL U.S. DEPARTMENT OF HOMELAND SECURITY EMERGENCY MANAGEMENT ADMINISTRATION PASS-THROUGH STATE – OFFICE OF THE GOVERNOR</b>
<b>REQUIREMENTS</b>	<b>COMPLIANCE AND INTERNAL CONTROL</b>
<b>NONCOMPLIANCE</b>	<b>REPORTING</b>
<b>CONDITION</b>	During our test, we noted that the <b>Municipality</b> submitted lately the quarterly report for the period ended September 30, 2005. In addition, the amounts did not reconcile with the General Ledger.
<b>CRITERIA</b>	Code of Federal Regulations, 44CFR, Part 13, Subpart C, Section 13.41 (b) (4), establish that when reports are required on a quarterly or semiannual basis, they will be due 30 days after reporting period. When required on an annual basis, they will be due 90 days after the grant year. Final reports will be due 90 days after the expiration or termination of grant support. Code of Federal Regulations, 44CFR, Part 13, Subpart C, Section 13.20 (a) (2), establish that grantees and subgrantees must maintain records which adequately identify the source and application of funds provided for financially-assisted activities. These records must contain information pertaining to grant or subgrant awards and authorizations, obligations, unobligated balances, assets, liabilities, outlays or expenditures, and income.
<b>CAUSE</b>	<b>Municipality</b> doesn't have a proper system to maintain an effective control over the submission of the quarterly reports and didn't maintain a record keeping of the supporting documents.
<b>EFFECT</b>	<b>Municipality</b> is not monitoring the submission of the quarterly reports and this situation leads to noncompliance with the reporting requirements.
<b>RECOMMENDATION</b>	We recommend the <b>Municipality</b> to verify the accounting records and record the necessary adjustments in order to reconcile the expenditures reported in the quarterly reports and the General Ledger.
<b>QUESTIONED COSTS</b>	<b>NONE</b>
<b>MANAGEMENT RESPOSE</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, 2006

---

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

---

<b>FINDING</b>	<b>NUMBER 06-III-04 (see Finding Number 06-III-01)</b>
<b>FEDERAL PROGRAM</b>	<b>PUBLIC ASSISTANT GRANTS (CFDA NO. 97.036) FEDERAL U.S. DEPARTMENT OF HOMELAND SECURITY EMERGENCY MANAGEMENT ADMINISTRATION PASS-THROUGH STATE – OFFICE OF THE GOVERNOR</b>
<b>REQUIREMENTS</b>	<b>COMPLIANCE AND INTERNAL CONTROL</b>
<b>NONCOMPLIANCE</b>	<b>SPECIAL TESTS AND PROVISIONS</b>
<b>CONDITION</b>	On our test of Completed Projects, we noted that for a project of debris removal which total budgeted amount was \$398,049.97; the <b>Municipality</b> has supporting documentation for expenditures for the amount of \$102,663. The <b>Municipality</b> paid for the project, and when FEMA funds were received, the Federal Office reimbursed to the <b>Municipality</b> for the whole amount (\$398,049.97), even though the <b>Municipality</b> does not have files with all supporting documents. A similar situation was detected by the auditors of the GAR in a final determination for the audit of the Project DR-PR-1552 (Jeanne Storm).
<b>CRITERIA</b>	Code of Federal Regulations, 44CFR, Part 13, Subpart C, Section 13.20 (a) (2), establish that grantees and subgrantees must maintain records which adequately identify the source and application of funds provided for financially-assisted activities. These records must contain information pertaining to grant or subgrant awards and authorizations, obligations, unobligated balances, assets, liabilities, outlays or expenditures, and income; (6) establishes that accounting records must be supported by such source documentation as cancelled checks, paid bills, payrolls, time and attendance records, contract and subgrant award documents, etc.
<b>CAUSE</b>	<b>Municipality</b> failed to maintain an adequate control over the recordkeeping of documents that justify the Completed Projects.
<b>EFFECT</b>	<b>Municipality</b> can not demonstrate that the expenditures incurred were for allowable activities.
<b>RECOMMENDATION</b>	We recommend the implementation of an adequate control over the recordkeeping of document that justifies the Completed Projects.
<b>QUESTIONED COSTS</b>	None
<b>MANAGEMENT RESPOSE</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, 2006

---

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

<b>Finding Number</b>	03-III-03	<b>Procurement Standards</b> Missing contracts' clauses.
<b>CFDA Number</b>	93.600	
<b>Questioned Cost</b>	None	
<b>Auditee Comments</b>		System and procedures were corrected.

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

NONE

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

NONE

**(4) Audit findings is no longer valid:**

NONE

**END OF SCHEDULE**