

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

MUNICIPIO DE FAJARDO
AUDITORÍA 2008-2009
30 DE JUNIO DE 2009

REGISTRAR GENERAL
DE LA COMUNIDAD PUERTORRIANA

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

BASIC FINANCIAL STATEMENTS

FISCAL YEAR ENDED JUNE 30, 2009

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF FAJARDO, PUERTO RICO
BASIC FINANCIAL STATEMENTS
FISCAL YEAR ENDED JUNE 30, 2009
(WITH THE ADDITIONAL REPORTS AND INFORMATION
REQUIRED BY THE GOVERNMENT AUDITING STANDARDS
AND OMB CIRCULAR A-133)

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PART I
FINANCIAL



201 Gautier Benítez Ave.
Consolidated Mail 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, 2009, 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, 2009, 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 28, 2009 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 17 and 46 and 47, 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, 2010

Caguas, Puerto Rico

December 28, 2009



COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF FAJARDO, PUERTO RICO
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2009

The following discussion and analysis of the Municipality of Fajardo' financial performance provides an overview of the Municipality's financial activities for the fiscal year ended June 30, 2009. Please read it in conjunction with the financial statements which follow this section.

FINANCIAL HIGHLIGHTS

Highlights for Government-wide Financial Statements

The government-wide financial statements report information about the Municipality as a whole using the economic resources measurement focus and accrual basis of accounting:

- The assets of the Municipality, on a government-wide basis, exceeded its liabilities at the close of fiscal year 2009 by \$115,883,357 (net assets).
- Revenues decreased by \$560,746 and expenses increased by \$2,285,139 in comparison with year 2008, as restated.
- Net change in net assets amounted to \$3,680,366.
- A decrease of 35% with respect to prior year (2008) net change.

Highlights for Fund Financial Statements

The fund financial statements provide detailed information about the Municipality's most significant funds using the current financial resources measurement focus and modified accrual basis of accounting:

- At the close of the current fiscal year, the Municipality's governmental funds reported combined ending fund balances of \$53,350,767, an increase of \$2,051,943 in comparison with the prior year.
- The General Fund reported an excess of expenditures over revenues and other financing uses of \$5,815,172 and an unreserved fund balance of \$14,730,699. Unreserved fund balances increased by \$7,116,330 from prior year.

General Financial Highlights

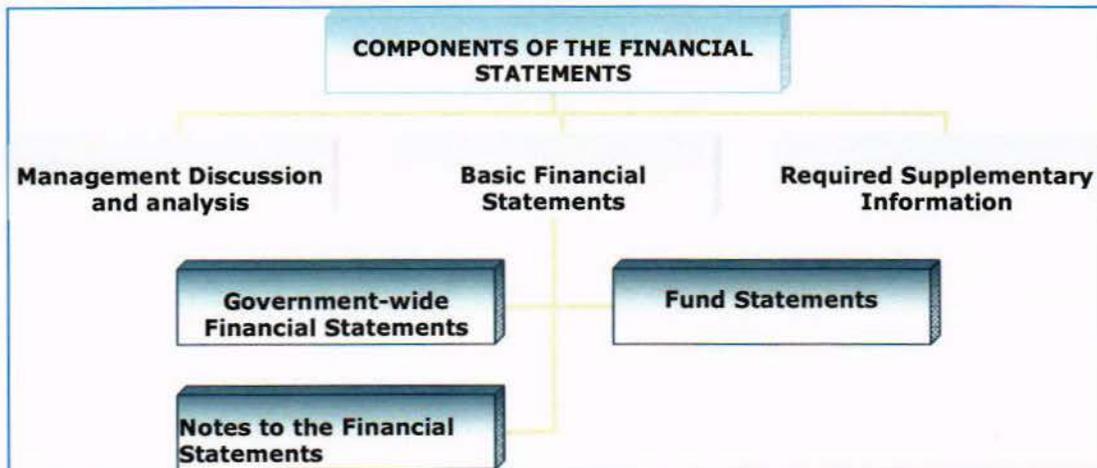
- The investment in net capital assets as of June 30, 2009 was \$75,735,503 (net of related debt).
- Long term debt general and special obligations decreased by \$904,000 approximately 4% with respect to prior year balance.
- Other long term debts increases and net reductions from payments amounted to \$168,845.
- On a budgetary basis, actual revenues exceeded actual expenditures by \$5,655,765.
- Revenues increase was mainly due to under estimate of \$2,005,925 in miscellaneous revenues, although Municipality realized economies, principally in general administration \$2,126,721.

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

FOR THE FISCAL YEAR ENDED JUNE 30, 2009

OVERVIEW OF THE FINANCIAL STATEMENTS

The Municipality's basic financial statements comprise three components: (1) management discussion and analysis (presented here), (2) basic financial statements, and (3) required supplementary information.



The Municipality's basic financial statements consist of two kinds of statements, each with a different view of the Municipality's finances. The government-wide financial statements provide both long-term and short-term information about the Municipality's overall financial status. The fund financial statements focus on major aspects of the Municipality's operations, reporting those operations in more detail than the government-wide statements:

Basic Financial Statements

- **Government-Wide Financial Statements**

The government-wide statements report information about the Municipality as a whole using accounting methods similar to those used by private-sector businesses. They are prepared using the flow of economic resources measurement focus and the accrual basis of accounting. The first government-wide statement – 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 the Municipality's net assets are an indicator of whether its financial health is improving or deteriorating. Other non-financial factors such as the condition of the Municipality's roads and other infrastructure may need to be considered to assess the overall health of the Municipality. The second statement – the *Statement of Activities* – presents information showing how the net assets changed during the year. All of the current year's revenues and expenses are taken into account in the statement of activities regardless of when cash is received or paid.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF FAJARDO, PUERTO RICO
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2009

The government-wide statements reports as governmental activities the Municipality's basic services such as public safety, public works, health and sanitation, culture and recreation, solid waste disposal, human services and welfare, and community development; education and general administration. These activities are primarily financed through property taxes, other local taxes and intergovernmental revenues. Included in the governmental activities are the governmental funds.

- ***Fund Financial Statements***

The fund financial statements provide more detailed information about the Municipality's most significant funds. Funds are accounting devices that the Municipality uses to keep track of specific sources of funding and spending for particular purposes. Some funds are required by Federal and Commonwealth regulations, as well by bond covenants.

The Municipality's basic services are included in governmental funds, which are used to account for essentially the same functions reported as governmental activities in the government-wide statements. However, unlike the government-wide statements, the governmental funds are prepared using the flow of current financial resources measurement focus and the modified accrual basis of accounting. Under this approach the financial statements focus on near-term inflows and outflows of external resources, as well on balances of expendable resources available at year end. Consequently, the governmental fund statements provide a detailed short-term view that helps the reader determine whether there are more or fewer financial resources that can be spent in the near future to finance the Municipality's programs. Because this information does not encompass the additional long-term focus of the government-wide statements, additional information is provided on a subsequent page that explains the relationship (or differences) between the government-wide and fund statements.

The governmental fund statements focus on major funds. The Municipality's major funds are the general fund (which accounts for the main operating activities of the Municipality) and funds that complies with a minimum criterion (percentage of the assets, liabilities, revenues or expenditures). Funds that do not comply with this criterion are grouped and presented in a single column as other governmental funds.

- ***Notes to the Financial Statements***

Provides integral information needed to explain the basis for the numbers used within the Basic Financial Statements and provide more detailed data.

Required Supplementary Information

Provides additional information to better understand the financial position of the Municipality and contains the Budgetary Comparison Schedule for the General Fund.

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

FOR THE FISCAL YEAR ENDED JUNE 30, 2009

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE

Net Assets

The following table presents a summary of the Statements of Net Assets as of June 30, 2009 and 2008:

Net assets (assets over liabilities) may serve over time as a useful indicator of a government's financial position. Net assets for the year increased, with respect to prior year as restated. The most significant changes were an increase in unrestricted assets of \$5,419,089.

Table 1		
Commonwealth of Puerto Rico Municipality of Fajardo, Puerto Rico Statement of Net Assets As of June 30, 2009		
	2009	2008
Current and non-current assets.....	\$ 63,895,984	\$ 62,271,482
Capital assets (As Restated).....	<u>84,193,302</u>	<u>82,713,776</u>
Total Assets	<u>148,089,286</u>	<u>144,985,258</u>
Current liabilities.....	1,610,212	1,321,527
Deferred revenues.....	4,610,761	4,740,629
Long-term liabilities	<u>25,984,956</u>	<u>26,720,111</u>
Total Liabilities	<u>32,205,929</u>	<u>32,782,267</u>
Assets:		
Investment in capital assets, Net of		
Related Debt	75,735,503	74,526,214
Restricted	24,344,343	27,292,355
Unrestricted (As Restated)	<u>15,803,511</u>	<u>10,384,422</u>
Total Net Assets	<u>\$115,883,357</u>	<u>\$112,202,991</u>

The largest portion of the Municipality's net assets reflects its investment in capital assets (e.g., land, buildings, equipment, and infrastructure) for \$75,735,503 total capital assets (\$86,799,876) less accumulated depreciation and less any related outstanding debt (\$11,064,373) used to acquire or construct those assets. The Municipality uses these assets to provide services to its citizens and consequently, these assets are not available for future spending. The resources needed to repay the debt related to these capital assets must be provided from other

sources, because capital assets are not generally liquidated for the purposes of retiring debt.

Restricted net assets represent resources that are subject to external restrictions on how they may be used.

Unrestricted net assets are the part of the net assets that can be used to finance day-to-day operations without constraints established by debt covenants, enabling legislation or other legal requirements.

As of June 30, 2009 the Municipality presented unrestricted net assets of \$15,803,511. This balance was affected by long term obligations such as compensated absences \$3,348,043 and other debts for the amount of \$1,215,913 for which the Municipality did not provide funding in previous budgets. Historically, such obligations have been budgeted on a pay as you go basis without providing funding for their future liquidation.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF FAJARDO, PUERTO RICO
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2009

Changes in net assets

The following table summarizes the changes in net assets for the years ended June 30, 2009 and 2008:

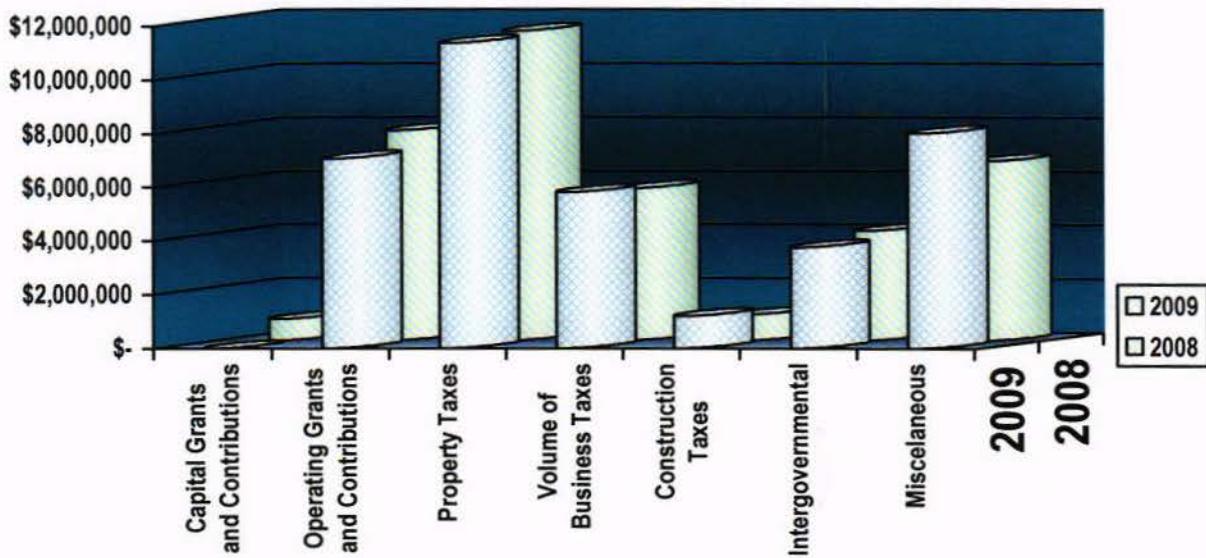
Table 2		
Commonwealth of Puerto Rico		
Municipality of Fajardo, Puerto Rico		
Changes in Net Assets		
For Fiscal Years Ending June 30, 2009		
	2009	2008
Revenues:		
Program Revenues:		
Capital Grants and Contributions	\$ -	\$ 787,000
Operating Grants and Contributions ...	7,068,748	7,807,842
General Revenues:		
Property Taxes.....	11,049,268	11,504,059
Volume of Business Taxes.....	5,795,746	5,639,390
Construction Taxes	1,198,075	962,627
Intergovernmental	3,762,075	4,065,138
Other General Revenues	8,010,977	6,679,579
Total revenues	<u>36,884,889</u>	<u>37,445,635</u>
Expenses:		
General Administration.....	(14,967,175)	(14,333,688)
Public Safety	(1,061,642)	(893,755)
Public Works.....	(3,592,499)	(3,480,723)
Culture and Recreation and Instruction	(1,574,975)	(1,494,734)
Interest and Other charges	(734,485)	(1,192,185)
Health and Sanitation.....	(2,746,306)	(2,282,866)
Solid Waste Disposal	(0)	(1,044)
Human Services and Welfare	(1,809,423)	(1,740,812)
Urban Development.....	(2,822,267)	(1,635,907)
Public Instruction.....	(3,895,751)	(3,863,670)
Total expenses	<u>(33,204,523)</u>	<u>(30,919,384)</u>
Changes in net assets	3,680,366	6,526,251
Net assets – beginning, as Restated*	112,202,991	105,676,740
Net assets – ending	<u>\$115,883,357</u>	<u>\$112,202,991</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF FAJARDO, PUERTO RICO
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2009**

Figure 1 presents revenues comparison by sources of the governmental activities during the past two years:

FIGURE 1

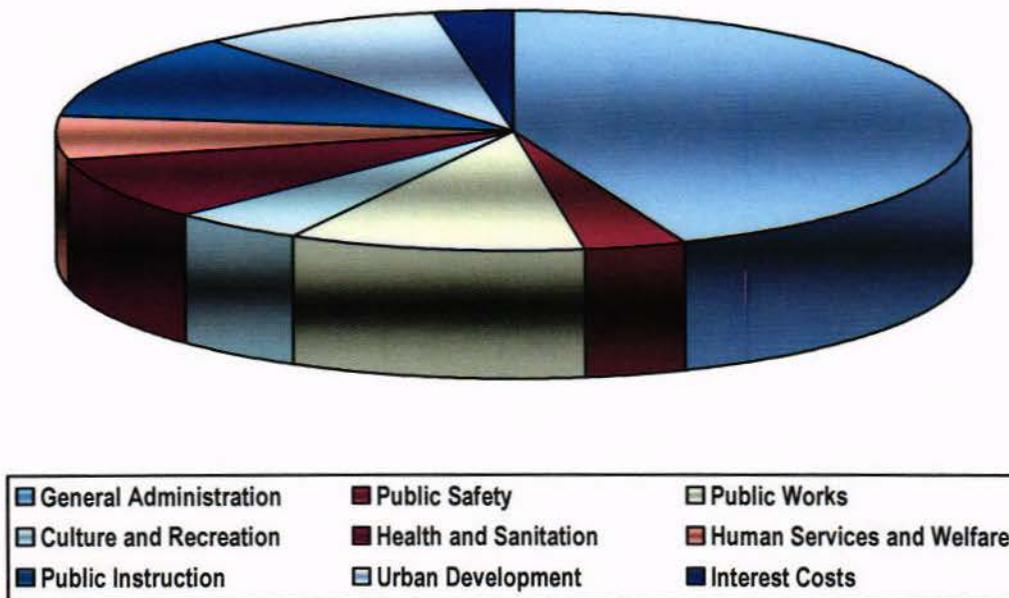
**Commonwealth of Puerto Rico
Municipality of Fajardo, Puerto Rico
Revenue by Source - Governmental Activities
Fiscal Years ended June 30, 2008 and 2009**



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF FAJARDO, PUERTO RICO
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2009**

Figure 2 presents expenses by function of the governmental activities during the fiscal year 2008-2009:

FIGURE 2



Approximately 11% of the Municipality's revenues came from intergovernmental, 19% from grants and contributions, 31% from property taxes, and 39% from other sources. The Municipality's expenses cover a range of services. The largest expenses are general administration with 46%, public instruction with 12%, and public works with 11%, health and sanitation with 9%, public safety with 4%, and human services and welfare with 6%. Program revenues of the Municipality covered 20% of total expenses.

With respect to prior year, revenues decreased by approximately \$560,746 or 1%, principally on property taxes.

Expenses increased 7% or \$2,285,139 in comparison with 2008 year. Significant increases were registered on benefits to employees, and donations and services incurred for the benefit of the community.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF FAJARDO, PUERTO RICO
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2009**

The following table focuses on the cost of each of the Municipality's largest functions/programs as well as each functions/program's net cost (total cost less fees generated by the programs and program-specific intergovernmental aid):

TABLE 3

Net Cost of Municipality's Governmental Activities				
Fiscal years ended June 30,				
Functions/Programs	Total Cost of Services		Net Cost of Services	
	2009	2008	2009	2008
General Administration	\$14,967,175	14,333,688	\$13,602,089	12,546,935
Public Safety	1,061,642	893,755	1,061,642	893,755
Public Works	3,592,499	3,480,723	3,592,499	3,480,723
Culture and Recreation	1,574,975	1,494,734	1,574,975	1,494,734
Health and Sanitation	2,746,306	2,282,866	2,746,306	2,282,866
Human Services and Welfare	1,809,423	1,740,812	880,144	630,881
Urban Development	2,822,267	1,635,907	1,866,050	(142,843)
Others	4,630,236	5,056,899	812,070	1,137,491
	<u>\$33,204,523</u>	<u>30,919,384</u>	<u>\$26,135,775</u>	<u>\$22,324,542</u>

Some of the cost of governmental activities in 2009 was paid by those who directly benefited from the programs and other governments and organizations that subsidized certain programs with grants and contributions. The \$26,135,775 net cost of services was substantially covered by other general revenues including property, volume of business license taxes and intergovernmental.

FINANCIAL ANALYSIS OF THE MUNICIPALITY'S FUNDS

Governmental Funds

The focus of the Municipality's governmental funds is to provide information on near-term inflows, outflows and balances of resources available for spending. Such information is useful in assessing the Municipality's financing requirements. In particular, unreserved fund balance may serve as a useful measure of a Municipality's net resources available at the end of a fiscal year. For the Fiscal year ended June 30, 2009 the governmental funds reported combined ending fund balances of \$53,350,767, a net increase of \$2,051,943, in comparison with the prior year. This increase was caused primarily by a net change in the non-major funds corresponding to the uses of prior years fund balance. Of total combined fund balances, 14,730,699 constitutes unreserved fund balance of general fund which was financed by the used of state assignments fund. The remainder of fund balance is reserved to indicate that is not available for new spending.

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

FOR THE FISCAL YEAR ENDED JUNE 30, 2009

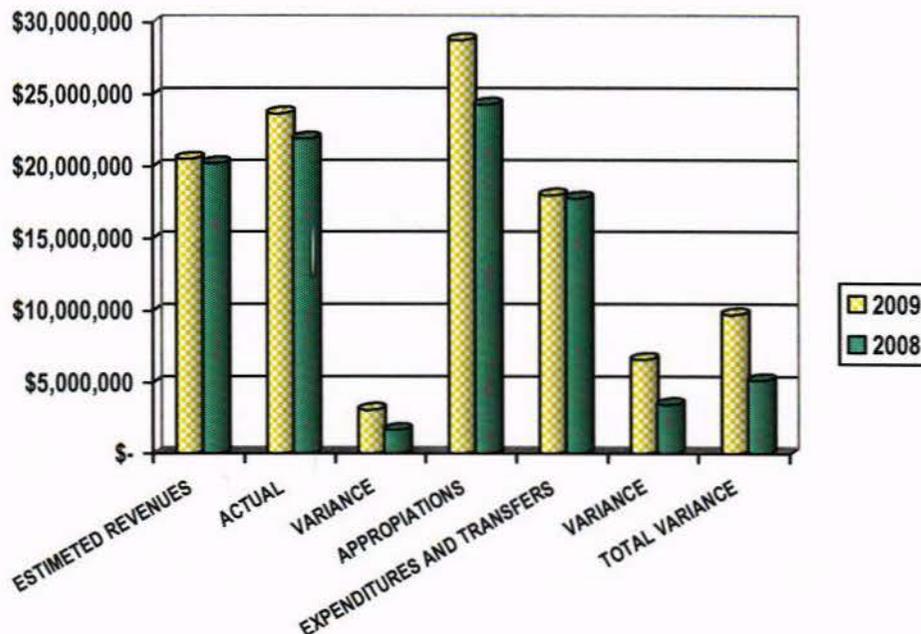
The general fund is the operating fund of the Municipality. Unreserved fund balance of the general fund represents approximately 28% of total ending general fund balance (deficit). For the year ended June 30, 2009, the fund balance (deficit) of the general fund increased by \$5,815,172 when compared with the prior year. The principal component of the net increases is an excess of revenues over expenditures.

GENERAL FUND BUDGETARY HIGHLIGHTS

The general fund original budget for the fiscal period 2008-2009 presented an increase of 5% with respect to prior year budget. The Municipality does not included as an amendment to the budget the reduction on projected revenues in property taxes and miscellaneous revenues. Budget expenditures were amended during the year in accordance with additional revenues and functions estimates (see **Figure 3** below).

FIGURE 3

Commonwealth of Puerto Rico
Municipality of Fajardo Puerto Rico
Fiscal Years ended June 30, 2009 and 2008
Budgetary Comparison



The positive variance between revised budget and actual expenditures was due mainly to that the Municipality reported less expenditure than appropriations in those functions for payments to purchase of supplies, professional and nonprofessional services, and solid waste disposal.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF FAJARDO, PUERTO RICO
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2009**

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital assets

At the end of the fiscal year, the Municipality has invested \$84,193,302 (net of accumulated depreciation) in a broad range of capital assets, including buildings, land, construction in progress and equipment. This amount represents a net increase of \$ 1,479,526 or 2% from the prior year, as restated.

TABLE 4

Commonwealth of Puerto Rico Municipality of Fajardo, Puerto Rico Capital Assets [Net] As of June 30,		
	Governmental Activities	
	2009	(As restated) 2008
NON-DEPRECIABLE ASSETS:		
Land	\$35,708,453	\$35,275,201
Construction in progress	0	938,286
Others	765,615	765,615
Total Non Depreciable Capital Assets	36,474,068	36,979,102
Depreciable assets:		
Buildings	42,795,602	39,486,296
Equipment and Vehicles	2,752,991	2,729,391
Heavy Equipment	5,093,524	4,626,998
Infrastructure	36,157,759	36,265,608
Total accumulated Depreciation	(39,080,642)	(37,373,619)
Total	\$84,193,302	\$82,713,776

The Municipality acquired a total of \$3,186,549 of capital assets during the fiscal year 2008-2009 as follows:

- Construction in Progress – \$1,135,062
- Acquisition of Equipment and Vehicles – \$490,126
- Buildings and Improvements -1,128,109
- Land-433,252
- Infrastructure – \$0

Other projects related to repair and maintenance of roads (not capitalized) was developed during the year 2009.

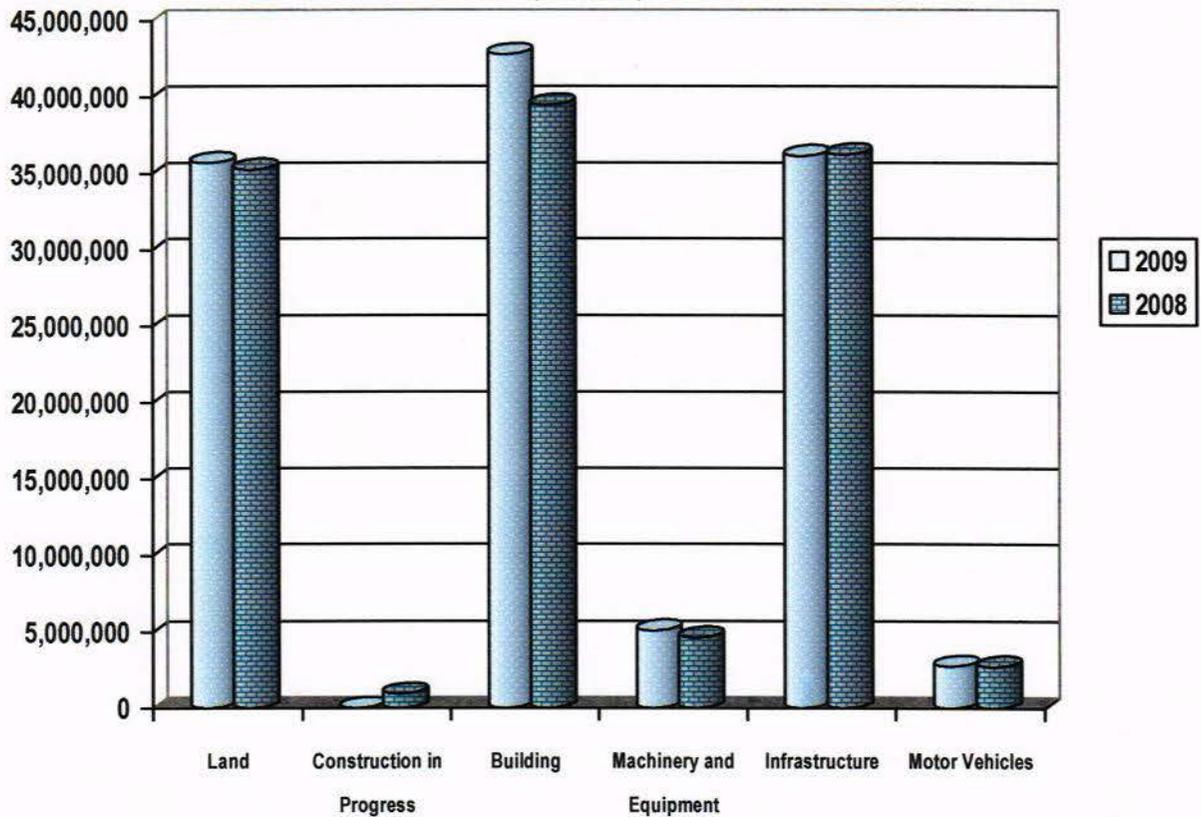
COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF FAJARDO, PUERTO RICO
MANAGEMENT'S DISCUSSION AND ANALYSIS

FOR THE FISCAL YEAR ENDED JUNE 30, 2009

Figures 4 below present the components of capital assets during the fiscal years 2009 and 2008:

FIGURE 4

Commonwealth of Puerto Rico
Municipality of Fajardo, Puerto Rico
Components of Capital Assets
(In Dollars)



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

FOR THE FISCAL YEAR ENDED JUNE 30, 2009

Long-Term Debt

At year-end, the Municipality had \$ 21,421,000 in general obligation bonds, a decrease of 4% with respect to prior year. The following is a summary of the Municipality's outstanding debts as of June 30, 2009 and 2008:

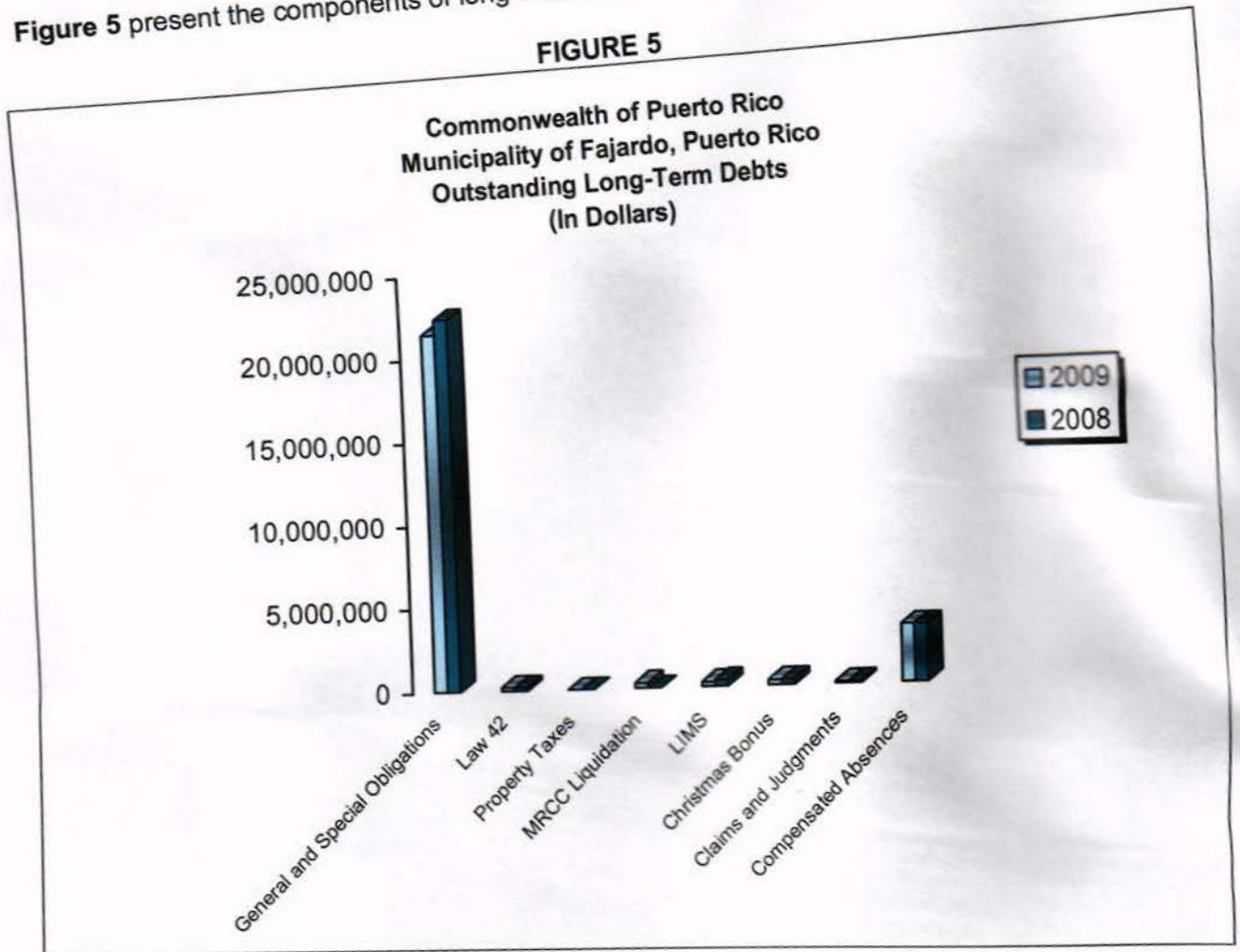
TABLE 5

Commonwealth of Puerto Rico Municipality of Fajardo, Puerto Rico Outstanding Long-Term Debts As of June 30,		
	Governmental Activities	
	2009	2008
General Obligation Bonds	\$ 21,421,000	\$ 22,325,000
Property Taxes	978	1,950
MRCC Liquidation	310,570	-
LIMS	274,449	373,449
Law 42	213,783	217,749
Claims and Judgments	101,227	101,227
Christmas bonus	314,906	340,367
Compensated Absences	3,348,043	3,360,369
Total	\$25,984,956	\$26,720,111

The decrease in the others debts is due to recognition of unemployment benefits. More detailed information about the Municipality's long term liabilities is presented in Note 10 and 11 to the financial statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF FAJARDO, PUERTO RICO
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2009**

Figure 5 present the components of long-term debts during the fiscal year 2009 and 2008:



ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

The Municipality's selected and appointed officials considered many factors when setting the fiscal year 2008-2009 budget. One of these factors is the economy. Among economic areas considered are the population growth estimates, personal income, housing statistics and unemployment rates. The Municipality's unemployment rate now stands at 16.1%, which compares with the Commonwealth rate of 15.2%.

The Municipality applied a conservative approach in development budget estimates. Amounts available for appropriations in the General Fund for the fiscal year 2009 are \$19 million approximately \$1.1 million less than the fiscal year 2008. Budgeted expenditures are expected to stabilize accordingly to the projected revenues. Among planned projects, this budget may be adjusted in accordance with economic injection projected when the construction projects promoted by the Municipality and others private projects were developed during the year.

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

FOR THE FISCAL YEAR ENDED JUNE 30, 2009

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 demonstrate the Municipality's accountability for the money it receives. If you have questions about this report or need additional information, contact the Municipality's Finance Department at [(787) 863-1802] or P.O. Box 865, Fajardo, Puerto Rico 00738.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF FAJARDO, PUERTO RICO

STATEMENT OF NET ASSETS
JUNE 30, 2009

	<u>GOVERNMENTAL ACTIVITIES</u>
ASSETS:	
Cash and Investments	\$ 44,405,281
Cash with Fiscal Agent	13,935,775
Receivables (net):	
Property Taxes	426,089
Sales and Use Taxes	265,460
Due from Governmental Units	157,453
Federal Grants	<u>4,583,733</u>
Total Currents Assets	<u>63,773,791</u>
Deferred Charges	<u>122,193</u>
Capital Assets:	
Land, Improvement and Construction in Progress	36,474,068
Other Capital Assets [Net of Depreciation]	<u>47,719,234</u>
Total Capital Assets	<u>84,193,302</u>
TOTAL ASSETS	<u>148,089,286</u>
LIABILITIES:	
Accounts Payable and Accrued Expenses	1,145,960
Accrued Interest	271,532
Due to Governmental Units	192,720
Deferred Revenues	4,610,761
Long-Term Liabilities:	
Due Within One Year	4,013,722
Due in More than One Year	<u>21,971,234</u>
TOTAL LIABILITIES	<u>32,205,929</u>
NET ASSETS:	
Investment in Capital Assets, Net of Related Debt	75,735,503
Restricted for:	
Head Start Program	1,743,993
Capital Projects	3,521,510
Debt Service	10,171,227
Community Development Projects	1,530,652
Other Purposes	7,376,961
Unrestricted	<u>15,803,511</u>
TOTAL NET ASSETS	<u>\$ 115,883,357</u>

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, 2009

Functions/Programs	Expenses	Program Revenues			Net (Expense) Revenues (See Next Page)
		Charges For Services	Operating Grants and Contributions	Capital Grants and Contributions	
Governmental Activities:					
Mayor and Municipal Legislature	\$ 2,685,700	\$ -	\$ -	\$ -	\$ (2,685,700)
General Government	12,281,475	-	1,365,086	-	(10,916,389)
Public Safety	1,061,642	-	-	-	(1,061,642)
Public Works	3,592,499	-	-	-	(3,592,499)
Culture and Recreation	1,574,975	-	-	-	(1,574,975)
Health and Sanitation	2,746,306	-	-	-	(2,746,306)
Human Services and Welfare	1,809,423	-	929,279	-	(880,144)
Urban Development	2,822,267	-	956,217	-	(1,866,050)
Public Instruction	3,895,751	-	3,818,166	-	(77,585)
Interest on Long-Term Debt	734,485	-	-	-	(734,485)
Total Governmental Activities	33,204,523	-	7,068,748	-	(26,135,775)
General Revenues:					
Taxes:					
Property Taxes, levied for General Purposes					8,254,653
Property Taxes, levied for Debt Service					2,794,615
Volume of Business Taxes					5,795,746
Sales and Use Taxes					4,058,312
Licenses and Permits					1,198,075
Intergovernmental					3,762,075
Interest					1,418,182
Miscellaneous					2,534,483
Total General Revenues					29,816,141
CHANGES IN NET ASSETS					
3,680,366					
Net Assets – Beginning of Year, As Restated					
112,202,991					
NET ASSETS – ENDING OF YEAR					
\$ 115,883,357					

See accompanying Notes to Basic Financial Statements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF FAJARDO, PUERTO RICO

BALANCE SHEET – GOVERNMENTAL FUNDS
JUNE 30, 2009

	GENERAL FUND	HEAD START FUND	ARTS CENTER FUNDS	DEBT SERVICE FUND	OTHER GOVERNMENTAL FUNDS	TOTAL GOVERNMENTAL FUNDS
ASSETS:						
Cash and Investment	\$ 19,991,579	\$ 65,240	\$ 8,853,170	\$ -	\$ 15,495,292	\$ 44,405,281
Cash with Fiscal Agent	-	-	-	10,016,670	3,919,105	13,935,775
Receivables:						
Property Taxes	-	-	-	426,089	-	426,089
Sales and Use Taxes	-	-	-	-	265,460	265,460
Federal Grants	-	3,512,936	-	-	1,070,797	4,583,733
Due from Other Funds	345,074	-	-	-	-	345,074
Due from Governmental Units	157,453	-	-	-	-	157,453
Total Assets	\$ 20,494,106	\$ 3,578,176	\$ 8,853,170	\$ 10,442,759	\$ 20,750,654	\$ 64,118,865
LIABILITIES AND FUND BALANCES:						
Liabilities:						
Account Payable	\$ 111,460	\$ 203,490	\$ -	\$ -	\$ 831,010	\$ 1,145,960
Bonds Payable	-	-	-	1,004,000	-	1,004,000
Account Interest	-	-	-	271,532	-	271,532
Due to Governmental Units	192,720	-	-	-	-	192,720
Due to Other Funds	-	322,137	-	-	22,937	345,074
Deferred Revenues:						
Volume of Business Tax	4,386,415	-	-	-	-	4,386,415
Commonwealth of Puerto Rico	157,453	-	-	-	-	157,453
Federal Grants	-	2,268,341	-	-	996,603	3,264,944
Total Liabilities	4,848,048	2,793,968	-	1,275,532	1,850,550	10,768,098
Fund Balances:						
Reserve For:						
Encumbrances	570,285	-	-	-	-	570,285
Debt Service	-	-	-	9,167,227	-	9,167,227
Capital Projects	-	-	8,853,170	-	10,234,604	19,087,774
Others Purpose	345,074	784,208	-	-	8,665,500	9,794,782
Unreserved	14,730,699	-	-	-	-	14,730,699
Total Fund Balances	15,646,058	784,208	8,853,170	9,167,227	18,900,104	53,350,767
Total Liabilities and Fund Balances	\$ 20,494,106	\$ 3,578,176	\$ 8,853,170	\$ 10,442,759	\$ 20,750,654	\$ 64,118,865

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

**RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET
TO THE STATEMENT OF NET ASSETS
JUNE 30, 2009**

Total Fund Balances – Government Funds (Page 20) \$ 53,350,767

Amount reported for Governmental Activities in the Statement of Net Assets (Page 18) 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	\$ 36,474,068	
Depreciable Capital Assets	50,642,117	
Infrastructure Assets	36,157,759	
Accumulated Depreciation	<u>(39,080,642)</u>	
Total Capital Assets		84,193,302

Other Assets used in governmental activities are not financial resources and therefore are not reported in the funds:

Deferred Charges		122,193
------------------	--	---------

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:

Community Development Block Grant Program	772,257	
Head Start Program	2,268,341	
Christmas Bonus	157,453	3,198,051

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

General Obligation Bonds	(20,417,000)	
Property Taxes - Treasury Department	(978)	
Law Number 42 - MRCC	(213,783)	
LIMS - MRCC	(274,449)	
MRCC Liquidation	(310,570)	
Christmas Bonus	(314,906)	
Claims and Judgments	(101,227)	
Compensated Absences	<u>(3,348,043)</u>	
Total Long-Term Liabilities		<u>(24,980,956)</u>

Total Net Assets of Governmental Activities (Page 18) \$ 115,883,357

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, 2009

	GENERAL FUND	HEAD START FUND	ARTS CENTER FUNDS	DEBT SERVICE FUND	OTHER GOVERNMENTAL FUNDS	TOTAL GOVERNMENTAL FUNDS
REVENUES:						
Property Taxes	\$ 8,565,223	\$ -	\$ -	\$ 2,794,615	\$ -	\$ 11,359,838
Volume of Business Taxes	5,795,746	-	-	-	-	5,795,746
Sales and Use Taxes	-	-	-	856,542	3,201,770	4,058,312
Federal Assistances	-	3,995,622	-	-	1,992,206	5,987,828
Intergovernmental	4,158,158	-	-	-	1,365,086	5,523,244
Licenses and Permits	1,198,075	-	-	-	-	1,198,075
Interest	1,418,182	-	-	-	-	1,418,182
Miscellaneous	2,530,225	-	-	-	4,258	2,534,483
Total Revenues	23,665,609	3,995,622	-	3,651,157	6,563,320	37,875,708
EXPENDITURES:						
Current:						
Mayor and Municipal Legislature	2,634,078	-	-	-	51,622	2,685,700
General Government	6,954,668	-	-	-	4,746,918	11,701,586
Public Safety	993,361	-	-	-	-	993,361
Public Works	2,715,206	-	-	-	177,414	2,892,620
Culture and Recreation	1,395,680	-	-	-	93,943	1,489,623
Health and Sanitation	1,781,277	-	-	-	965,029	2,746,306
Public Instruction	-	3,895,751	-	-	-	3,895,751
Human Services and Welfare	861,164	-	-	-	948,259	1,809,423
Urban Development	27,587	-	-	-	2,555,697	2,583,284
Capital Outlay	181,035	-	-	-	3,005,514	3,186,549
Debt Service:						
Principal	-	-	-	1,105,077	-	1,105,077
Interest and Other Charges	-	-	-	734,485	-	734,485
Total Expenditures	17,544,056	3,895,751	-	1,839,562	12,544,396	35,823,765
Excess of Revenues Over (Under) Expenditures	6,121,553	99,871	-	1,811,595	(5,981,076)	2,051,943
OTHER FINANCING SOURCES (USES):						
Transfer – In	-	-	-	593,961	168,261	762,222
Transfer – Out	(306,381)	-	-	-	(455,841)	(762,222)
Total Other Financing Sources and Uses	(306,381)	-	-	593,961	(287,580)	-
Net Change in Fund Balance	5,815,172	99,871	-	2,405,556	(6,268,656)	2,051,943
Fund Balance – Beginning	9,830,886	684,337	8,853,170	6,761,671	25,168,760	51,298,824
FUND BALANCE – ENDING	\$ 15,646,058	\$ 784,208	\$ 8,853,170	\$ 9,167,227	\$ 18,900,104	\$ 53,350,767

*OK/Plaza
08/10/2010*

Net Change in Fund Balances – Government Funds (Page 22)	\$ 2,051,943
Amount reported for Governmental Activities in the Statement of Activities (Page 19) 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:	
Capital Outlays	\$ 3,186,549
Depreciation Expense	<u>(1,707,023)</u>
Excess of Capital Assets over Depreciation Expense	1,479,526
Revenues in the Statement of Activities that do not provide current financial resources are reported as revenues in the funds:	
Community Development Block Grant	(106,710)
Head Start Program	(177,456)
MRCC Liquidation	(693,923)
Christmas Bonus	<u>(12,730)</u>
	(990,819)
Repayment of long-term principal is expenditure in the governmental funds, but issuing debt reduced Long-Term Liabilities in the Statement of Net Assets. In the current period repayments were	
	1,105,077
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:	
Christmas Bonus	25,461
Bond Issue Costs Amortization	(3,148)
Decrease in Compensated Absences	<u>12,326</u>
Total Additional Expenses	<u>34,639</u>
Change in Net Assets of Governmental Activities (Page 19)	<u>\$ 3,680,366</u>

1. FINANCIAL REPORTING ENTITY

A. Organization

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. As a government entity, the **Municipality** is exempt from both federal and state taxes.

B. Reporting Entity

A reporting entity is comprised of the primary government, component units and other organizations that are included to ensure that financial statements are not misleading. The primary government consists of all funds, departments, boards and agencies that are not legally separate from the **Municipality** and for which the **Municipality** is financial accountable.

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*.

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: (1) 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; (2) 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; (3) 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, 2009, and the respective changes in financial position, where applicable, thereof for the fiscal year then ended.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Financial Statement Presentation

The basic financial statements of the **Municipality** have been prepared in conformity with accounting principles generally accepted in the United States of America as applicable to local governmental units (USGAAP). The basic financial statements include both government-wide (based on the **Municipality** as a whole) and fund financial statements, which provide a more detailed level of financial information. Both the government-wide and fund financial statements (within the basic financial statements) categorize primary activities as governmental type.

The financial information of the **Municipality** is presented in this report as follows:

Management's Discussion and Analysis

Management's discussion and analysis is required supplementary information that introduces the basic financial statements and provides an analytical overview of the **Municipality's** financial activities.

Government-wide Financial Statements (GWFS)

The GWFS (the *Statement of Net Assets* and the *Statement of Activities*) report information of all the activities of the **Municipality**.

The focus of the *Statement of Net Assets* is designed to be similar to bottom line results for the **Municipality's** governmental activities and business type activities. This statement combines and consolidates governmental fund's current financial resources (short-term spendable resources) with capital assets and long-term obligations. The *Statement of Net Assets* presents the reporting entities' assets and liabilities, with the difference reported as net assets.

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*.

For most part, the effect of interfund activity has been removed from these financial statements. Governmental activities, which normally are supported by taxes and intergovernmental revenues, are reported separately from business-type activities, which rely, to a significant extent, on fees and charges for support.

Governmental Funds Financial Statements (GFFS)

The fund financial statements (the *Balance Sheet*, the *Statement of Revenues, Expenditures, and Changes in Fund Balance*) 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 GFFS are presented in different measurement focus and basis of accounting than the GWFS, 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.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

Notes to the Basic Financial Statements

The notes to the financial statements provide information that is essential to a user's full understanding of the data provided in the basis financial statements.

Required Supplementary Information

The basic financial statements are followed by a section of required supplementary information. This section includes a *Budgetary Comparison Schedule – General Fund*, which includes reconciliation between the statutory fund balance for budgetary purposes and the fund balance for the General Fund as presented in the GFFS.

B. Measurement Focus and Basis of Accounting

Government-wide Financial Statements

The GWFS are reported using the *economic resources measurement focus* and the *accrual basis of accounting*, as are the proprietary funds. Subject to the additional rules and limitations detailed below, revenue (including interest on deposits and investments) is generally recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.

All revenues, expenses, gains, losses, assets and liabilities resulting from exchange and exchange-like transactions are generally recorded when the exchange takes place. In exchange transactions, each party to the transaction receives and gives up essentially equal values. An exchange-like transaction is one in which there is an identifiable exchange and the values exchanged, though related, may not be quite equal. The accompanying GWFS include exchange-like transactions such as license fees, fines, penalties, forfeitures, permits, charges for services, and most miscellaneous revenues, which are recorded as revenues when collected because they are generally not measurable until actually received.

The **Municipality** groups its non-exchange transactions into the following four classes in the basic financial statements:

Derived Tax Revenues – in this revenue, which result from assessments that the **Municipality** places on exchange transactions, receivables and revenues are recorded when the underlying exchange has occurred.

Imposed Non-exchange Revenues – in this revenue (such as property taxes and volume of business taxes), which result from assessments made by the **Municipality** on non-governmental entities, including individuals, other than assessments on exchange transactions, receivables are generally recorded in the period when an enforceable legal claim has arisen. Property taxes and volume of business taxes are recognized as revenues (net of amounts considered not collectible) in the fiscal year when resources are required to be used or the first fiscal year that the use of the resources is permitted.

Government Mandated Non-exchange Transactions – in this revenue (such as intergovernmental grants and contributions), receivables and revenues are generally recorded when all eligibility requirements imposed by the provider have been met. For part of the grants, the **Municipality** must expend resources on the specific purpose or project before the provider reimburses any amounts. Therefore, revenue is generally recognized as qualifying reimbursable expenditures are incurred.

Voluntary Non-exchange Transactions – in this revenue (such as donations and certain grants and entitlements) receivables and revenues are generally accounted for in the same manner as government mandated non-exchange transactions discussed above.

Events that are neither exchange nor non-exchange transactions are recorded when it is probable that a loss has been incurred and the amount of loss is reasonably estimable.

Receipts on any type of revenue sources collected in advance for use in the following fiscal year are recorded as deferred revenues.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

Governmental Funds Financial Statements

The GFFS are reported using the *current financial resources measurement focus* and the *modified accrual basis of accounting*. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be *available* when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purposes, the **Municipality** considers revenues to be available if they are collected within sixty (60) days of the end of the current fiscal period. At June 30, 2009, all revenues sources met this availability criterion.

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**.

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

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

In a manner similar to GWFS, but subject to and limited by the availability criteria discussed above, all revenues, expenses, gains, losses, assets and liabilities resulting from exchange, exchange-like transactions are also generally recorded when the exchange takes place while all revenues, expenses, gains, losses and assets resulting from non-exchange transactions are recorded when an enforceable legal claim arises or when all eligibility requirements imposed by the provider have been met, applicable.

The **Municipality** generally accrues a governmental fund liability and expenditures (including salaries, professional services, supplies, utilities, etc.) in the period in which the government incurs the liability, to the extent that these liabilities are normally expected to be liquidated in a timely manner and in full with current available financial resources. The accompanying balance sheet – governmental funds generally reflects only assets that will not be converted into cash to satisfy current liabilities. Long-Term assets and those assets that will not be converted into cash to satisfy current liabilities are generally not accounted for in the accompanying balance sheet – governmental funds. At the same time, long-term liabilities (generally, those unmatured that will not require the use of current financial resources to pay them) are not accounted for in the accompanying balance sheet – governmental funds. Modifications to the accrual basis of accounting include:

- a. Principal and interest on bonds payable are recorded when they matured (when payment is due), except for principal and interest of bonds due on July 1, 2009, which are recorded as governmental fund liabilities of June 30, 2009 which is the date when resources were available in the debt service fund.
- b. Obligations from compensated absences and the estimated liability for municipal solid waste landfill post-closure care costs are recorded only when they mature (when payment is due).
- c. Certain accounts payable, intergovernmental payables and other accrued liabilities not due and payable (unmatured) or not normally expected to be liquidated in full and in a timely manner with available and expendable financial resources, are recorded in the accompanying *Statement of Net Assets*. Such liabilities are recorded in the governmental funds when they mature.
- d. Executory purchase orders and contracts are recorded as a reservation of fund balance in the GFFS.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

The measurement focus of the GFFS is on decreases of net financial resources (expenditures) rather than expenses. Most expenditures are measurable and are recorded when the related governmental fund liability is incurred. Allocation of costs, such as depreciation and amortization, are recorded in the accompanying *Statement of Activities*, but are not recorded in the accompanying GFFS.

The **Municipality** reports the following major governmental 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.

Arts Center Fund – This fund is used to account for the construction of an Arts Center.

The non-major funds are combined in a single column in the GGFS.

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed in the governmental-wide financial statements to the extent that those standards do not conflict with or contradict guidance of the *Governmental Accounting Standards Board*.

As a general rule the effect of interfund activity has been eliminated from the GWFS.

C. Stewardship, Compliance, and Accountability

Budgetary Information

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.

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

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

The **Municipality** follows these procedures, in accordance with law, in order to establish the budgetary data reflected in the Budgetary Comparison Schedule – General Fund:

Original Budget

1. Prior of May 15 of each fiscal year, the Mayor submits to the Municipal Legislature a proposed budget for the fiscal year commencing the following July 1 in addition of a budget message.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

2. The budget document is available for public inspection prior to its approval by the Municipal Legislature.
3. The Commissioner of Municipal Affairs examines the budget to verify if it complied with the law's standards and sends it to the Mayor for any comments or recommendation before the limited date establishes by the Law.
4. Prior to June 13, the annual budget is legally enacted through passage of the annual appropriation ordinance to be effective on July 1.

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.

Final Budget

The final budgetary data presented in the Budgetary Comparison Schedule – General Fund reflects the following changes to the original budget:

1. Certain annual appropriations are budgeted on a project basis. If such projects are not completed at the end of the fiscal year, unexpended appropriations, including encumbered funds, and unexpended grant appropriations, are carried forward to the following year. In certain circumstances, other regular annual appropriations may be carried forward after appropriate approval. Annually appropriated funds, not authorized to be carried forward, lapse at the end of the fiscal year. Appropriations carried forward from the prior year are included in the final budgetary data.
2. Appropriations may be adjusted during the year with the approval of the Mayor and the Municipal Legislature, e.g. supplemental appropriations. Additionally, the Mayor is authorized to make certain transfer of surplus within the departments. Such adjustments are reflected in the final budgetary data.

The Annual Appropriation Ordinance adopts the budget at the character level of expenditure within departments. As described above, the Mayor is authorized to make certain transfers of appropriations within departments. Accordingly, the legal level of budgetary control by the Municipal Legislature is the department Level.

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. Interfund transactions of the General Fund are not included in the budgetary basis.
3. Certain accrued liabilities and other debts are not included in the budgetary basis.
4. Certain revenues susceptible to accrual, i.e., both measurable and available, are not included in the budgetary data.

The Special Revenue Fund has 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.

B. Assets, Liabilities, and Net Assets

1) Cash and Investment, and Cash with Fiscal Agent

The **Municipality's** cash and investment are composed of demand deposits in commercial banks, demand deposits in the Governmental Development Bank of Puerto Rico (GDB), and cash equivalents in commercial banks. The **Municipality** has adopted the *Statement of Uniform Investment Guidelines for the Municipalities of the Government of Puerto Rico*, issued by the GDB as promulgated by Law No. 113 of August 3, 1995. The Finance Director of the **Municipality**, follow the guidelines, is responsible for investing the available resources in certificates of deposit and other short-term investments.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

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

Cash with fiscal agent in the Debt Service Fund represents special additional property tax collections retained by the Government, deposit in the GDB and restricted for the payment of the **Municipality's** debt service, as established by law. Cash with fiscal agent in other governmental funds consists of undisbursed proceeds of certain bonds and notes issued for the acquisition and construction of major capital improvements, or grants which are maintained in a cash custodian account by the GDB. This sinking fund is maintained by the GDB, agency which acts as the insurer and payer of the **Municipality's** bonds and notes issued in accordance with law.

2) *Receivables and Payables*

Activity between funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as either "due to/from other funds" (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, if any, are offset by a fund balance reserve account in applicable governmental funds to indicate that they are not available for appropriation and are not expendable available financial resources.

Receivables consist of all revenues earned but not collected at June 30, 2009. These account receivables are shown net of estimated allowances for uncollectible accounts, which are determined upon past collection experience, historical trends, and current economic conditions. Intergovernmental receivables in the general fund represent mostly sales and usage taxes, federal grant and contributions, property tax accounts that are levied by Municipal Revenue Collection Center (MRCC), a governmental entity created by the Government. Intergovernmental receivables in the other governmental funds represent amounts owed to the **Municipality** for reimbursement of expenditures incurred pursuant to federally funded grant and contributions and state appropriations, and the amount in the debt service fund represents the distribution of property tax collected which is restricted for the debt service.

3) *Inventories*

The **Municipality** used the purchase method to account for the purchases office and printing supplies, gasoline, oil and other expendable supplies held for consumption. This method records items as expenditures, in the appropriate fund, when they are acquired and, accordingly, the inventory is not recorded in the basic financial statements.

4) *Deferred Charges*

Deferred charges in the accompanying *Statement of Net Assets* consist of bond issuance costs, net of accumulated amortization. Deferred charges are amortized over the term of the related debt using the straight-line method. In the GFFS, bond issuance costs are recorded in the current period as expenditures, whether or not withheld from the actual debt proceeds received.

5) *Capital Assets*

Capital assets, which include land, buildings and improvement, machinery and equipment, motor vehicles, and infrastructure assets (e.g., roads, bridges, sidewalks, and similar items), are reported in the applicable governmental or business-type activities columns in the GWFS. Capital assets, other than infrastructure assets, are defined by the government as assets with an initial, individual cost of more than \$500 (amount not rounded) and an estimated useful life in excess of two years. For improvements other than buildings, the capital outlay must be greater than \$10,000, extend the estimated useful life for ten years, and be greater than 10% of the original cost of the asset. The **Municipality** reports infrastructure assets on a network and subsystem basis.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

Accordingly, the amounts spent for the construction or acquisition of infrastructure assets are capitalized and reported in the government-wide financial statements regardless of their amount.

In the case of the initial capitalization of general infrastructure assets (i.e., those reported by governmental activities) the government chose to include all such items regardless of their acquisition date or amount.

The **Municipality** was able to estimate the historical cost for the initial reporting of these assets through back trending (i.e., estimating the current replacement cost of the infrastructure to be capitalized and using an appropriate price-level index to deflate the cost to the acquisition year or estimated acquisition year). As the government constructs or acquires additional capital assets each period, including infrastructure assets, they are capitalized and reported at historical cost. The reported value excludes normal maintenance and repairs which are essentially amounts spent in relation to capital assets that do not increase the capacity or efficiency of the item or extend its useful life beyond the original estimate. In the case of donations the government values these capital assets at the estimated fair value of the item at the date of its donation.

Capital outlay is recorded as expenditures of the General Fund and other governmental funds and as assets in the GFFS to the extent the **Municipality** capitalization threshold is met. Interest incurred during the construction phase of the capital assets of business-type activities is reflected in the capitalized value of the asset acquired. Depreciation and amortization expense is recorded only in the GWFS. Depreciable capital assets are generally depreciated or amortized over their estimated useful lives under the straight-line method, except for equipment held under capital leases which is depreciated over the shorter of its estimated useful life or the lease term. No depreciation is recorded for land and construction in progress. The estimated useful lives of major capital asset categories are:

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

Depreciation and amortization expense of capital assets is recorded as a direct expense of the function/program specifically identified with the asset. Depreciation and amortization of infrastructure is not allocated to various function/programs but reported as direct expense of the public works and urban development functions.

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

6) Deferred Revenues

In the GWFS, deferred revenues arise only when the **Municipality** receives resources before it has a legal claim to them. In the GFFS, arises when one of the following situations occur: (1) potential revenue does not meet both the measurable and available criteria for revenue recognition in the current period (unavailable revenue), and (2) the **Municipality** receives resources before it has a legal claim to them (unearned revenue).

7) Long-Term Obligations, Bonds Issuance Costs, and Premium or Discount

The liabilities reported in the GWFS include the general and special obligation bonds, long-term notes, other long-term liabilities (e.g., vacation, sick leave, claims and judgments, long-term liabilities to other governmental entities and third parties. Bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds using the effective interest method. Bonds payable are reported net of the applicable bond premium or discount.

In the GFFS, governmental fund types recognize bond premiums and discounts as other financing sources and uses, respectively, and bond issuance costs as debt service expenditures. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

8) *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 at the current rate. 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; and (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, including its share of social security and Medicare payments made on behalf of the employees in the accrual for vacation and sick leave pay. All vacation pay is accrued when incurred in the GWFS and Proprietary Fund Financial Statements. For the GWFS, the current portion is the amount estimated to be used in the following year. For the GFFS, all of the compensated absences are considered long-term and therefore, are not a fund liability and represents a reconciling item between the fund level and government-wide presentations.

9) *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 when the liability is incurred. The Long-Term Liabilities includes, when appropriate, an amount estimated as a contingent liability or liabilities with a fixed or expected due date, which will require future available financial resources for its payment.

10) *Accounting for Pension Costs*

The **Municipality** adopted the provisions of GASBS No. 50, *Pension Disclosure*, which amended GASBS No. 27, *Accounting for Pensions by State and Local Governments Employers*, by requiring disclosure of how the contractually required contribution rate is determined by governments participating in multi-employer cost-sharing pension plans.

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

For the purpose of applying the requirements of GASBS No. 27, the state government of the Government is considered to be the sponsor of the Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS) and System 2000, a multiemployer cost-sharing defined benefit pension plan and a hybrid defined contribution plan, respectively, in which the employees of the **Municipality** participate. The **Municipality** is considered a participant, and not a sponsor, of these retirement systems since the majority of the participants in the aforementioned pension trust funds are employees of the Government and the basic financial statements of such retirement systems are part of the financial reporting entity of the Government.

11) *Landfill*

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.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

12) Net Assets/Fund Balance

Net Assets

The GWFS and Proprietary Funds Financial Statements utilize a net assets presentation, which are categorized as follow:

- *Invested in Capital Assets, Net of Related Debt* – These consists of capital assets, net of accumulated depreciation and amortization, reduced by the outstanding balances of bonds payable, notes payable and other debts that are attributed to the acquisition, construction or improvements of those assets. For the purposes of determining the outstanding debt attributed to capital assets, the total long-term debt related to the acquisition, construction or improvements of capital assets has been reduced by any related unspent debt proceeds and any related unamortized debt issuance costs. In addition, the outstanding debt attributed to capital assets does not include accrued interest payable, non-capital accrued liabilities, inter-fund loans and other financial assets. Net assets invested in capital assets, net of related debt is comprised of the following:

	<u>Governmental Activities</u>
Capital Assets, Net of Accumulated Depreciation	\$ 84,193,302
Outstanding Balance on Related Debt	(21,421,000)
Unspent Capital Debt Proceeds	<u>12,963,201</u>
Total Invested in Capital Assets, Net of Related Debt.....	<u>\$ 75,735,503</u>

- *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, it is the **Municipality's** policy to use restricted resources first, then unrestricted resources as they are needed.

Fund Balance

The GFFS 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. Following is a brief description of the nature of certain reserves.

- *Reserve for Encumbrances* – Represent future expenditures under purchase orders, contracts and other commitments. These committed amounts generally will become liabilities in future periods as the goods or services are received.
- *Reserve for Debt Service* – The fund balance of the debt service funds is reserved for the payment of debt service in the subsequent years.
- *Reserve for Capital Projects* – Certain assets, primarily cash and investments, and cash with fiscal agent to be invested in capital projects under contracts and other commitments. These committed amounts generally will become liabilities in future periods as the projects are completed.
- *Reserve for Other Purposes* – Certain assets, primarily cash of grants and contributions that are authorized to be carried over and expended in the ensuing year.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

C. Interfund Transactions

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

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

Intra-Entity Transactions – Advances between funds are also presented as amounts due to and due from other funds. However, these transfers and related amounts receivables and payables are considered internal balances and activities that have been eliminated in the government-wide financial statements.

D. Risk Financing

The **Municipality** carries commercial insurance to cover property and casualty, theft, tort claims and other losses. Insurance policies are negotiated by the Puerto Rico Treasury Department and costs are allocated among all the municipalities of Puerto Rico. Also, principal officials of the **Municipality** are covered under various surety bonds. Cost of insurance allocated to the **Municipality** and deducted from the gross property tax collections by the MRCC for the year ended June 30, 2009 amounted to approximately \$429,602. The current insurance policies have not been cancelled or terminated. In addition, MRCC deducted approximately \$134,176 for workers compensation insurance covering all municipal employees for the same period.

E. Use of Estimates

The preparation of the basic financial statements in conformity with USGAAP 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.

F. Reclassifications

Various reclassifications have been made in the accompanying basic financial statements which affect the comparability with the basic financial statements issued for previous fiscal years.

G. Future Adoption of Accounting Pronouncements

The Governmental Accounting Standards Board (GASB) issued the following pronouncements that have effective dates after June 30, 2009:

GASB Statement No. 51, *Intangible Assets*. This Statement requires that an intangible asset be recognized in the *Statement of Net Assets* only if it is considered identifiable. Additionally, this Statement establishes a specified-conditions approach to recognizing intangible assets that are internally generated. Effectively, outlays associated with the development of such assets should not begin to be capitalized until certain criteria are met. Outlays incurred prior to meeting these criteria should be expensed as incurred. This Statement also provides guidance on recognizing internally generated computer software as an intangible asset. This Statement is effective for financial statements for periods beginning after June 15, 2009. The provisions of this Statement generally are required to be applied retroactively.

For governments that were classified as phase 1 or phase 2 governments for the purpose of implementing GASBS No. 34, retroactive reporting is required for intangible assets acquired in fiscal years ending after June 30, 1980, except for those considered to have indefinite useful lives as of the effective date of this Statement and those that would be considered internally generated. Retroactive reporting of these intangible assets by phase 3 governments is encouraged but not required. Retroactive reporting is not required but is permitted for intangible assets considered to have indefinite useful lives as of the effective date of this Statement and those considered to be internally generated.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*. Statement 53 is intended to improve how state and local governments report information about derivative instruments—financial arrangements used by governments to manage specific risks or make investments—in their financial statements. The Statement specifically requires governments to measure most derivative instruments at fair value in their financial statements that are prepared using the economic resources measurement focus and the accrual basis of accounting. The guidance in this Statement also addresses hedge accounting requirements and is effective for financial statements for reporting periods beginning after June 15, 2009, with earlier application encouraged.

GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*. Statement 54 is to enhance the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied and by clarifying the existing governmental fund type definitions. This Statement establishes fund balance classifications that comprise a hierarchy based primarily on the extent to which a government is bound to observe constraints imposed upon the use of the resources reported in governmental funds.

The initial distinction that is made in reporting fund balance information is identifying amounts that are considered *nonspendable*, such as fund balance associated with inventories. This Statement also provides for additional classification as restricted, committed, assigned, and unassigned based on the relative strength of the constraints that control how specific amounts can be spent. The requirements of this Statement are effective for financial statements for periods beginning after June 15, 2010, with earlier application encouraged.

3. CASH AND INVESTMENTS

Cash in Banks

The **Municipality's** cash and investments at June 30, 2009 are composed of: (1) demand deposits in commercial banks, (2) demand deposits in the Government Development Bank of Puerto Rico (GDB, fiscal agent), and (3) cash equivalents in commercial banks. Cash equivalents of \$58.3 million are deposits in interest bearing commercial bank accounts and GDB, and certificates of deposit in commercial banks, and are recorded at cost, which approximates fair value.

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

The **Municipality** follows the practice of pooling cash. At June 30, 2009, the pool cash account in interest bearing commercial banks accounts had a balance of \$44.4 million of which \$20.0 million in the General Fund, \$65,240 of Head Start Program, \$8.8 million in the Art Center Fund, and \$15.5 in Other Governmental Funds of which \$2.6 million, \$0.6 million, and \$2.0 million was invested in certificate of deposits in Popular Bank of Puerto Rico, Fajardo Branch (the first two), and WesternBank, Fajardo Branch that generates an annual interest rate of 3.65%, 3.00%, and 3.65%, respectively. The balance in the pooled cash account is available to meet current operating requirements and any unrestricted excess, if any, is generally invested in interest bearing accounts with commercial banks that generates an average of 2.25% annual interest rate. Any deficiency in the pooled cash account is assumed by the general fund and covered through future budgetary appropriation.

Under the laws and regulations of the Government, public funds deposited by the **Municipality** in commercial banks must be fully collateralized for the amounts deposited in excess of the Federal Deposit Insurance Corporation (FDIC) coverage. All securities pledged as collateral are held by agents designated by the Government's Secretary of the Treasury, but not in the **Municipality's** name.

Cash with fiscal agent in the debt service fund consists principally of property tax collections amounting to \$10.0 million that are restricted for the payment of the **Municipality's** debt service, as required by law. Cash with Fiscal Agent consist principally of \$3.9 million in other governmental funds that are restricted for the acquisition, construction or improvement of major capital assets. The amounts deposit in GDB is maintained in interest bearing accounts and is not collateralized.

The **Municipality** follows the provisions of GASBS No. 40, *Deposit and Investment Risk Disclosure, an Amendment to GASB Statement No. 3*. Accordingly, the following is essential information about credit risk, interest rate risk, custodial credit risk, and foreign exchange exposure of deposits and investments of the **Municipality** at June 30, 2009:

3. CASH AND INVESTMENTS (continuation)

Credit Risk

This is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. At June 30, 2009, the **Municipality** has invested only in cash equivalents of \$44.5 million consisting of deposit in interest bearing commercial bank accounts, which are insured by the FDIC, generally up to a maximum of \$100,000 (actually \$250,000 up to December 2009). As previously mentioned, public funds deposited by the **Municipality** in commercial banks must be fully collateralized for the amounts deposited in excess of the FDIC coverage. No investments in debt of equity securities were made during the Fiscal Year ended June 30, 2009. Therefore, the **Municipality's** management has concluded that the credit risk related to any possible loss related to defaults by commercial banks on the **Municipality's** deposits is considered low at June 30, 2009.

Interest Rate Risk

This is the risk that changes in interest rates of debt investments will adversely affect the fair value of an investment. The **Municipality** manages its exposure to declines in fair values by: (1) not including debt or equity investments in its investments portfolio at June 30, 2009, (2) limiting the weighted average maturity of its investments in certificates of deposit to periods of three months or less, and (3) keeping most of its banks deposits in certificates of deposit and in interest bearing accounts generating interest at prevailing market rates. Therefore, at June 30, 2009, the interest risk associated with the **Municipality's** cash and cash equivalent is considered low.

Custodial Credit Risk

This is the risk that, in the event of the failure of a depository financial institution, the **Municipality** will not be able to recover its cash and investments or will not be able to recover collateral securities that are in the possession of an outside party. Pursuant to the Investment Guidelines for the Government adopted by GDB, the **Municipality** may invest in obligations of the Government, obligations of the United States, certificates of deposit, commercial paper, banker's acceptance, or in pools of obligations of the municipalities of Puerto Rico, which are managed by GDB. At June 30, 2009, the **Municipality** has balances deposited in commercial banks amounting to \$44.4 million which are insured by the FDIC up to the established limit and the excess are fully collateralized as explained above. Deposits in GDB, amounting to \$13.9 million are uninsured and uncollateralized. However, no losses related to defaults by GDB on deposit transactions have been incurred by the **Municipality** through June 30, 2009. It is management's policy to only maintain deposits in banks affiliated to FDIC to minimize the custodial credit risk, except for GDB. Therefore, the **Municipality's** management has concluded that at June 30, 2009, the custodial credit risk associated with the **Municipality's** cash and cash equivalents is considered low.

Foreign Exchange Risk

This is the risk that changes in exchange rates will adversely affect the value of an investment or a deposit. According to the aforementioned investment guidelines, adopted by the **Municipality**, the **Municipality** is prevented from investing in foreign securities or any other types of investments for which foreign exchange risk exposure may be significant. Accordingly, management has concluded that the foreign exchange risk related to the **Municipality's** deposits is considered low at June 30, 2009.

4. RECEIVABLES

Following is the account receivables of other governmental funds as of June 30, 2009:

	AMOUNT
CDBG	\$ 889,777
Child Care Food Program	127,368
Others	<u>53,652</u>
Total Federal Grants	<u>\$ 1,070,797</u>

5. OTHER RECEIVABLES

The due from governmental units for the fiscal year ended June 30, 2009, corresponds to the Puerto Rico Treasury Department (Christmas Bonus) for \$157,453 and Property Tax Final Liquidation from MRCC for \$426,089 of the Debt Service Fund.

6. INTERFUND RECEIVABLE, PAYABLES AND TRANSFERS

A. Interfund Receivable and Payable Balances

Due to/from Other Funds at June 30, 2009 are summarized as follows:

INTERFUND RECEIVABLE	INTERFUND PAYABLE	AMOUNT
General	Head Start Fund	\$ 322,137
Other Fund	General Fund	<u>22,937</u>
TOTAL		<u>\$ 345,074</u>

6. INTERFUND RECEIVABLE, PAYABLES AND TRANSFERS

B. Interfund Transfers

Transfers are indicative of funding for capital projects or debt service, and subsidies of various operations.

INTERFUND TRANSFERS WITHIN THE GOVERNMENTAL FUNDS			
SOURCES	TRANSFER TO	AMOUNT	PURPOSE
General Fund	Debt Service Fund	\$ 138,120	Debt Payment
General Fund	Other Governmental Fund	168,261	Equity Transfer
Other Governmental Fund	Debt Service Fund	<u>455,841</u>	Equity Transfer
Total		<u>\$ 762,222</u>	

7. DUE TO OTHER GOVERNMENTAL UNITS

As of June 30, 2009, balance due to other governmental units of the General Fund for services rendered to the **Municipality**, consists of the following:

	AMOUNT
PR Department of Labor	\$ 61,540
PR Water and Sewer Authority	13,258
Retirement System Administration	112,551
General Service Administration	<u>5,371</u>
Total Due to Governmental Units	<u>\$ 192,720</u>

8. DEFERRED REVENUES

Governmental funds report *deferred revenue* in connection with receivables for revenues 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 revenue* and *unearned revenue* reported in the governmental funds were as follows:

	UNAVAILABLE	UNEARNED
Volume of Business Taxes	\$ -	\$ 4,386,415
Other Governmental Funds	996,603	-
Head Start	2,268,341	-
Christmas Bonus	<u>157,453</u>	-
Total Deferred/Unearned Revenue	<u>\$ 3,422,397</u>	<u>\$ 4,386,415</u>

9. CAPITAL ASSETS

Capital Assets activities for the fiscal year ended June 30, 2009 was as follows:

DESCRIPTION	BALANCE JUNE 30, 2008	ADJUSTMENT	RECLASSI- FICTION	INCREASE	DECREASE	BALANCE JUNE 30, 2009
Non-Depreciable Capital Assets:						
Land	\$ 35,275,201	\$ -	\$ -	\$ 433,252	\$ -	\$ 35,708,453
Construction in Progress	938,286	-	(2,073,348)	1,135,062	-	-
Others	765,615	-	-	-	-	765,615
Total Non-Depreciable Capital Assets	36,979,102	-	(2,073,348)	1,568,314	-	36,474,068
Depreciable Capital Assets:						
Buildings and Improvements	39,486,296	461,282	1,719,915	1,128,109	-	42,795,602
Infrastructure	36,265,608	(461,282)	353,433	-	-	36,157,759
Machinery and Equipment	4,626,998	-	-	466,526	-	5,093,524
Motor Vehicles	2,729,391	-	-	23,600	-	2,752,991
Total Depreciable Capital Assets	83,108,293	-	2,073,348	1,618,235	-	86,799,876
Less Accumulated Depreciation:						
Buildings and Improvements	(12,409,561)	(405,475)	-	(697,253)	-	(13,512,289)
Infrastructure	(17,395,247)	(801,038)	-	(555,368)	-	(18,751,653)
Machinery and Equipment	(3,951,116)	96,852	-	(360,768)	-	(4,215,032)
Motor Vehicles	(2,455,713)	(52,321)	-	(93,634)	-	(2,601,668)
Total Accumulated Depreciation	(36,211,637)	(1,161,982)	-	(1,707,023)	-	(39,080,642)
Total Depreciable Capital Assets (Net)	46,896,656	(1,161,982)	2,073,348	(88,788)	-	47,719,234
CAPITAL ASSETS, NET	\$ 83,875,758	\$ (1,161,982)	\$ -	\$ 1,479,526	\$ -	\$ 84,193,302

Depreciation expenses were charged to governmental functions/programs as follows:

	AMOUNT
General Government	\$ 614,528
Public Safety	238,983
Public Works	68,281
Culture and Recreation	699,880
Urban Development	85,351
Total Depreciation Expenses	\$ 1,707,023

10. GENERAL LONG-TERM DEBTS

A. General Obligations Bonds

The principal long-term obligations of the **Municipality** are general obligation bonds issued to finance the construction and improvements of public facilities. The **Municipality's** obligations long-term debt retirements are appropriated and paid from resources accumulated in the Debt Service Fund (See Note 11).

10. GENERAL LONG-TERM DEBTS (continuation)

General obligations bonds as of June 30, 2009, are comprised of the following individual issues:

Type of Obligation and Purpose	Maturity Date	Interest Rate	Amount
General Obligation Bonds – Property Taxes:			
\$11,130,000, Series 1997-98 - General Construction	2016	5.19% to 6.34%	\$ 7,010,000
\$14,440,000, Series 2006-07 - General Construction	2031	5.59% to 7.00%	14,161,000
\$370,000, Series 1994-95 - General Construction	2019	6.106% to 8.206%	250,000
Total General Obligation Bonds			\$ 21,421,000

B. Other Long-Term Debts

Property Taxes – Treasury Department

This amount represents the excess of advance property taxes over collection previously administered by Puerto Rico Treasury Department. On July 1, 2002, the enacted Law Number 29, authorized that part of the excess of revenue from LOTO should be use to amortized this debt. Annually the Treasury Department should notify to the **Municipality** the amount applied to the debt.

Borrowing from MRCC

On July 1, 2002, the **Municipality** entered into a repayment agreement with the GDB and MRCC to repay the uncollectible property tax sale authorized by the enacted Law Number 42. The original debt was \$235,722 to be paid during 30 years plus annual interest of 6.1875%.

MRCC Liquidation

The total amount of \$310,570 to be paid during fiscal year 2009-2010 without interests corresponded to the Fiscal Year 2008-2009 final liquidation of property taxes.

Christmas Bonus

This amount represents the estimated accrued Christmas bonus accumulated as of June 30, 2009 and payroll related benefits, representing the benefit to employees to be paid during the first week of December 2009.

Claims and Judgments

This amount represents the amount accrued for possible claims arising from litigations.

Compensated Absences

This amount represents the estimated accrued vacation benefits, accrued sick leave benefits and payroll related benefits, representing the **Municipality's** commitment to fund such costs from future operations.

10. GENERAL LONG-TERM DEBTS (continuation)

Following are the Other Long-Term Debts:

DESCRIPTION	BALANCE	NEW	RETIREMENTS	BALANCE	AMOUNTS	AMOUNTS
	JULY 1, 2008		AND	JUNE 30, 2009	DUE WITHIN	DUE AFTER
		ISSUES	ADJUSTMENT		ONE YEAR	NEXT YEAR
Property Taxes-Treasury Dept.	\$ 1,950	\$ -	\$ (972)	\$ 978	\$ 972	\$ 6
Law Number 42 - MRCC	217,749	-	(3,966)	213,783	4,214	209,569
LIMS - MRCC	373,449	-	(99,000)	274,449	104,978	169,471
MRCC Liquidation	-	310,570	-	310,570	310,570	-
Christmas Bonus	340,367	314,906	(340,367)	314,906	314,906	-
Claims and Judgments	101,227	-	-	101,227	-	101,227
Compensated Absences	3,360,369	332,463	(344,789)	3,348,043	2,274,082	1,073,961
TOTAL	\$ 4,395,111	\$ 957,939	\$ (789,094)	\$ 4,563,956	\$ 3,009,722	\$ 1,554,234

C. Changes in General Long-Term Debts

The following is a summary of changes in long-term debts for the year ended June 30, 2009:

DESCRIPTION	BALANCE	NEW	RETIREMENTS	BALANCE	AMOUNTS	AMOUNTS
	JULY 1, 2008		AND	JUNE 30, 2009	DUE WITHIN	DUE AFTER
		ISSUES	ADJUSTMENTS		ONE YEAR	NEXT YEAR
General	\$ 22,325,000	\$ -	\$ (904,000)	\$ 21,421,000	\$ 1,004,000	\$ 20,417,000
Others Debts	4,395,111	957,939	(789,094)	4,563,956	3,009,722	1,554,234
TOTAL	\$ 26,720,111	\$ 957,939	\$ (1,693,094)	\$ 25,984,956	\$ 4,013,722	\$ 21,971,234

D. Debt Compliance

There are a number of limitations and restrictions contained in the various bond indentures. The Municipality believes it is in compliance with all significant limitations and restrictions.

The annual requirements to amortize the long-term debts outstanding as of June 30, 2009 are as follows:

YEAR ENDING JUNE 30,	General Obligation Bonds		Other Long-Term Obligations		TOTAL	
	PRINCIPAL	INTEREST	PRINCIPAL	INTEREST	PRINCIPAL	INTEREST
	PAYMENT	PAYMENT	PAYMENT	PAYMENT		
2010	\$ 1,004,000	\$ 959,857	\$ 3,009,722	\$ 30,988	\$ 4,013,722	\$ 990,845
2011	1,069,000	1,343,229	115,803	24,567	1,184,803	1,367,796
2012	1,136,000	1,274,076	62,915	17,757	1,198,915	1,291,833
2013	1,208,000	1,199,978	5,060	12,319	1,213,060	1,212,297
2014	1,301,000	1,119,988	5,408	12,000	1,306,408	1,131,988
2015-2019	5,465,000	4,322,554	32,401	54,488	5,497,401	4,377,042
2020-2024	3,047,000	3,071,356	43,944	42,947	3,090,944	3,114,303
2025-2029	3,984,000	1,851,850	59,599	27,293	4,043,599	1,879,143
2030-2034	3,207,000	361,865	53,916	6,879	3,260,916	368,744
Unmatured	-	-	1,175,188	-	1,175,188	-
TOTAL	\$ 21,421,000	\$ 15,504,753	\$ 4,563,956	\$ 229,238	\$ 25,984,956	\$ 15,733,991

11. 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 12).

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.

12. PROPERTY TAXES

The **Municipality** is authorized by Act No. 81 to impose and collect property taxes from any natural or legal person that, at January 1st of each calendar year: (1) is engaged in trade or business and is the owner of personal or real property used in trade or business, or (2) owns residential real property with a value in excess of \$15,000 (at 1957 market price).

The MRCC 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 personal property tax is self assessed by the taxpayer on a return, which is to be filed and paid in full by May 15 of each year with the MRCC and based on current values as of December 31 of previous year. Real property tax is assessed by the MRCC on each piece of real estate and on each building or residence. The property tax contribution is levied each year over the appraised value of the real property at the beginning of the calendar year. The real property assessment is based on the current value existing in the year 1957.

The MRCC is responsible for the billing of real property taxes and collections of both, personal and real property taxes on behalf of all the municipalities of Puerto Rico. Prior to the beginning of each fiscal year, the MRCC informs the **Municipality** of the estimated amount of property taxes expected to be collected for the ensuing fiscal year. Throughout the year, the MRCC advances funds to the **Municipality** based on the initial estimated collections. The MRCC is required by law to prepare a settlement statement on a fiscal year basis, whereby a comparison is made between the amounts advanced to the **Municipality** and amounts actually collected from taxpayers. This settlement has to be completed on a preliminary basis not later than three months after fiscal year-end, and a final settlement made not later than six months after year-end. If the MRCC remits to the **Municipality** property taxes advances, which are less than the tax actually collected, a receivable from the MRCC is recorded at June 30. However, if advances exceed the amount actually collected, a borrowing from MRCC is recorded at June 30. The difference between the advances and the final settlement from MRCC for the fiscal year 2009 resulted in a receivable of \$426,089 for the Debt Service Fund and a payable (long-term) in the General Fund for the amount of \$310,570 [See Note 10 (B)].

The tax rate for fiscal year 2009 is 10.43% for real property and 8.43% for personal property of which 1.03% of both are for the redemption of public debt issued by the Commonwealth of Puerto Rico and 9.40% and 7.40%, respectively, belongs to the **Municipality**. The Commonwealth of Puerto Rico also contributes an annual tax rate of 0.20% of the property tax collected. The remaining percentage is distributed as follows: (a) 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. A portion of such amount is deposited in an equalization fund together with a percentage of the net revenues of the Puerto Rico electronic lottery and a subsidy from the Commonwealth of Puerto Rico. The remaining portion belonging to the **Municipality** of 3.40% represents the ad-valorem property taxes withheld by the MRCC and restricted for debt service, which is accounted for through the debt service fund (See Note 11). The **Municipality** hasn't 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. As part of Law No. 83 of August 30, 1991, as amended, the exempt amount to be paid by the Puerto Rico Treasury Department to the **Municipality** was frozen as of January 1, 1992. The Municipal Revenue Collection Center, instead of the property taxpayer, becomes the source of payment in these cases.

12. PROPERTY TAXES (continuation)

In addition, the law 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 MRCC 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 MRCC from taxpayers. The MRCC 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 MRCC. Due to the fact that collections of property tax are applied to the advances of property tax paid by the MRCC, the amortization of the advance at end of year was not available due to that is in process of verification by external auditors.

13. VOLUME OF BUSINESS TAXES

Volume of Business Taxes is recorded in the fiscal year in which payments is due and, accordingly, represents taxes which are due and uncollected at June 30, 2009. 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 23 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 23. 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.

14. SALES AND USE TAXES

On July 29, 2007 Government approved Act No. 80 which amends Act No. 117 of July 4, 2006 to impose to all the municipalities of Puerto Rico uniform municipal sales and use tax of 1.5%. Effective August 1, 2007 1.0% of the 1.5% is collected by the municipalities and the remaining 0.5% is collected by the Puerto Rico Secretary of Treasury (PRST). The act also provides for restrictions on the use of the sales tax, which is required be invested in solid waste and recycling programs, capital improvements and health and public safety costs.

Amount collected by the PRST is deposited in accounts of special funds in GDB, subject to restrictions imposed and distributed as follows: 0.2% will be deposited in a "Municipal Development Fund" to finance costs as restricted by the act; 0.2% will be deposited in a "Municipal Redemption Fund" to finance loans as part of the debt service fund; and 0.1% is retained by Puerto Rico Secretary of Treasury and will be deposited in a "Municipal Improvement Fund" to be assigned by the Legislature for capital improvement projects.

Municipality imposes a Sales and Use Taxes on the sales price of a taxable item or on the purchase price of all usage, storage or consumption of a taxable item. All merchants required to collect the Sales and Use Tax, are required to file a monthly Sales and Use Tax Return Form, no later than the 20th of the following month from the month being reported.

Sales and Use Taxes receivable represents filed Sales and Usage Taxes returns that were collected subsequent to June 30, 2009, but pertaining to the current year period.

15. CONSTRUCTION EXCISE TAXES

Municipality imposes and collects municipal construction excise taxes to most natural and legal persons and any governmental instrumentality that carry out activities related to construction, expansion, major repairs, relocations, alterations and other types of permanent improvements to residential, commercial and industrial buildings, and any structures within the territorial area of the **Municipality**. The tax is also applicable to infrastructure projects, the installation of machinery, equipment and fixtures, and other types of construction-related activities.

The construction excise tax generally is a self-assessed tax imposed over the cost of the project, net of certain exemptions such as the costs associated with the acquisition of land, existing buildings and improvements, project design and other engineering fees, licenses and permits, consulting and legal fees. The tax is paid by the taxpayer before the beginning of the construction project. The activities covers by this tax and the exemption granted are as follows:

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.

16. 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.

17. PENSION PLAN

Description of the Plan

Employees of the **Municipality** participate in the Employee's Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS). The ERS is cost-sharing multiple-employer defined benefit pension plan sponsored by the Government under the Act No. 447, approved on May 15, 1951, as amended. ERS covers all regular employees of the Government 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.

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

17. PENSION PLAN (continuation)

Participants who have completed at least 30 years of creditable service are entitled to receive the Merit Annuity. Participants who have not attained 55 years of age will receive up to a maximum of 65% of the average salary, as defined, or if they have attained 55 years of age will receive up to a maximum of 75% of the average salary, as defined. Disability retirement benefits are available to members for occupational disability up to a maximum benefit of 50% of the average salary, as defined. However, for non-occupational disability, a member must have at least 10 years of creditable services.

The contribution requirements for both employees and employers are established by law and are not actuarially determined. Employees are required 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 their monthly gross salary. The **Municipality** is required by Act No. 447 to contribute 9.275% of its employees' gross salaries.

Act No. 1 of 1990 made certain amendments applicable to new participants joining the ERS effective April 1, 1990. These changes consist principally of the establishment of contributions at 8.275% of their monthly gross salary, an increase in the retirement age to 65, a decrease in the annuity benefit to 1.5% of the average salary, as defined, for all years of creditable services, a decrease in the maximum disability, and death benefits annuities from 50% to 40% of average salary, as defined, and the elimination of the Merit Annuity for participants who have completed 30 years of creditable services.

Law Number 305 was enacted on September 24, 1999, amended the Act Number 447 for the purpose of establishing a new program (System 2000). System 2000 became effective on January 1, 2000. Employees participating in the current system (ERS) as of December 31, 1999, may elect either to stay in the defined-benefit plan or transfer to the new program. Persons joining the government on or after January 1, 2000, will only be allowed to become members of System 2000.

System 2000 is a hybrid defined contribution plan, also known as a cash balance plan. Under this new plan there will be a pool of pension assets, which will be invested by the System, together with those of the current defined-benefit plan. Benefits at retirement age will not be guaranteed by the Government. The annuity will be based on a formula which assumes that each year the employees' contribution (with a minimum of 8.275% up to a maximum of 10%) of their monthly salary, and will be 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. Participants receive periodic account statements similar to those of defined contribution plans showing their accrued balances. Disability pensions are not being granted under System 2000. The employers' contributions (9.275% of the employees' salary) will be used to fund the current plan.

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.

Funding Policy

The authority under which the funding policy and the obligations to contribute to the ERS and System 2000 by the plans' members, employers and other contributing entities (state of municipal contributions), are established or may be amended by law.

Contribution requirements are established by law and are as follows:

Municipality	9.275% of gross salary
Employees:	
Hired on or before March 31, 1990	5.775% of gross salary up to \$6,600 8.275% of gross salary over \$6,600
Hired on or after April 1, 1990	8.275% of gross salary

Annual Contribution

Total employee contributions to the above-mentioned plans during the year ended June 30, 2009, 2008 and 2007 amounted to approximately \$1,127,441. The Municipality's contributions during those years are recognized as total pension expenditures/expenses in the category of administration as follow:

FISCAL YEAR	LAW NO. 447	SYSTEM 2000
2009	\$ 240,922	\$ 175,835
2008	253,525	171,756
2007	277,587	172,628

17. PENSION PLAN (continuation)

These amounts represented the 100% of the required contribution for the corresponding year. Additionally, changes made in the types and amounts of benefits offered by special laws and costs of living adjustments, led to a one-time recommended contribution to fund the retroactive adjustment related to the changes.

The Employee's Retirement System of the Government of Puerto Rico provides additional information of the ERS and System 2000. They issue a publicly available financial report that includes financial statements and required supplementary information for ERS, as a component unit of the Government. That report may be obtained by writing to the Administration at PO Box 42003, Minillas Station, San Juan, PR 00940-2003.

18. CONTINGENCIES

A. Claims and Judgments

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

In addition, the **Municipality** is a defendant or co-defendant in several legal proceedings, which are in discovery stage. Certain of these claims are covered by insurance. Legal counsel with the information currently available can not determine the final outcome of these claims, with the exception of three (3) lawsuits related to forceful expropriation, to which the legal counsel has estimate a potential loss of \$101,227. Accordingly, the financial statements include this provision in the Long-Term Liabilities.

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.

C. Construction Commitments

The **Municipality** had commitments of approximately of \$0.5 million for the construction, improvements, or renovation of several facilities.

19. NET ASSETS RESTATEMENTS

A. Net Assets Restatements

During the year, the **Municipality** adjusted the governmental net assets for reclassification of capital assets inventory and the corresponding accumulated depreciation. The following schedule reconciles the June 30, 2008 Net Assets, as previously reported to Beginning Net Assets, as restated, July 1, 2008, for Governmental Activities.

Net Assets, as Previously Reported, June 30, 2008	\$ 113,364,973
Adjustment to Capital Assets	<u>(1,161,982)</u>
Net Assets, as Restated, July 1, 2008	<u>\$ 112,202,991</u>

END OF NOTES

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF FAJARDO, PUERTO RICO

REQUIRED SUPPLEMENTARY INFORMATION
BUDGETARY COMPARISON SCHEDULE – GENERAL FUND
FOR THE FISCAL YEAR ENDED JUNE 30, 2009

	Budget Amounts		Actual Amounts (Budgetary Basis) (See Note A)	Variance with Final Budget
	Original	Final		
BUDGETARY FUND BALANCE, JULY 1, 2008	\$ 10,575,481	\$ 10,575,481	\$ 10,575,481	\$ -
Resources (Inflows):				
Property Taxes	8,254,320	8,454,319	8,565,223	110,904
Volume of Business Taxes	5,508,215	5,508,215	5,795,746	287,531
Intergovernmental Revenues	3,813,081	3,813,081	4,158,158	345,077
Licenses and Permits	1,215,800	1,194,965	1,198,075	3,110
Interests	1,200,000	1,055,836	1,418,182	362,346
Miscellaneous	559,300	524,300	2,530,225	2,005,925
Total Resources (Inflows)	20,550,716	20,550,716	23,665,609	3,114,893
Amounts Available for Appropriation	31,126,197	31,126,197	34,241,090	3,114,893
Charges to Appropriations (Outflows):				
Mayor and Municipal Legislature	3,143,122	3,644,561	2,919,499	725,062
General Government	7,586,135	8,053,746	6,652,087	1,401,659
Public Safety	1,238,005	1,255,397	1,010,598	244,799
Public Works	3,398,654	3,255,376	2,785,698	469,678
Culture and Recreation	1,207,561	1,573,172	1,432,907	140,265
Health and Sanitation	2,429,833	2,059,996	1,788,625	271,371
Human Services and Welfare	1,424,306	1,449,038	898,115	550,923
Urban Development	-	27,587	27,587	-
Capital Outlays	123,100	193,607	188,347	5,260
Transfer to Other Funds	-	3,112,183	306,381	2,805,802
Total Charges to Appropriations	20,550,716	24,624,663	18,009,844	6,614,819
BUDGETARY FUND BALANCE, JUNE 30, 2009	\$ 10,575,481	\$ 6,501,534	\$ 16,231,246	\$ 9,729,712

See accompanying Notes to Required Supplementary Information.

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

	<u>General Fund</u>
Sources/Inflows of Resources:	
Actual Amounts (Budgetary Basis) *Available for Appropriation* from the Budgetary Comparison Schedule (See Page 46)	\$ 34,241,090
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>(10,575,481)</u>
Total Revenues as Reported on the Statement of Governmental Funds Revenues, Expenditures and Changes in Fund Balance (See Page 22)	<u>\$ 23,665,609</u>
Uses/Outflows of Resources:	
Actual Amounts (Budgetary Basis) *Total Charges to Appropriation* from the Budgetary Comparison Schedule (See Page 46)	\$ 18,009,844
Difference – Budget to GAAP:	
Encumbrances for supplies and equipment ordered but not received are reported in the year the order is placed for budgetary reporting purposes	(570,285)
Payments of encumbrances of prior year that are expenditures for financial reporting purposes but are not outflows for budgetary purposes	410,878
Transfers to other funds are outflows of budgetary resources but are not expenditures for financial reporting purposes	<u>(306,381)</u>
Total Expenditures as Reported on the Statement of Governmental Funds Revenues, Expenditures and Changes in Fund Balance (See Page 22)	<u>\$ 17,544,056</u>

NOTE B Explanation of Differences Between Budgetary Fund Balance and GAAP Fund Balance

Budgetary Fund Balance, June 30, 2009	\$ 16,231,246
Timing Differences:	
Encumbrance	570,285
Cancellation of Prior Year Encumbrance	354,582
Restriction from Deferred Revenues	(4,543,868)
Perspective Differences:	
Due from Other Funds not Available	345,074
Cancellation of Due to Other Funds	<u>2,688,739</u>
Fund Balance, June 30, 2009	<u>\$ 15,646,058</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, 2009**

FEDERAL GRANTOR / PASS THROUGH GRANTOR / PROGRAM OR CLUSTER TITLE	FEDERAL CFDA NUMBER	PASS-THROUGH ENTITY IDENTIFYING NUMBER	FEDERAL EXPENDITURES
U.S. Department of Agriculture:			
USDA – Rural Development:			
Rural Housing Preservation Grants	10.433		\$ 22,333
Pass-Through Administration for the Childhood Care and Integral Development:			
Child and Adult Care Food Program (USDA)	10.558	N/AV 241-2008-029 241-2009-029	6,453 95,102 <u>296,538</u>
Subtotal Child and Adult Care Food Program			<u>398,093</u>
Total U.S. Department of Agriculture			<u>420,426</u>
U.S. Department of Housing and Urban Development:			
Community Development Block Grants/ Entitlements Grant (CDBG)	14.218		1,198,104
Section 8 Housing Choice Voucher Program	14.871		<u>446,589</u>
Total U.S. Department of Housing and Urban Development ...			<u>1,644,693</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	2008-2009-020	<u>51,622</u>
Head Start Program	93.600	04F-2008-02CH9944/05-AD/TA 04F-2009-02CH9944/05-AD/TA	2,762,454 <u>1,133,297</u>
Subtotal Head Start Program			<u>3,895,751</u>
Total U.S. Department of Health and Human Services			<u>3,947,373</u>
U.S. Department of Homeland Security:			
Pass-Through Office of the Governor Authorized Representative:			
State Homeland Security Program	97.004	2005-GE-T5-4009 2004-GE-T4-0008	31,931 <u>89,121</u>
Total U.S. Department of Homeland Security			<u>121,052</u>
TOTAL EXPENDITURES OF FEDERAL AWARDS			<u>\$6,133,544</u>

See accompanying Notes to Schedule of Expenditures of Federal Awards.

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 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 - \$3,895,751 and Other Governmental Funds \$2,237,793.

NOTE 6 MAJOR PROGRAMS

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

END OF NOTES



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 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, 2009, which collectively comprise the **Municipality's** basic financial statements and has issued our report thereon dated December 28, 2009. 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. Accordingly, we do not express an opinion on the effectiveness of the Entity's internal control over financial reporting.

A *control deficiency* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the **Municipality's** ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the **Municipality's** financial statements that is more than inconsequential will not be prevented or detected by the **Municipality's** internal control.

A *material weakness* is a significant deficiency, or combination of significant deficiencies, that result in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the **Municipality's** internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weakness. We did not identify deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.



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

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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*.

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, 2010

Caguas, Puerto Rico
December 28, 2009





201 Gaudier Benítez Ave.
Consolidated Mail 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, 2009. 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, 2009. However, the results of our auditing procedures disclosed an instance 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 item 2009-III-01.

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 the 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, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the **Municipality's** internal control over compliance.



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

Our consideration of the internal control over compliance was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies or material weaknesses as defined below. However, as discussed below, we identified certain deficiency in internal control over compliance that we consider to be significant deficiency.

A *control deficiency* is the **Municipality's** internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the **Municipality's** ability to administer a federal program such that there is more than a remote likelihood that a noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the **Municipality's** internal control. We consider the deficiency in internal control over compliance described in the accompanying Schedule of Findings and Questioned Costs as item 2009-III-01 to be significant deficiency.

A *material weakness* is a significant deficiency, or combination of significant deficiencies that result in more than a remote likelihood that material noncompliance with the type of compliance requirement of a federal program will not be prevented or detected by the **Municipality's** internal control. We did not consider the deficiency described in the accompanying Schedule of Findings and Questioned Costs to be material weakness.

The **Municipality's** responses to the finding identified in our audit are described in the accompanying Schedule of Findings and Questioned Costs. We did not audit the **Municipality's** response and, accordingly, we express no opinion on it.

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.

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Certified Public Accountants & Consultants
License Number 12, expires on December 1, 2010

Caguas, Puerto Rico
December 28, 2009



PART III
FINDINGS AND QUESTIONED COSTS

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:

- Significant deficiency (ies) identified that are not considered to be material weaknesses? Yes None Reported
- Material weakness (es) identified? Yes No

Noncompliance material to financial statements noted? Yes No

Federal Awards

Internal control over major programs:

- Significant deficiency (ies) identified that are not considered to be material weaknesses? 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/Entitlements Grant
93.600	Head Start Program
97.004	State Homeland Security Program

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

Auditee qualified as low-risk auditee? Yes No

SECTION II – FINANCIAL STATEMENT FINDINGS

NO MATTER IS REPORTED.

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING REFERENCE NUMBER	NUMBER 2009-III-01
FEDERAL PROGRAM	COMMUNITY DEVELOPMENT BLOCK GRANTS / ENTITLEMENTS GRANT (CFDA NO. 14.218) U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
AWARD NUMBER	B-08-MC-720012
COMPLIANCE REQUIREMENT	ALLOWABLE COST/COST PRINCIPLES
TYPE OF FINDING	NONCOMPLIANCE AND SIGNIFICANT DEFICIENCY
CRITERIA	Code of Federal Regulations, 24 CFR, Part 570 Subpart H, Section 570.482 (f)(6), states that the state and its grant recipients must maintain sufficient records to demonstrate the level of public benefit, based on the above standards, that is actually achieved upon completion of the CDBG – assisted economic development activities. Also OMB Circular A-87, Attachment A, Section C (1) (j) states that to be allowable under Federal awards, costs must meet the following general criteria: be adequately documented.
CONDITION	During our evaluation of Certification of Participants of the Housing Rehabilitation Assistance Program we found an internal document from the Program Management to the participants that state the following: "Any participant from the Housing Rehabilitation Assistance Program should perform their repairs in or before sixty (60) calendar days. If you can't perform the repairs in sixty (60) calendar days you must request a time extension and if not requested we will be forced to request the reimbursement of the materials cost. The cost of manpower is your responsibility." After our evaluation of thirty (30) files of participants we found that in twenty five (25) cases the final and only visit made upon the receipt of the materials by the participants was made after sixty (60) days. And in four (4) other cases when the visit was made and the participant did not have used the materials, a time extension from the participants was not documented and no action by the Municipality was taken. In one (1) case the sixty (60) days had passed and at the time of our evaluation no follow up visit was documented.
CAUSE	The Municipality is not verifying in or before the sixty (60) day if the materials have been used to enforce their internal regulations.
EFFECT OR POSSIBLE EFFECT	Municipality may incur in unallowable costs if they don't verify that the donations are used for the purposes established.
RECOMMENDATION	We recommend Municipality to establish the internal controls necessary to ensure that all the processes related to the Housing Rehabilitation Assistance Program are properly monitored and documented.
QUESTIONED COSTS	Not determined.

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING REFERENCE NUMBER NUMBER 2009-III-01 (continuation)

**RESPONSIBLE OFFICIAL'S
RESPONSE AND CORRECTIVE
ACTION PLANNED**

The Officer of Federal Affairs at June 30, 2009 handled 145 cases of Housing Rehabilitation Assistance. At the present, our office staff has conducted 145 inspections with the following results: 131 materials used, 6 requested time extension writing and 8 were not available all time of inspection. In each case a report by the inspector was included and photos from improvements made. The 6 cases requesting extension of time will be re-checked in (30 days) as the 8 cases that were not available. Will also send you written notice of the day that we will be visiting. In addition, we have separated one day a week (Tuesday or Thursday) to carry out inspections of Housing Rehabilitation Assistance provided during this fiscal year.

IMPLEMENTATION DATE June 30, 2010

RESPONSIBLE PERSON Mrs. Mabel Cosme Nieves

END OF SCHEDULE

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

NONE

(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