

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

MUNICIPIO DE FAJARDO
AUDITORÍA 2010-2011
30 DE JUNIO DE 2011

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF FAJARDO**

**BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED
JUNE 30, 2011**

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF FAJARDO
BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

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MUNICIPALITY OF FAJARDO
BASIC FINANCIAL STATEMENTS
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PART I - FINANCIAL SECTION

INDEPENDENT AUDITORS' REPORT

To the Honorable Mayor and
Municipal Legislature
Municipality of Fajardo
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, as of and for the year ended June 30, 2011, 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 opinions on these financial statements based on our audit.

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

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 of Fajardo as of June 30, 2011, and the respective changes in financial position thereof 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 February 10, 2012 on our consideration of the Municipality's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grants, 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 on pages 3 through 15, and the Budgetary Comparison Schedule on page 46 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 methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Municipality of Fajardo's financial statements as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the 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, the information is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

San Juan, Puerto Rico
February 10, 2012

Ortiz, Arsenio Rivera H

The stamp E18906 was affixed to the original of this report.



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF FAJARDO, PUERTO RICO
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

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, 2011. 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 2011 by \$140,023,905 (net assets).
- Revenues decreased by \$1,384,106 and expenses increased by \$6,414,136 in comparison with year 2010, as restated.
- Net change in net assets amounted to \$ 13,357,504, an increase with respect to prior year (2010) 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 \$60,766,970 an increase of \$5,987,790 in comparison with the prior year.
- The General Fund reported an excess of revenues over expenditures and other financing uses of \$ 1,053,571 and an unassigned fund balance of \$14,882,326. Unassigned fund balances decreased by \$1,236,268 from prior year.

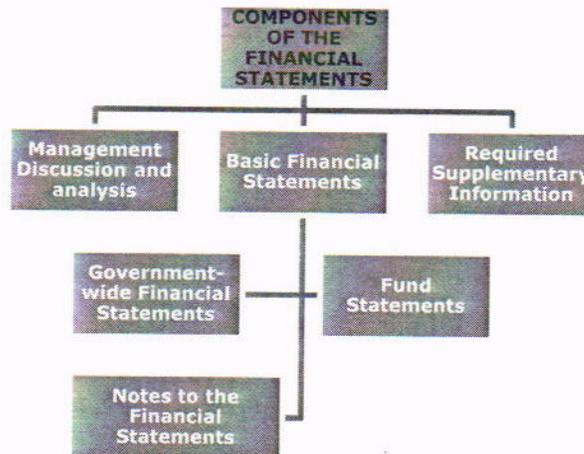
General Financial Highlights

- The investment in net capital assets as of June 30, 2011 was \$85,026,207(net of related debt).
- Long term debt general and special obligations decreased by \$2,205,000 approximately 4% with respect to prior year balance.
- Other long term debts decreases and net reductions from payments amounted to \$2,489,651, respectively.
- On a budgetary basis, actual revenues exceeded actual expenditures by \$17,864,347, revenues increase was mainly due to over estimate of \$2,519,654 in miscellaneous revenues, although Municipality realized economies, principally in general administration \$2,637,598.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF FAJARDO, PUERTO RICO
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2011

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, 2011**

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, 2011**

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, 2011 and 2010:

Net assets (assets over liabilities) may serve over time as a useful indicator of a government's financial position. Net assets for the year decreased, with respect to prior year as restated. The most significant changes were an increase in restricted assets of \$ 15,265,916

Table 1		
Commonwealth of Puerto Rico Municipality of Fajardo, Puerto Rico Statement of Net Assets As of June 30, 2011		
	2011	2010
Current and non-current assets.....	\$78,069,026	\$ 68,141,379
Capital assets (As Restated).....	<u>89,772,020</u>	<u>90,914,132</u>
Total Assets	<u>167,841,046</u>	<u>159,055,511</u>
Current liabilities.....	902,804	1,107,961
Deferred revenues.....	6,145,063	6,899,843
Long-term liabilities (As Restated).....	<u>20,769,274</u>	<u>24,244,024</u>
Total Liabilities	<u>27,817,141</u>	<u>32,251,828</u>
Investment in capital assets, Net of		
Related Debt.....	85,026,207	82,857,737
Restricted.....	42,322,055	27,056,139
Unrestricted (As Restated).....	<u>12,675,643</u>	<u>16,752,525</u>
Total Net Assets	<u>\$ 140,023,905</u>	<u>\$ 126,666,401</u>

The largest portion of the Municipality's net assets reflects its investment in capital assets (e.g., land, buildings, equipment, and infrastructure) for \$85,026,207 total capital assets (\$89,772,020) less accumulated depreciation (\$42,460,921) and less any related outstanding debt (\$745,813) 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, 2011 the Municipality presented unrestricted net assets of \$12,675,643. This balance was affected by long term obligations such as compensated absences \$1,968,774 and other debts for the amount of \$520,877 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, 2011**

Changes in Net Assets

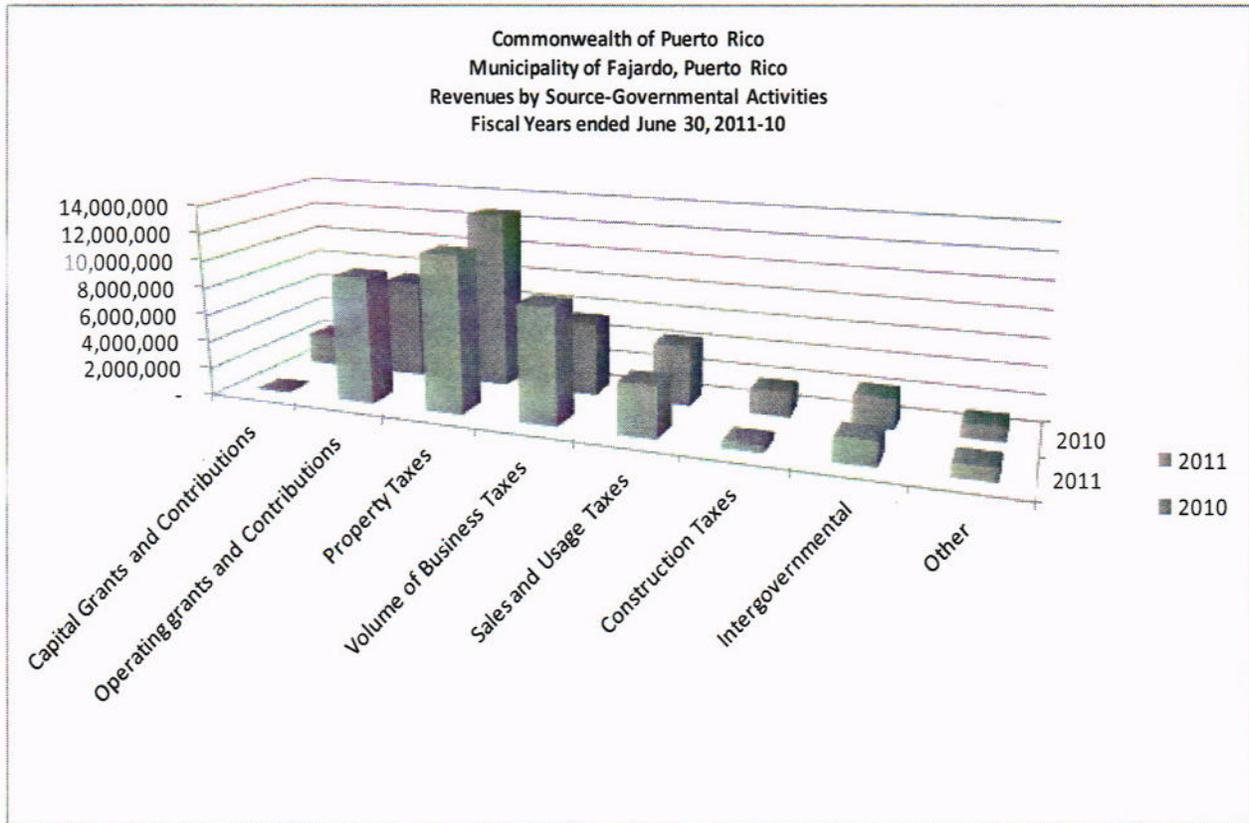
The following table summarizes the changes in net assets for the years ended June 30, 2011 and 2010:

	2011	2010
Revenues:		
Program Revenues:		
Capital Grants and Contributions	\$ -	\$ 2,395,225
Operating Grants and Contributions...	9,217,241	7,304,077
General Revenues:		
Property Taxes	11,397,583	12,842,417
Volume of Business Taxes	8,408,328	5,388,135
Sales and Usage Taxes	3,730,994	4,377,562
Construction Taxes	535,228	1,811,044
Intergovernmental	1,775,359	2,236,701
Other General Revenues	995,870	1,089,548
Total revenues	<u>36,060,603</u>	<u>37,444,709</u>
Expense		
General Administration	11,885,109	13,492,383
Public Safety	834,861	954,192
Public Works	2,803,382	2,141,482
Culture and Recreation and Instruction	845,109	1,178,175
Health and Sanitation	194,315	4,664,811
Human Services and Welfare	1,302,247	1,361,001
Public Instruction	4,324,413	4,664,811
Urban Development	-	1,696,180
Interest Cost	513,663	505,881
Total expenses	<u>22,703,099</u>	<u>29,117,235</u>
Changes in net assets	13,357,504	8,327,474
Net assets – beginning, as Restated*	<u>126,666,401</u>	<u>118,338,927</u>
Net assets – ending	<u>\$140,023,905</u>	<u>\$126,666,401</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF FAJARDO, PUERTO RICO
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

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

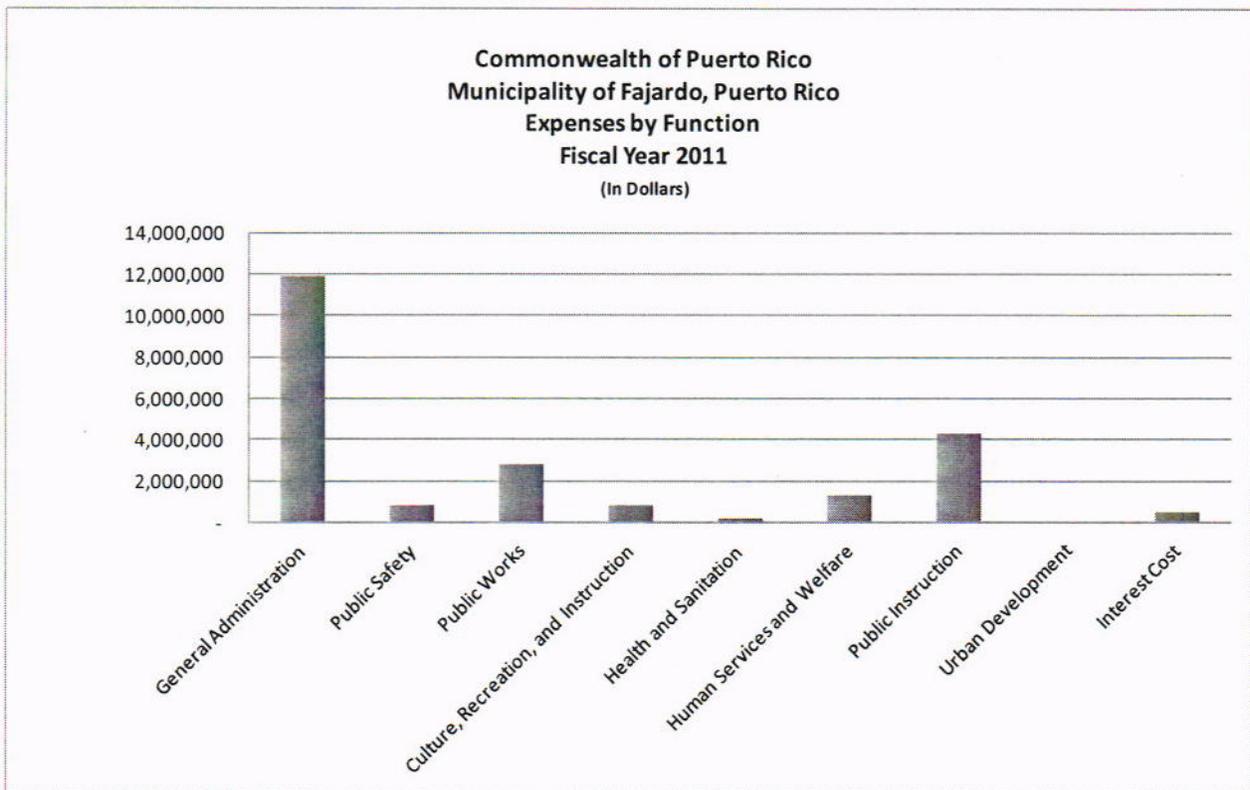
FIGURE 1



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF FAJARDO, PUERTO RICO
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

Figure 2 presents expenses by function of the governmental activities during the fiscal year 2010-2011:

FIGURE 2



Approximately 5% of the Municipality's revenues came from intergovernmental, 32% from property taxes, and 3% from other sources. The Municipality's expenses cover a range of services. The largest expenses are general administration with 52%, public works with 12%, health and sanitation with 1%, 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 \$1,384,106 or 4%, principally on capital grants and contributions, property taxes and construction taxes.

Expenses decreased 22% or \$6,414,136 in comparison with 2010 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, 2011**

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	
	2011	2010	2011	2010
General Administration	\$11,885,109	13,492,385	\$8,775,884	\$13,330,213
Public Safety	834,861	954,192	834,861	954,192
Public Works	-	2,141,482	-	2,141,482
Culture and Recreation	845,109	1,178,175	845,109	1,178,175
Health and Sanitation	194,315	3,123,128	194,315	
Human Services and Welfare	1,302,247	1,361,001	1,302,247	630,881
Urban Development	2,803,382	1,696,180	1,019,779	142,843
Other	4,838,076	505,881	513,663	851,805
	<u>\$22,703,099</u>	<u>\$29,117,235</u>	<u>\$13,485,858</u>	<u>\$21,162,560</u>

Some of the cost of governmental activities in 2011 was paid by those who directly benefited from the programs and other governments and organizations that subsidized certain programs with grants and contributions. The \$13,485,858 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, 2011, the governmental funds reported combined ending fund balances of \$60,766,970, a net increase of \$5,967,790 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, 14,882,326 constitutes unassigned 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.

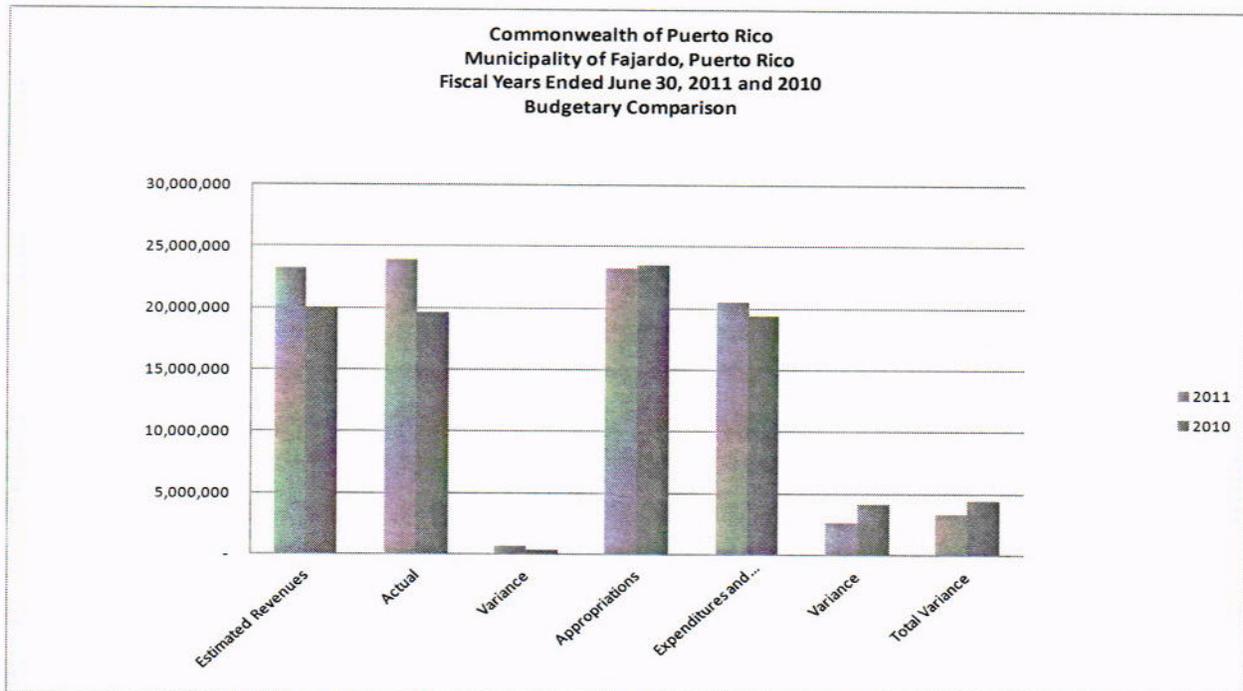
**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF FAJARDO, PUERTO RICO
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

The general fund is the operating fund of the Municipality. Unassigned fund balance of the general fund represents approximately 26% of total ending general fund balance (deficit). For the year ended June 30, 2011, the fund balance (deficit) of the general fund increased by \$1,053,571 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 2010-2011 presented an increase of 5% with respect to prior year budget. During the fiscal year budget revenues were increased by \$731,787 due to a revision of original estimate of property taxes and intergovernmental revenues. 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



The negative variance of \$3,972,496 between revised budget and actual expenditures was due mainly to reduction in revenue as explained in the preceding paragraph in excess of economies in some functions. 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, 2011

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

At the end of the fiscal year, the Municipality has invested \$89,772,020 (net of accumulated depreciation) in a broad range of capital assets, including buildings, land, and equipment. This amount represents a net decrease of \$ 1,142,112 or 1% from the prior year, as restated.

TABLE 4

Commonwealth of Puerto Rico Municipality of Fajardo, Puerto Rico Capital Assets (Net) As of June 30 2011		
	Governmental Activities	
	2011	(As restated) 2010
NON-DEPRECIABLE ASSETS:		
Land	\$ 42,123,225	\$ 42,123,225
Construction in progress	-	-
Others	<u>765,615</u>	<u>765,615</u>
Total non depreciable capital assets	<u>42,888,840</u>	<u>42,888,840</u>
Depreciable assets:		
Buildings	44,457,881	44,267,188
Equipment and Vehicles	3,473,482	3,473,482
Heavy Equipment	5,254,979	5,093,524
Infrastructure	36,157,759	36,157,759
Total accumulated depreciation	<u>(42,460,921)</u>	<u>(40,966,661)</u>
Total	<u>\$ 89,772,020</u>	<u>\$90,914,132</u>

The Municipality acquired a total of \$352,148 of capital assets during the fiscal year 2011-2010 as follows:

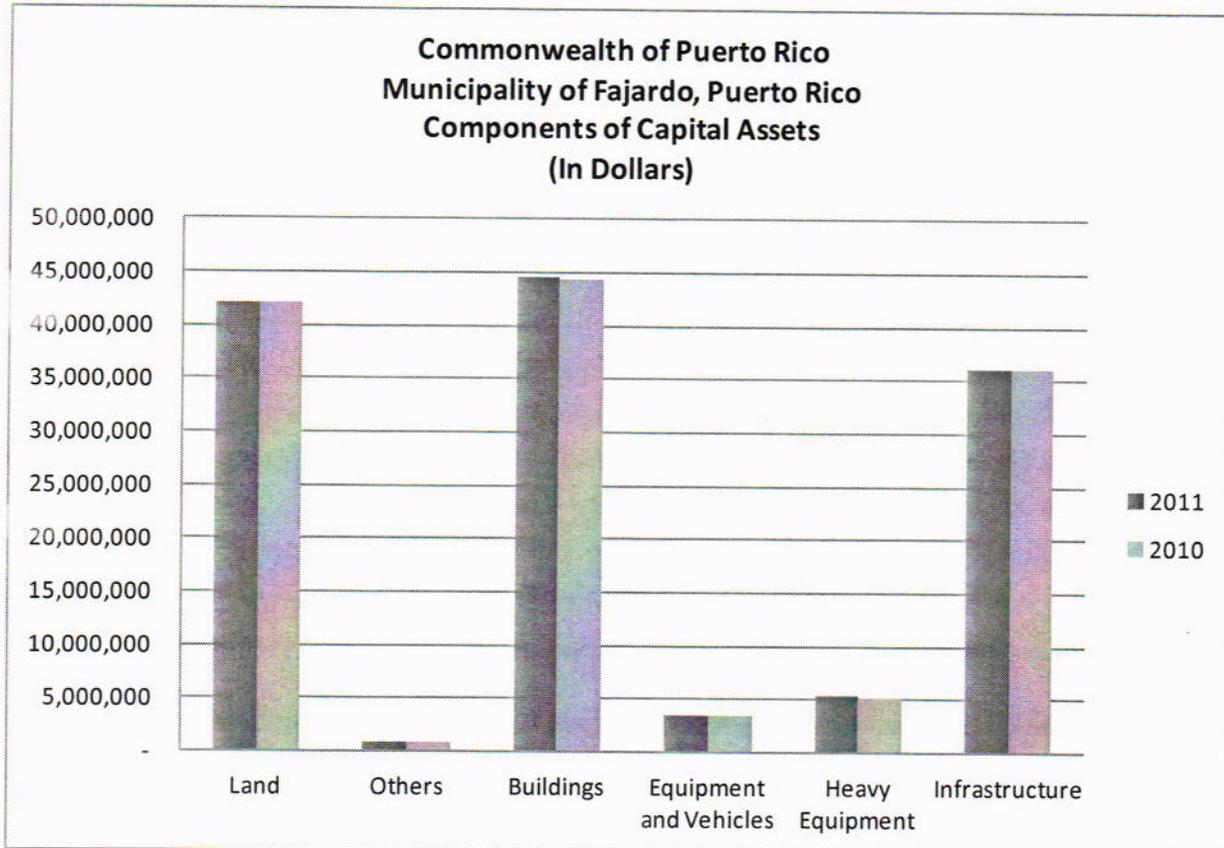
- Acquisition of Equipment and Vehicles – \$161,455
- Buildings and Improvements -\$190,693

Other projects related to repair and maintenance of roads (not capitalized) was developed during the fiscal year 2011.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF FAJARDO, PUERTO RICO
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

Figure 4 below present the components of capital assets during the fiscal years 2011 and 2010:

FIGURE 4



Long-Term Debt

At year-end, the Municipality had \$18,212,000 in general and special obligation bonds, an decrease of 2.83% with respect to prior year. The following is a summary of the Municipality's outstanding debt as of June 30, 2011 and 2010:

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF FAJARDO, PUERTO RICO
MANAGEMENT'S DISCUSSION AND ANALYSIS
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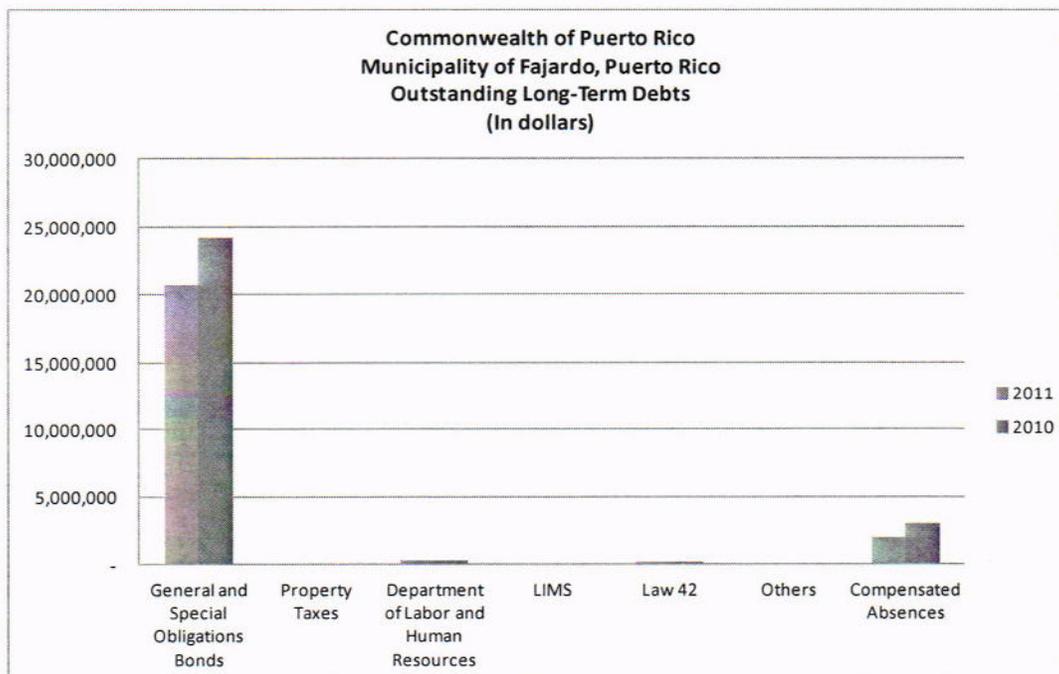
TABLE 5

Commonwealth of Puerto Rico Municipality of Fajardo, Puerto Rico Outstanding Long-term Dbt As of June 30 2011		
	Governmental Activities	
	2011	2010
General and Special Obligation Bonds	\$19,348,000	\$20,417,000
Property Taxes	-	6
Department of Labor and Human Resources	257,634	310,574
LIMS	62,634	159,471
Law 42	200,609	209,569
Others	-	101,227
Compensated Absences	1,968,774	3,046,177
Total	\$21,837,651	\$24,244,024

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 to the financial statements.

Figure 5 presents the components of long-term debts during the fiscal year 2011 and 2010:

FIGURE 5



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF FAJARDO, PUERTO RICO
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

The Municipality's selected and appointed officials considered many factors when setting the fiscal year 2010-2011 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 10.2%, which compares with the Commonwealth rate of 14.1%.

The Municipality applied a conservative approach in development budget estimates. Amounts available for appropriations in the General Fund for the fiscal year 2011 are \$19 million, approximately \$1,000,000 thousand more than the fiscal year 2010. The Municipality expects an increase in revenues for the next years due to a new sales tax enacted by state legislature and Municipality ordinance during fiscal year 2010-2011. 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 project promoted by the Municipality and others private projects were develop during the year.

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 PO Box 865, Fajardo, Puerto Rico 00738.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF FAJARDO, PUERTO RICO

STATEMENT OF NET ASSETS

JUNE 30, 2011

	<u>GOVERNMENTAL ACTIVITIES</u>
ASSETS:	
Cash and Investments (Note 3).....	\$ 35,991,531
Cash with Fiscal Agent.....	33,308,623
Receivables (net):	
Property Taxes.....	103,093
Sales Taxes.....	311,538
Due from Governmental Units.....	257,634
Due from Other funds.....	858,023
Other	150,000
Federal Grants.....	7,088,584
Total Currents Assets	<u>78,069,026</u>
Capital Assets (Note 9):	
Land, Improvement, and Construction in Progress.....	42,888,840
Other Capital Assets [Net of Depreciation].....	46,883,180
Total Capital Assets.....	<u>89,772,020</u>
TOTAL ASSETS	<u>\$ 167,841,046</u>
LIABILITIES:	
Accounts Payable and Accrued Expenses.....	\$ 535,821
Accrued Interest.....	312,724
Due to Governmental Units.....	54,259
Deferred Revenues:	
Municipal license tax.....	6,145,063
Long-Term Liabilities (Note 10):	
Due Within One Year.....	1,666,654
Due in More than One Year.....	19,102,620
TOTAL LIABILITIES	<u>27,817,141</u>
NET ASSETS:	
Investment in Capital Assets, Net of Related Debt.....	85,026,207
Restricted for:	
Head Start.....	3,627,866
Capital Projects.....	3,603,560
Debt Service.....	12,940,231
Community Development Projects.....	3,699,037
Other Purposes.....	18,451,361
Unrestricted	<u>12,675,643</u>
TOTAL NET ASSETS	<u>\$ 140,023,905</u>

The accompanying notes are an integral part of these basic financial statements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF FAJARDO, PUERTO RICO

STATEMENT OF ACTIVITIES

FOR THE FISCAL YEAR ENDED JUNE 30, 2011

Functions/Programs	Expenses	Program Revenues			Net (Expense) Revenues
		Charges For Services	Operating Grants and Contributions	Capital Grants and Contributions	
Governmental Activities:					
Mayor and Municipal Legislature.....	\$ 1,712,400	\$ -	\$ -	\$ -	\$ (1,712,400)
General Government.....	10,172,709	-	3,109,225	-	(7,063,484)
Public Safety.....	834,861	-	-	-	(834,861)
Public Works.....	2,803,382	-	1,783,603	-	(1,019,779)
Culture and Recreation.....	845,109	-	-	-	(845,109)
Health and Sanitation.....	194,315	-	-	-	(194,315)
Public Instruction.....	4,324,413	-	4,324,413	-	-
Human Services and Welfare.....	1,302,247	-	-	-	(1,302,247)
Interest on Long-Term Debt.....	513,663	-	-	-	(513,663)
Total Governmental Activities.....	22,703,099	-	9,217,241	-	(13,485,858)

General Revenues:

Taxes:	
Property Taxes, levied for General Purposes.....	8,209,480
Property Taxes, levied for Debt Service.....	3,188,103
Volume of Business Taxes.....	8,408,328
Sales and Uses Taxes.....	3,730,994
License and Permits.....	535,228
Intergovernmental.....	1,775,359
Interest.....	106,514
Miscellaneous.....	889,356
Total General Revenues and Transfers.....	26,843,362
CHANGES IN NET ASSETS.....	13,357,504
Net Assets – Beginning of Year.....	126,666,401
NET ASSETS – ENDING OF YEAR.....	\$ 140,023,905

The accompanying notes are an integral part of these basic financial statements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF FAJARDO, PUERTO RICO
BALANCE SHEET - GOVERNMENTAL FUNDS
JUNE 30, 2011

ASSETS:	GENERAL FUND	HEAD START FUND	SALES AND USAGE TAXES FUND	ARTS CENTER FUND	DEBT SERVICE FUND	OTHER GOVERNMENTAL FUNDS	TOTAL GOVERNMENTAL FUNDS
Cash and Investment.....	\$ 21,310,554	\$ 389,092	\$ 3,490,616	\$ 8,853,170	\$ -	\$ 10,801,269	\$ 35,991,531
Cash with Fiscal Agent.....	-	-	-	-	\$14,285,862	10,169,591	33,308,623
Receivables:							
Property Taxes.....	-	-	-	-	103,093	-	103,093
Sales Tax.....	-	-	311,538	-	-	-	311,538
Federal Grants.....	-	4,516,904	-	-	-	2,571,680	7,088,584
Other Receivables.....	150,000	-	-	-	-	-	150,000
Due from Other Funds.....	858,023	-	-	-	-	-	858,023
Due from Governmental Units.....	257,634	-	-	-	-	-	257,634
Total Assets.....	\$ 22,576,211	\$ 4,905,996	\$ 3,802,154	\$ 8,853,170	\$ 14,388,955	\$ 23,542,540	\$ 78,069,026
LIABILITIES AND FUND BALANCES:							
Liabilities:							
Account Payable.....	\$ 535,821	\$ 935,130	\$ -	\$ -	\$ -	\$ 1,208,021	\$ 2,676,972
Bonds Payable.....	-	-	-	-	1,136,000	-	1,136,000
Accrued Interest.....	-	-	-	-	312,724	-	312,724
Due to Governmental Entities.....	54,259	-	-	-	-	-	54,259
Due to Other Funds.....	-	343,000	-	-	-	515,023	858,023
Deferred Revenues:							
Volume of Business Tax.....	6,145,063	-	-	-	-	-	6,145,063
Commonwealth of Puerto Rico.....	257,634	-	-	-	-	-	257,634
Federal Grants.....	-	3,287,701	-	-	-	2,571,680	5,859,381
Total Liabilities.....	6,992,777	4,565,831	-	-	1,448,724	4,294,724	17,302,056
Commitments and Contingencies (Note 17)							
Fund Balances:							
Restricted	-	340,165	3,802,154	8,853,170	12,940,231	19,247,816	45,183,536
Assigned	701,108	-	-	-	-	-	701,108
Unassigned	14,882,326	-	-	-	-	-	14,882,326
Total fund balances	15,583,434	340,165	3,802,154	8,853,170	12,940,231	19,247,816	60,766,970
Total Liabilities and Fund Balances.....	\$ 22,576,211	\$ 4,905,996	\$ 3,802,154	\$ 8,853,170	\$ 14,388,955	\$ 23,542,540	\$ 78,069,026

The accompanying notes are an integral part of these basic financial statements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF FAJARDO, PUERTO RICO

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

JUNE 30, 2011

Total Fund Balances – Government Funds		\$ 60,766,970
Amount reported for Governmental Activities in the Statement of Net Assets are different because:		
Capital assets used in governmental activities are not financial resources and therefore are not reported in the funds. In the current period, these amounts are:		
Non Depreciable Capital Assets.....	\$ 42,888,840	
Depreciable Capital Assets.....	53,186,342	
Infrastructure Assets.....	36,157,759	
Accumulated Depreciation.....	(42,460,921)	
Total Capital Assets.....		89,772,020
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:		
CDBG.....	1,343,862	
Head Start Program.....	3,287,701	
Other funds.....	1,227,818	
Municipal License Tax.....	6,145,063	
Christmas Bonus.....	257,634	
Total		12,262,078
Some liabilities are not due and payable in the current period and therefore are not reported in the funds. Those liabilities consist of:		
General Bonds and Special Bonds.....	(18,212,000)	
General Bonds and Special Bonds Interest.....	(1,136,495)	
Law Number 42-MRCC.....	(205,089)	
MRCC Liquidation.....	(58,154)	
Christmas Bonus.....	(257,634)	
Compensated Absences.....	(2,907,791)	
Total Long-Term Liabilities.....		<u>(22,777,163)</u>
Total Net Assets of Governmental Activities		<u>\$ 140,023,905</u>

The accompanying notes are an integral part of these basic financial statements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF FAJARDO, PUERTO RICO

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

FOR THE FISCAL YEAR ENDED JUNE 30, 2011

	GENERAL FUND	HEAD START FUND	SALES AND USAGE TAXES FUND	ARTS CENTER FUND	DEBT SERVICE	OTHER GOVERNMENTAL FUNDS	TOTAL GOVERNMENTAL FUNDS
REVENUES:							
Property Taxes.....	\$ 8,209,480	\$ -	\$ -	\$ -	\$ 3,135,248	\$ -	\$ 11,344,728
Volume of Business Taxes.....	8,408,328	-	-	-	-	-	8,408,328
Sales Taxes.....	-	-	2,902,565	-	828,429	-	3,730,994
Federal Assistanccs.....	-	3,890,727	-	-	-	3,610,284	7,501,011
Intergovernmental.....	1,775,359	-	-	-	-	-	1,775,359
Licenses and Permits.....	585,228	-	-	-	-	-	585,228
Intereses.....	106,514	-	-	-	-	-	106,514
Miscellaneous.....	839,356	-	-	-	-	-	839,356
Total Revenues.....	19,924,265	3,890,727	2,902,565	-	3,963,677	3,610,284	34,291,518
EXPENDITURES:							
Current:							
Mayor and Municipal Legislature.....	1,712,400	-	-	-	-	-	1,712,400
General Government.....	7,071,478	-	-	-	-	3,109,225	10,180,703
Public Safety.....	834,861	-	-	-	-	-	834,861
Public Works.....	2,793,382	-	-	-	-	-	2,793,382
Culture and Recreation.....	845,109	-	-	-	-	-	845,109
Health and Sanitation.....	194,315	-	-	-	-	-	194,315
Public Instruction.....	1,302,247	4,324,413	-	-	-	-	4,324,413
Human Services and Welfare.....	160,106	-	2,768,089	-	-	-	2,928,195
Capital Outlay.....	-	-	-	-	-	-	-
Debt Service:							
Principal.....	-	-	-	-	2,674,440	-	2,674,440
Interest and Other Charges.....	-	-	-	-	513,663	-	513,663
Total Expenditures.....	14,913,898	4,324,413	2,768,089	-	3,188,103	3,109,225	28,303,728
Excess of Revenues Over (Under) Expenditures.....	5,010,367	(433,686)	134,476	-	775,574	501,059	5,987,790
OTHER FINANCING SOURCES (USES):							
Transfer - In.....	-	-	-	-	-	3,956,796	3,956,796
Transfer - Out.....	(3,956,796)	-	-	-	-	-	(3,956,796)
Total Other Financing Sources and Uses.....	(3,956,796)	-	-	-	-	3,956,796	-
Net Change in Fund Balance.....	1,053,571	(433,686)	134,476	-	775,574	4,457,855	5,987,790
Fund Balance - Beginning.....	14,529,863	773,851	3,667,678	8,853,170	12,164,657	14,789,961	54,779,180
FUND BALANCE - ENDING.....	\$ 15,583,434	\$ 340,165	\$ 3,802,154	\$ 8,853,170	\$ 12,940,231	\$ 19,247,816	\$ 60,766,970

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The accompanying notes are an integral part of these basic financial statements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF FAJARDO, PUERTO RICO

RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES
IN FUND BALANCE OF GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES
FOR THE FISCAL YEAR ENDED JUNE 30, 2011

Net Change in Fund Balances – Government Funds		\$ 5,987,790
Amount reported for Governmental Activities in the Statement of Activities are different because:		
Governmental funds report capital outlays as expenditures. However, in the Statement of Activities the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense. In the current period, these amounts are:		
Capital Assets	\$ 2,928,195	
Depreciation Expense	(1,494,260)	
Excess of Capital Assets over Depreciation Expense		1,433,935
Revenues in the Statement of Activities that do not provide current financial resources are reported as revenues in the funds:		
Head Start Program		3,080,013
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		
		2,674,440
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	42,940	
Decrease in Compensated Absences	138,386	
Total Additional Expenses		<u>181,326</u>
Change in Net Assets of Governmental Activities		<u>\$ 13,357,504</u>

The accompanying notes are an integral part of these basic financial statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF FAJARDO
NOTES OF THE BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

fiscal year then ended. The more significant of these accounting policies are described below and, where appropriate, subsequent pronouncements will be referenced.

A. Financial Reporting Entity

The accompanying basic financial statements include all departments and organizations units whose funds are under the custody and control of the **Municipality**. In evaluating the **Municipality** as a reporting entity, management has addressed all the potential component units. The decision to include a potential component unit in the reporting entity was made by applying the provisions of GASBS No. 14.

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

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

These financial statements present the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information of the **Municipality**, as of June 30, 2011, and the respective changes in financial position, where applicable, thereof for the fiscal year then ended.

B. Measurement Focus and Basis of Accounting

Government-wide Financial Statements

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

Governmental Fund Financial Statements

The governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recorded when

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF FAJARDO
NOTES OF THE BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2011

susceptible to accrual; as soon as it is both measurable and available. "Available" means collectible within the current period or soon enough thereafter, normally within sixty (60) days, to be used to pay liabilities of the current period. Expenditures are generally recognized when the related liability is incurred.

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

In applying the "susceptible to accrual" concept to intergovernmental revenues (federal grants) pursuant to GASBS No. 33, *Accounting and Financial Reporting for Non exchange 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. Expenditures are generally recorded when a liability is incurred, as under accrual accounting. Modifications to the accrual basis of accounting include the following:

- Employee's vested annual vacation and sick leave is recorded as expenditure when utilized. The amount of accumulated annual vacation and sick leave unpaid at June 30, 2011, has been reported only in the government-wide financial statements.

C. Financial Statement Presentation

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

Government-wide Financial Statements

The government-wide financial statements (the **Statement of Net Assets** and the **Statement of Activities**) report information of all the activities of the **Municipality**. For most part, the effect of interfund activity has been removed from these government-wide financial statements. Governmental activities, which normally are supported by taxes and intergovernmental

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF FAJARDO
NOTES OF THE BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2011

revenues, are reported separately from business-type activities, which rely to a significant extent on fees and charges for support.

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

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

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

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

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

Governmental Fund Financial Statements

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF FAJARDO
NOTES OF THE BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2011

Traditional users of governmental financial statements will find the Fund Financial Statements presentation more familiar. The focus is on Major Funds, rather than the previous financial model's fund types. The Governmental Major Fund Statements are presented on current financial resources and modified accrual basis of accounting. This is the manner in which these funds are normally budgeted. This presentation deemed most appropriate to (a) demonstrate legal and covenant compliance, (b) demonstrate the source and use of liquid resources, and (c) demonstrate how the **Municipality's** actual experience conforms to the budgeted fiscal plan.

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

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

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

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

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

Sales and Usage Taxes Fund-This fund used to account for accumulation of resources for, and the payment of special purpose obligations.

Arts Center Fund- This is used to account for construction of an Arts center.

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

CDBG Fund – This is the fund used to account for all the transactions of the Community Development Block Grant Program. The primarily objectives of this program is to development of viable communities by providing decent housing, a suitable living

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF FAJARDO
NOTES OF THE BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2011

development of viable communities by providing decent housing, a suitable living environment and expanded economic opportunities, principally for persons of low and moderate income.

D. Budgetary Data

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

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

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

1. Prior of May 15 of each fiscal year, the Mayor submits to the Municipal Legislature a proposed budget for the fiscal year commencing the following July 1 in addition of a budget message.
2. The budget document is available for public inspection prior to its approval by the Municipal Legislature.
3. The Commissioner of Municipal Affairs examines the budget to verify if it complied with the law's standards and sends it to the Mayor for any comments or recommendation before the limited date establishes by the Law.
4. Prior to June 13, the annual budget is legally enacted through passage of the annual appropriation ordinance.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF FAJARDO
NOTES OF THE BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

5. If a budget is not adopted prior to the end of the end of the fiscal year, the annual budget for the preceding fiscal year, as approved by the Municipal Legislature and the Mayor, is automatically renewed for the ensuing fiscal year until a new budget is approved. This permits the Municipality to continue making payments for its operating and other expenses until the new budget is approved.
6. Subsequent to the enactment of the annual appropriation ordinance, the Municipal Legislature has the authority to make necessary amendments made during the fiscal year and are reflected in the budget information included in the Budgetary Comparison Schedule – General Fund.
7. Budgetary data for the Special Revenue Fund has not been presented in the accompanying basic financial statements as such funds are budgeted over the life of the respective grant or project and not on an annual basis.

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

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

1. Encumbrances are recorded as expenditures under the budgetary basis and as a reserve of fund balances under GAAP.
2. The non-exonerated portion of the property tax advances are presented as revenue in the budgetary basis and as other financing sources under GAAP.
3. Inter-fund transactions of the General and Special Revenue Funds are not included in the budgetary basis.
4. Certain accrued liabilities and other debts are not included in the budgetary basis.
5. Certain revenues susceptible to accrual, i.e., both measurable and available, are not included in the budgetary data.

All encumbrance appropriations in the operating budget lapse at the end of the fiscal year. Property taxes collected during the current year by the Municipal Revenue Collection Center (Fiscal Agent) are presented as revenues in the accounting basis but are not considered in the budgetary schedule.

The special funds of the Special Revenue Fund have not been included in the budgetary comparison because balances are not budgeted. Also the budget prepared for the Federal Finance Awards Programs included in the Capital Projects and Special Revenue Funds is

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF FAJARDO
NOTES OF THE BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

based on a program period which is not necessarily a year. Accordingly, it's not practical to present an annual comparison of budget for such programs.

E. Cash, Cash Equivalent, and Investment

Under Puerto Rico statutes, public funds deposited in commercial banks must be fully collateralized for the amount deposited in excess of federal depository insurance. All securities pledged as collateral are held by the Secretary of the Treasury of Puerto Rico. In addition, the Municipality maintains deposits with the Government Development Bank for Puerto Rico (GDB). The Municipality's bank balances in commercial banks of approximately \$14.3 million in the general fund were fully collateralized at June 30, 2011. The deposits at GDB of approximately \$5.6 million that are restricted principally for capital projects, and the \$4.1 million in the debt service fund are unsecured and uncollateralized, as no collateral is required to be carried by governmental banks. The excess is covered by collateral provided by banks and held by the Treasury Department of the Commonwealth of Puerto Rico pursuant to applicable laws and regulations.

F. Receivable

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

G. Inventories

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

H. Capital Assets

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF FAJARDO
NOTES OF THE BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

Depreciation on all assets is provided on the straight-line basis over the following estimated useful lives:

<u>CAPITAL ASSETS</u>	<u>YEARS</u>
Buildings	70
Improvement Other than Buildings	70
Infrastructure	10-70
Motor Vehicles	5
Machinery and Equipments	5-10

I. Compensated Absences

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

1. The **Municipality's** obligation relating to employee's rights to receive compensation for future absences is attributable to employee's services already rendered.
2. The obligation relates to rights that vest or accumulate.
3. Payment of the compensation is probable.
4. The amount can be reasonably estimated.

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

J. Insurance

The **Municipality** has insurance coverage for its public facilities, primarily to provide protection from catastrophic losses. Also, principal officials of the **Municipality** are covered under various surety bonds. The Secretary of the Treasury Department of the Commonwealth of Puerto Rico is the agent commissioned to place all of the **Municipality's** insurance coverage.

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Corresponding premiums payable are withheld by the Municipal Revenue Collection Center from quarterly advances of annual property tax and subsidy sent to the **Municipality**.

K. Inter-fund Transactions

Inter-fund 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 inter-fund 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:

Inter-fund Transfers – Legally required transfers that are reported when incurred as transfers-in by the recipient fund and as transfers-out by the disbursing fund, with receivables and payables presented as amounts due to and due from other funds. Advances between funds are also presented as amounts due to and due from other funds. However, these transfers and related amounts receivables and payables are considered internal balances and activities that have been eliminated in the government-wide financial statements.

L. Fund Balances

In the current year, the Municipality adopted the provisions of GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions* (GASB No. 54), which enhanced the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied. This statement establishes fund balance classifications that comprise a hierarchy based primarily on the extent to which the Municipality is bound to observe constraints imposed upon the use of the resources reported in governmental funds.

Pursuant to the provisions of GASB No. 54, the accompanying fund financial statements report fund balance amounts that are considered nonspendable, such as fund balance associated with inventories. Other fund balances have been reported as restricted, committed, assigned, and unassigned, based on the relative strength of the constraints that control how specific amounts can be spent, as described as follows:

1. *Nonspendable* - Represent resources that cannot be spent readily with cash or are legally or contractually required not be spent, including but not limited to inventories, prepaid items, and long term balances of interfund loans and accounts receivable.
2. *Restricted* - Represent resources that can be spent only for the specific purposes stipulated by constitutional provisions, external resource providers (externally imposed by creditors or grantors), or through enabling legislation (that is, legislation that creates a new revenue source and restricts its use). Effectively, restrictions may be changed or lifted only with the consent of resource providers.

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3. *Committed* - Represent resources used for specific purposes, imposed by formal action of the Municipal's highest level of decision making authority (Municipal Legislature through resolutions and ordinances) and can only be changed by a similar law, ordinance or resolution, no later than the end of fiscal year.
4. *Assigned* - Represent resources intended to be used by the Municipality for specific purposes but do not meet the criteria to be classified as restricted or committed (generally executive orders approved by the Mayor). Intent can be expressed by the Municipal Legislature, the Mayor or by an official or body to which the Municipal Legislature delegates authority in conformity with the Autonomous Municipalities Act of Puerto Rico, as amended. In governmental funds other than the general fund, assigned fund balance represents the remaining amount that is not restricted or committed.
5. *Unassigned* - Represent the residual classification for the Municipality's general fund and includes all spendable amounts not contained in the other classifications. In other funds, the unassigned classification is used only to report a deficit balance resulting from overspending for specific purposes for which amounts had been restricted, committed, or assigned.

Negative fund balance amounts are assigned amounts reduced to the amount that will raise the fund balance to zero. Consequently, negative residual amounts in restricted, committed, and assigned fund balance classification have been reclassified to unassigned fund balances.

The Municipality reports resources constrained to stabilization as a specified purpose (restricted or committed fund balance in the general fund) only if: (1) such resources meet the other criteria for those classifications, as described above and (2) the circumstances or conditions that signal the need for stabilization are identified in sufficient detail and are not expected to occur routinely. However, the Municipality has not entered into any stabilization-like arrangements, nor has set aside material financial resources for emergencies and has not established formal minimum fund balance amounts as of and for the fiscal year ended June 30, 2011.

In situations when an expenditure is made for a purpose for which amounts are available in multiple fund balance classifications, the Municipality uses restricted resources first, and then unrestricted resources. Within unrestricted resources, the Municipality generally spends committed resources first, followed by assigned resources, and then unassigned resources when expenditures.

The classification of the Municipality's individual governmental funds among general, debt service, special revenue, and capital projects fund types used in prior fiscal years for financial reporting purposes was not affected by the implementation of GASB No. 54. In addition, the financial positions and the results of operations reported in the accompanying fund financial statements as of and for the fiscal year ended June 30, 2011 have not been affected for this change in accounting principle. Accordingly, the accompanying fund financial statements have not reported any retroactive restatements or reclassifications of fund equities as of July 1, 2010.

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M. Claims and Judgments

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

N. Use of Estimates

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

3. CASH, CASH EQUIVALENTS, AND INVESTMENTS

Investments consist of certificates of deposit. The Municipality's cash, cash equivalent and investments at year-end were entirely covered by the Federal Deposit Insurance Corporation (FDIC) coverage, up to a maximum of \$250,000 in each bank, and the excess by collateral provided by the banks and held by the Department of the Treasury pursuant the applicable laws and regulations. Cash with fiscal agent is maintained in interest bearing accounts in the Government Development Bank of Puerto Rico and is not collateralized.

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

During the year, the Municipality invested its funds in interest bearing bank accounts and short-term certificates of deposit. As June 30, 2011, the market value of investments recorded in Special Revenue Fund approximated its carrying value as follow:

<u>Certificate of Deposit</u>	<u>Principal Number</u>	<u>Amount</u>	<u>Interest Rate</u>	<u>Expiration Date</u>
Popular Bank	1110000048	\$2,600,000	0.55%	09/19/2011
Popular Bank	1110000050	600,000	0.35%	10/04/2011
Popular Bank	1110000058	5,000,000	0.40%	10/19/2011
Popular Bank	1110000059	5,000,000	0.50%	10/19/2011
		<u>\$13,200,000</u>		

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4. RECEIVABLES

Other receivables for the fiscal year ended June 30, 2011 corresponds to the Puerto Rico Treasury Department (Christmas bonus).

5. INTERFUND TRANSACTIONS

Inter-fund receivables and payables balances at June 30, 2011 consisted of the following:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
General Fund	Other governmental Fund	\$ 515,023
General Fund	Head Start Fund	<u>343,000</u>
		<u>\$ 858,023</u>

Inter-fund transfers between the general and debt service funds represent the interest income received from the CRIM.

6. DUE FROM OTHER AGENCIES

Represents grants and contributions due from local and federal agencies:

Health and Human Services - Head Start	\$ 4,516,904
Housing and Urban Development – CDBG	1,343,862
Other Receivables fund	1,134,371
Other Agencies – Voucher Portability	<u>93,447</u>
	<u>\$ 7,088,584</u>

7. DUE TO OTHER GOVERNMENTAL UNITS

As of June 30, 2011, balance due to other governmental units of the General Fund for services rendered to the **Municipality**, consists of the following:

General Services Administration	\$ 2,900
Employee's Retirement System	30,400
Puerto Rico Aqueduct and Sewer Authority	18,501
Puerto Rico Department of Treasury	<u>2,458</u>
	<u>\$ 54,259</u>

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8. DEFERRED REVENUES

Municipal License Tax

The deferred revenues of approximately \$6.1 million in the general fund related to the municipal license tax collected in fiscal years 2010-2011 that will be earned in fiscal year 2011-2012.

9. CAPITAL ASSETS

Capital assets activities for the fiscal year ended June 30, 2011 was as follows:

<u>Governmental Activities</u>	<u>Balance July 1, 2010</u>	<u>Additions</u>	<u>Retirements</u>	<u>Balance June 30, 2011</u>
Capital Assets not being Depreciated:				
Land	\$42,123,225	\$ -	\$ -	\$ 42,123,225
Non Depreciable Assets	765,615			765,615
Total Capital Assets not being depreciated	<u>42,888,840</u>			<u>42,888,840</u>
Capital Assets being depreciated:				
Building	44,267,188	190,693		44,457,881
Infrastructure	36,157,759			36,157,759
Motor Vehicles	3,473,482			3,473,482
Equipment	5,093,524	161,455		5,254,979
Total Depreciable Capital assets	<u>88,991,953</u>	<u>352,148</u>		<u>89,344,101</u>
Less Accumulated Depreciation:				
Building	14,260,098	677,995		14,938,093
Infrastructure	19,307,021	325,545		19,632,566
Motor Vehicles	4,575,800	189,997		4,765,797
Equipment	2,823,742	300,723		3,124,465
Total Accumulated Depreciation	<u>40,966,661</u>	<u>1,494,260</u>		<u>42,460,921</u>
Total Capital Assets being depreciated, net	<u>48,025,292</u>	<u>1,142,112</u>		<u>46,883,180</u>
Governmental Activities Capital assets, net	<u>\$ 90,914,132</u>	<u>\$ 1,142,112</u>	<u>\$ -</u>	<u>\$ 89,772,020</u>

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

General Government	\$ 677,995
Public Safety	80,000
Public Works	400,720
Culture and Recreation	206,540
Urban Development	<u>129,005</u>
Depreciation Expense	<u>\$ 1,494,260</u>

10. GENERAL LONG-TERM DEBTS

A. GENERAL OBLIGATIONS BONDS AND SPECIAL NOTES PAYABLE

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

General obligations bonds and notes payable as of June 30, 2011, are comprised of the following individual issues:

<u>DESCRIPTION</u>	<u>AMOUNT</u>
General Obligations Bonds:	
\$11,435,000, Series 1999-98, for construction purposes, payable in annual installments ranging from \$173,985 to \$770,000, excluding variable interests from 5.190% to 5.94% until July 1, 2016	\$ <u>4,870,000</u>
Total General Obligations Bonds	\$ <u>4,870,000</u>
Special Obligations Notes:	
\$14,440,000, Series 2006-07 for construction purposes, payable in annual installments ranging from \$32,240 to \$351,000, excluding interests at 9.125%, until July ,2031	\$ 13,137,000
\$370,000 Series 1994-95, for construction purposes, payable in annual installments ranging from \$8,839 to \$15,000, excluding variable interests from 6.106% to 7.71%, until July 1, 2019.	<u>205,000</u>
Total General and Special Obligations	\$ <u>18,212,000</u>

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The **Municipality's** general obligations long-term note retirements are appropriated and paid from resources accumulated in the Debt Service Fund. The special obligations long-term notes retirements are paid through retention made by the Municipal Revenue Collection Center from monthly advance of annual property tax and subsidy sent to the **Municipality**.

Annual maturity requirements for the bonds and notes payable and loan guarantee assistance notes are as follows:

<u>Bond Payables</u>	<u>Principal</u>	<u>Interest</u>
2012	\$ 1,136,000	\$ 834,235
2013	1,208,000	1,199,978
2014	1,301,000	1,119,988
2015	1,391,000	964,852
2016	1,478,000	940,000
2017-2021	3,719,000	3,682,226
2022-2026	3,397,000	2,417,815
2027-2031	<u>5,718,000</u>	<u>1,307,320</u>
Total	<u>\$ 19,348,000</u>	<u>\$ 12,466,414</u>

B. ADVANCES FROM CRIM

These amounts represent the balance owed to CRIM at June 30, 2011, as described in note 12, and that will be repaid through financing to be obtained by the CRIM.

C. CHANGES IN GENERAL LONG-TERM DEBTS

Description	Balance July 01, 2010	New Issues	Retirements and Adjustments	Balance June 30, 2011	Amount due within one year	Amount due after next year
General	\$20,417,000	\$ -	\$ (1,069,000)	\$19,348,000	\$1,136,000	\$18,212,000
Christmas bonus	300,574	257,634	(300,574)	257,634	257,634	-
Property taxes	379,046	-	(115,803)	263,243	62,634	200,609
Claims and Judgments	101,227	-	(101,227)	-	-	-
Compensated Absences	3,046,177	-	(2,145,780)	900,397	210,386	690,011
	<u>\$24,244,024</u>	<u>\$ 257,634</u>	<u>\$ (3,732,384)</u>	<u>\$20,769,274</u>	<u>\$1,666,654</u>	<u>\$19,102,620</u>

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11. DEBT RETIREMENT

Revenues of the debt service fund consists of the ad-Val Orem 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 Municipal Revenues Collection Center (CRIM) of the Commonwealth of Puerto Rico is responsible by law for the assessment, levy and collection of all real and personal property taxes. The tax on personal property is self assessed by the taxpayer. The assessment is made in a return which must be filed with the CRIM by May 15 of each year. The tax on real property is assessed by the CRIM. The assessment is made as of January 1 of each year and is based on estimated current values of the property as of year 1957. The tax on personal property must be paid in full together with the return on or before May 15. The tax on real property is due in two equal installments in July 1 and January 1, following the assessment date.

The rates are 8.43% for real property and 7.40% for personal property. The composition is as follows:

Basic property 6.00%	4.10%	4.10%
Additional special property - state	1.03%	1.03%
Additional special property - municipal	3.50%	4.67%
Discounts made by state to tax payer	<u><.20%></u>	<u><.20%></u>
	<u>8.43%</u>	<u>7.40%</u>

The Municipality's basic property tax rate represents the portion which is appropriated for general purposes and accounted for in the general fund.

The "Additional special property tax - municipal" is restricted for debt service and retained by GDB for such purposes and it is recorded as revenue in the Debt Service Fund when collected by the CRIM and reported to the Municipality.

The "Additional special property tax - state" is collected by the CRIM for the payment of principal and interest of general obligation bonds and certain other obligations issued by the state government.

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Residential real property occupied by its owner is exempt by law from the payment of property taxes on the first \$150,000 of the assessed value. For such exempted amounts, the Department of Treasury assumes payment of the basic tax to the Municipality, except for property assessed at less than \$3,500, for which no payment is made. Revenue related to the basic tax on exempt property is recorded in the General Fund when payments are received from the CRIM.

Complete exemption from personal property taxes up to an assessment of \$50,000 is granted to merchants with an annual volume of net sales less than \$150,000.

Prior to the beginning of each fiscal year, the CRIM informs the Municipality of the estimated amount of property tax expected to be collected for the ensuing fiscal year. Throughout the year, the CRIM advances funds to the Municipality based on the initial estimated collections. The CRIM is required by law to prepare a settlement statement on a fiscal year basis, whereby a comparison is made between the amounts advanced to the Municipality and amounts actually collected from taxpayers. This settlement has to be completed on a preliminary basis not later than three months after fiscal year-end, and a final settlement made not later than six months after year end. If the CRIM remits to the Municipality property tax advances, which are less than the tax actually collected, a receivable from the CRIM is recorded at June 30. However, if advances exceed the amount actually collected by the CRIM, a payable to the CRIM is recorded at June 30. The advances from CRIM as of June 30, 2011, are presented as non-current liabilities in the government-wide financial statements.

13. VOLUME OF BUSINESS TAX

Volume of Business Tax is recorded in the fiscal year in which payment is due and, accordingly, represents taxes which are due and uncollected at June 30, 2011. The Volume of Business Tax is determined based on the gross income of all commerce and industrial organizations who have operations in the Municipality of Fajardo, and are not totally or partially exempt under the Industrial Incentive Law of Puerto Rico.

An annual return of business volume should be filed on or before April 15 of each year and payable in two equal installments due on July 1 and January 1. A discount of 5% is allowed when full payment is made on or before April 23. The rates of municipal license in the Municipality of Fajardo, are as follows:

Financing institution = 1.50% of gross revenues
Other organizations = .40%

14. INTERGOVERNMENTAL REVENUES

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

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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.

15. EMPLOYEE'S RETIREMENT PLAN

a. Plan Description

The Employee's Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS) is the administrator of a cost-sharing multiple-employer retirement system established by the Commonwealth of Puerto Rico. The System was created under the Act 447, approved on May 15, 1951, as amended, and became effective on January 1, 1952.

ERS covers all regular employees of the Commonwealth of Puerto Rico and its instrumentalities and of certain municipalities and components units not covered by their own retirement's systems.

Participation is mandatory except for members of the Legislature, Government Secretaries, Heads for Agencies and Public Instrumentalities, Assistants to the Governor, the Comptroller of 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 an age of at least fifty-five (55) years and have completed at least twenty-five (25) years of creditable service or members who have attained an age of at least fifty-eight (58) years and have completed at least fifty-eight (58) years and have completed at least ten (10) years of creditable service, are entitled to an annual benefit, payable monthly for life.

The amounts of the annuity will be one and one-half percent of the average compensation multiplied by the number of years of creditable service up to twenty years, plus 2% of the average compensation multiplied by the number of years of creditable service in excess of twenty years. In no case the annuity will be less than \$200 per month.

Participants who have completed at least thirty (30) years of creditable service are entitled to receive the Merit Annuity. Participants who have not attained fifty-five (55) years of age will receive 65% of the average compensation or if they have attained fifty-five (55) years of age will receive 75% of the average compensation. Disability retirement benefits are available to

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members for occupational and non-occupational disability. However, for non-occupational disability a member must have at least ten (10) years of service.

No benefit is payable if the participant receives a refund of his accumulated contributions.

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

System 2000 is a hybrid defined contribution plan, also known as a cash balance plan. Under this new plan, there will be a pool of pension assets, which will be invested by ERS, together with those of the current defined benefit plan. Benefits at retirement age will not be guaranteed by the Commonwealth of Puerto Rico. The annuity will be based on a formula which assumes that each year the employee's contribution (with a minimum of 8.275% of the employee's salary upon to a maximum of 10%) will be invested in an account which will be either: (1) earn a fixed rate based on the two-year Constant Maturity Treasury Note or, (2) earn rate equal to 75% of the return of the ERS's investment portfolio (net of management fees), or (3) earn a combination of both alternatives. Participants will receive periodic account statements similar to those of defined contribution plans showing their accrued balances. Disability pensions will not be granted under System 2000. The employer's contribution (9.275% of the employee's salary) will be used to fund the current plan.

b. Contribution Requirements

Commonwealth legislation requires employees to contribute 5.775% of gross salary up to \$6,600 plus 8.275% of gross salary in excess of \$6,600. The Municipality's contributions are 9.275% of gross salary. Contributions' requirements are established by law. The actuarially determined contribution requirement and contributions actually made for the year ended June 30, 2011 was approximately \$379,959.

Additional information on the ERS is provided in its financial statements for the year ended June 30, 2011, a copy of which can be obtained from the ERS, Minillas Station, PO Box 42003, San Juan, PR 00940.

16. ESTIMATED MUNICIPAL SOLID WASTE LANDFILL CLOSING COSTS

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

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closure and post-closure care costs that will be incurred near or after the date the landfill no longer accepts waste.

The Municipality owns a landfill, which is administered by Landfill Technologies under an agreement with the Municipality. 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 after the closing, releasing the Municipality of the estimated liability for future closure and post-closure care cost.

17. CONTINGENCIES

A. CLAIMS AND JUDGMENTS

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

In addition, the **Municipality** is a defendant or co-defendant in several legal proceedings, which are in discovery stage. Certain of these claims are covered by insurance. Legal counsel with the information currently available can not determine the final outcome of these claims, with the exception of one (1) lawsuit related to excessive used of force, to which the legal counsel hasimate a potential loss of \$3,000,000.

This lawsuit is in appeal in other Courts. Accordingly, the financial statements include adjustments in the Long-Term Liabilities because will be paid with future resources if the Courts decided in against of the **Municipality**.

B. FEDERAL GRANTS

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

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

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18. SALES AND USAGE TAXES

Municipality impose a Sales and Usage Taxes of 1.5% (1.0% collected and belong to the Municipality and 0.5% collected by the Puerto Rico Secretary of the Treasury) on the sales price of a taxable item or the purchase price of all usage, storage or consumption of a taxable item. All merchants required to collect the Sales and Usage Taxes, are required to file a monthly Sales and Use Tax Return Form, no later than the 10th of he following month being reported. The Act also provides for restrictions on the use of the resources (including the 0.5% collected by the Puerto Rico Secretary of Treasury) to be invested in solid wasted and recycling program, capital improvements and health and public safety costs.

The amount collected b the Puerto Rico Secretary of Treasury will be deposited in accounts or special fund GDB, subject to restrictions imposed and distributed as follows:

- a. 0.2% will be deposited in a Municipal Development Fund to finance costs as Restricted by the Act;
- b. 0.2% will be deposited in a Municipal Redemption Fund to finance loans Municipalities subject to restrictions imposed the a Act; and
- c. 0.1% will be deposited in a Municipal Improvement Fund to finance capital improvement projects. These funds will be distributed based on legislation from the Commonwealths Legislature.

Sales tax receivable represents filed sales tax returns that were collected subsequent to June 30, 2011, but pertaining to the current year period.

19. 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 building, 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 the project, net of certain exemptions such as the cost 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.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF FAJARDO
NOTES OF THE BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

Any construction, 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 of land.
- b. 2.00% for all low income housing project, and educational institutions of primary and second level.
- c. When construction is for a residence, made of at least 50% concrete, and said Residence is no part of a housing project, urbanization, condominium, or any project of 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 cost, \$ 5.00 rates will Taxes are payable before beginning construction or any activity related to the construction. Collection of taxes during current fiscal year, applicable to the next fiscal year, is recorded as deferred revenues in the General Fund.

20. FUND BALANCE

As of June 30, 2011, a fund balance is compromised of the following:

	General	Head Start Fund	Sales and usage taxes Fund	Debt Service	Capital Projects	Other Government Funds	Total Government Funds
Restricted:							
Public works	\$ -	\$ -	\$ 3,802,154	\$ -	\$ -	\$ 19,247,816	\$ 23,049,970
Education		340,165					340,165
Capital outlays					8,853,170		8,853,170
Debt service				12,940,231			12,940,231
Assigned :							
General							
Government	554,889						554,889
Public safety	16,817						16,817
Public works	79,908						79,908
Recreation	44,184						44,184
Health and welfare	5,310						5,310
Unassigned	14,882,326						14,882,326
Total	\$15,583,434	\$340,165	\$3,802,154	\$12,940,231	\$8,853,170	\$19,247,816	\$60,766,970

PART II – REQUIRED SUPPLEMENTARY INFORMATION

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF FAJARDO, PUERTO RICO
REQUIRED SUPPLEMENTARY INFORMATION
BUDGETARY COMPARISON SCHEDULE – GENERAL FUND
FOR THE FISCAL YEAR ENDED JUNE 30, 2011

	Budget Amounts		Actual Amounts (Budgetary Basis) (See Note A)	Variance with Final Budget
	Original	Final		
BUDGETARY FUND BALANCE, JULY 1, 2010	\$ 14,529,863	\$ 14,529,863	\$ 14,529,863	\$ -
Resources (Inflows):				
Property Taxes.....	8,349,105	8,349,105	8,209,480	(139,625)
Volume of Business Taxes.....	7,051,089	7,051,089	8,408,328	1,357,239
Sanitation.....	200,000	200,000	50,000	(150,000)
Intergovernmental Revenues.....	1,787,105	1,787,105	1,775,359	(11,746)
License and Permits.....	815,500	815,500	535,228	(280,272)
Rent.....	19,480	19,480	74,357	54,877
Interest.....	400,000	400,000	106,514	(293,486)
Miscellaneous.....	605,100	605,100	764,999	159,899
Prior year allocation	-	3,972,496	3,972,496	-
Total Resources (Inflows).....	19,227,379	23,199,875	23,896,761	696,886
Amounts Available for Appropriation.....	33,757,242	37,729,738	38,426,624	696,886
Charges to Appropriations (Outflows):				
Mayor and Municipal Legislature.....	3,744,702	4,073,685	1,712,400	2,361,285
General Government.....	7,171,281	6,925,878	8,737,361	(1,811,483)
Public Safety.....	1,266,973	1,257,073	834,861	422,212
Public Works.....	3,812,609	3,724,394	2,803,382	921,012
Culture and Recreation.....	979,117	1,030,200	845,109	185,091
Health and Sanitation.....	246,690	263,390	194,315	69,075
Human Services and Welfare.....	1,521,588	1,621,192	1,302,247	318,945
Capital Outlays.....	484,419	331,567	160,106	171,461
Transfer to Other Funds.....	-	3,972,496	3,972,496	-
Total Charges to Appropriations.....	19,227,379	23,199,875	20,562,277	2,637,598
BUDGETARY FUND BALANCE, JUNE 30, 2011	\$ 14,529,863	\$ 14,529,863	\$ 17,864,347	\$ 3,334,484

The accompanying note to budgetary comparison schedule is an integral part of this schedule.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF FAJARDO, PUERTO RICO
BUDGETARY COMPARISON SCHEDULE – GENERAL FUND
NOTES TO REQUIRED SUPPLEMENTARY INFORMATION

FOR THE FISCAL YEAR ENDED JUNE 30, 2011

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	\$ 38,426,624
Difference – Budget to GAAP:	
Prior-Year Revenue is not inflows of budgetary resources but are revenues for financial reporting purposes.....	5,394,402
The Fund Balance at the Beginning of Year is a budgetary resource but is not a Current-Year Revenue for financial reporting purposes.....	<u>(23,896,761)</u>
Total Revenues as Reported on the Statement of Governmental Funds Revenues, Expenditures and Changes in Fund Balance	<u>\$ 19,924,265</u>
Uses/Outflows of Resources:	
Actual Amounts (Budgetary Basis) "Total Charges to Appropriation" from the Budgetary Comparison Schedule	\$ 20,562,277
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.....	(701,108)
Payments of encumbrances of prior year that are expenditures for financial reporting purposes but are not outflows for budgetary purposes.....	(990,475)
Transfers to other funds are outflows of budgetary resources but are not expenditures for financial reporting purposes.....	<u>(3,956,796)</u>
Total Expenditures as Reported on the Statement of Governmental Funds Revenues, Expenditures and Changes in Fund Balance	<u>\$ 14,913,898</u>

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

Budgetary Fund Balance, June 30, 2011.....	\$ 17,864,347
Timing Differences:	
Change in Encumbrances.....	701,108
Restriction from Defferences Revenue	(3,314,531)
Cancelation of Prior Year Encumbrances	<u>332,510</u>
Fund Balance, June 30, 2011.....	<u>\$ 15,583,434</u>

PART III – SINGLE AUDIT SECTION

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF FAJARDO, PUERTO RICO
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2011

Federal Grantor/Program Title	Federal CFDA Number	Federal Disbursements/ Expenditures
U.S. Department of Agriculture		
USDA - Rural Development:		
Pass through Puerto Rico Department of Education		
Child and Adult Care Food Program (USDA)	10.558	\$ 392,902
Total U.S. Department of Agriculture		<u>392,902</u>
U.S. Department of Housing and Urban Development:		
Community Development Block Grants/ Entitlement Grants (CDBG) (Cluster)		
	14.218	924,385
Section 8 Housing Choice Voucher Program	14.871	544,802
Pass through Puerto Rico Family Department:		
Homelessness Prevention and Rapid Re-Housing Program (HRPR) - Recovery Act Funded		
	14.257	262,403
Pass-through Puerto Rico Health Department:		
Housing Opportunities for Persons with AIDS (HOPWA)	14.241	68,298
Total U.S. Department of Housing and Urban Development		<u>1,799,888</u>
U.S. Department of Health and Human Services:		
Pass-through Administration for the Childhood Care and Integral Development:		
ARRA- Child Care and Development Block Grant	93.713	9,105
Child Care and Development Block Grant	93.575	138,538
Subtotal for Child Care Program (Cluster)		<u>147,643</u>
Head Start Program (Cluster)	93.600	3,582,561
ARRA - Head Start Program (Cluster)	93.708	348,950
ARRA - Early Head Start Program (Cluster)	93.709	628,084
Subtotal Head Start Program (Cluster)		<u>4,559,595</u>
Total U.S. Department of Health and Human Services		<u>4,707,238</u>
U.S. Department of Transportation		
Federal Transit - Formula Grants (Urbanized Area Formula Program) - ARRA	20.507	510,788
TOTAL EXPENDITURES OF FEDERAL AWARDS		<u>\$ 7,410,816</u>

See the notes to the Schedule of Expenditures of Federal Awards.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF FAJARDO
NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

1. SIGNIFICANT ACCOUNTING POLICIES

The accompanying Schedule of Expenditures of Federal Awards is a summary of the activity of the Municipality of Fajardo's federal award programs presented on the modified accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America.

2. BASIS OF PRESENTATION

The expenditures of the schedule are included in the Municipality's basic financial statements. The reconciliation of expenditures in the basic financial statements to the Schedule of Expenditures of Federal Awards is as follows:

	<u>Expenditures</u>
Total federal expenditures per schedule	\$ <u>7,410,816</u>
Federal expenditures per basic financial statements included within:	
Head Start Program	\$ 3,582,561
ARRA - Head Start Program	348,950
Child and Adult Care Food Program	<u>392,902</u>
Total Head Start Fund	4,324,413
Federal expenditures included in other governmental funds	<u>3,086,403</u>
Total	\$ <u>7,410,816</u>

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

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

We have audited the financial statements of the governmental activities, each major fund and the aggregate remaining fund information of the Municipality of Fajardo, as of and for the year ended June 30, 2011, which collectively comprise the Municipality's basic financial statements and have issued our report thereon dated February 10, 2012. 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

Management of the Municipality is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered Municipality of Fajardo's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Municipality's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Municipality's internal control over financial reporting.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. *A material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

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

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Municipality of Fajardo's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our test 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 management, Commissioner Office of Municipal Affairs, others within the entity and the 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.

San Juan, Puerto Rico
February 10, 2012

The stamp E18907 was affixed to the original of this report.





Ortiz, Rivera, Rivera & Co.
Certified Public Accountants and Business Advisors

CPA Orlando Luis Ortiz Cabrera
CPA Marco Antonio Rivera Zúñiga
CPA Luis Rivera Zúñiga
CPA Zoraida Cruz Claudio

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

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

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

Compliance

We have audited Municipality of Fajardo's compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each Municipality of Fajardo's major federal programs for the year ended June 30, 2011. Municipality of Fajardo's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of Municipality of Fajardo's management. Our responsibility is to express an opinion on Municipality of Fajardo's compliance based on our audit.

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

In our opinion, the Municipality of Fajardo, complied in all material respects, with the requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2011.

Internal Control over Compliance

Management of Municipality of Fajardo is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts and grants

applicable to federal programs. In planning and performing our audit, we considered Municipality of Fajardo's internal control over compliance with the requirements that could have a direct and material effect on a major federal program to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Municipality's internal control over compliance.

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

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

This report is intended solely for the information and use of management, Commissioner Office of Municipal Affairs, others within the entity and the 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.

San Juan, Puerto Rico
February 10, 2012

Ortiz, Rivera, Rivera & Co.

The stamp E18908 was affixed
to the original of this report.



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF FAJARDO
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

1. SUMMARY OF AUDIT RESULTS

Financial Statements

Type of auditor's report issued: Unqualified opinion

Internal control over financial reporting:

Material weakness (es) identified? Yes X No

Significant deficiency (ies) identified? Yes X No

Noncompliance material to financial statements noted? Yes X No

Federal Awards

Internal control over major programs:

Material weakness (es) identified? Yes X No

Significant deficiency (ies) identified? Yes X No

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

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

Identification of major programs:

<u>CFDA Numbers</u>	<u>Name of federal programs or Cluster</u>
14.871	Section 8 Housing Choice Voucher
14.257	Homelessness Prevention and Rapid Re-Housing Program - Recovery Act
93.600	Head Start Program
93.708	Head Start Program (ARRA)
93.709	Early Head Start Program (ARRA)
20.507	Federal Transit - Formula Grant

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF FAJARDO
SCHEDULE OF STATUS OF PRIOR YEAR
AUDIT FINDINGS AND QUESTIONED COST
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

The Municipality of Fajardo has no prior year audit findings.