

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

**MUNICIPIO DE FAJARDO
AUDITORÍA 2011-2012
30 DE JUNIO DE 2012**

Oficina del Comisionado
de Asuntos Municipales
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**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF FAJARDO**

**BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED
JUNE 30, 2012**

PART I - FINANCIAL SECTION

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF FAJARDO
BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

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**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF FAJARDO
BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

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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, 2012, 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, 2012, 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 March 1, 2013 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.

Accounting principles generally accepted in the United States of America require that the management's discussion and Analysis on pages 3 to 15, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

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

San Juan, Puerto Rico
March 1, 2013

Ortiz, Rivera, Rivera & Co.

The stamp E16558 was affixed
to the original of this report.



ORTIZ, RIVERA, RIVERA & CO.

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**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF FAJARDO, PUERTO RICO
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

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, 2012. 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 2012 by \$144,333,015 (net assets).
- Revenues increased by \$5,917,196 and expenses increased by \$14,965,590 in comparison with year 2011.
- Net change in net assets amounted to \$4,309,110, an increase with respect to prior year (2011) 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 \$86,725,174 an increase of \$25,958,204 in comparison with the prior year.
- The General Fund reported an excess of revenues over expenditures and other financing uses of \$2,328,255 and an unassigned fund balance of \$17,821,689. Unassigned fund balances decreased by \$1,926,374 from prior year.

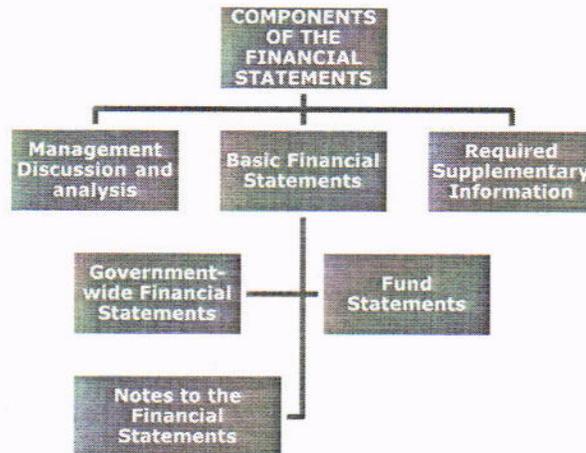
General Financial Highlights

- The investment in net capital assets as of June 30, 2012 was \$94,322,856 (net of related debt).
- Long term debt general and special obligations increased by \$22,399,000 approximately 116% with respect to prior year balance.
- Other long term debts decreases and net reductions from payments amounted to \$873,847, respectively.
- On a budgetary basis, actual revenues exceeded actual expenditures by \$10,234,731, revenues increase was mainly due an increase of \$4,352,431 in miscellaneous revenues, and the Municipality realized economies, principally in general administration \$4,092,971.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF FAJARDO, PUERTO RICO
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2012

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, 2012**

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, 2012**

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, 2012 and 2011:

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

	2012	2011
Current and non-current assets	\$107,282,222	\$ 78,069,026
Capital assets	<u>94,322,856</u>	<u>89,772,020</u>
Total Assets	<u>201,605,078</u>	<u>167,841,046</u>
Current liabilities	10,381,001	2,569,458
Deferred revenues	6,176,615	6,145,063
Long-term liabilities (As Restated).....	<u>40,714,447</u>	<u>19,102,620</u>
Total Liabilities	<u>57,272,063</u>	<u>27,817,141</u>
Investment in capital assets, Net of		
Related Debt.....	85,414,444	85,026,207
Restricted.....	40,309,593	42,322,055
Unrestricted (As Restated).....	<u>18,608,978</u>	<u>12,675,643</u>
Total Net Assets	<u>\$ 144,333,015</u>	<u>\$ 140,023,905</u>

The largest portion of the Municipality's net assets reflects its investment in capital assets (e.g., land, buildings, equipment, and infrastructure) for \$85,414,444 total capital assets (\$138,278,037) less accumulated depreciation (\$43,955,181) and less any related outstanding debt (\$8,908,412) 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, 2012 the Municipality presented unrestricted net assets of \$18,608,978. This balance was affected by long term obligations such as compensated absences \$1,818,818 and other debts for the amount of \$476,303 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, 2012**

Changes in Net Assets

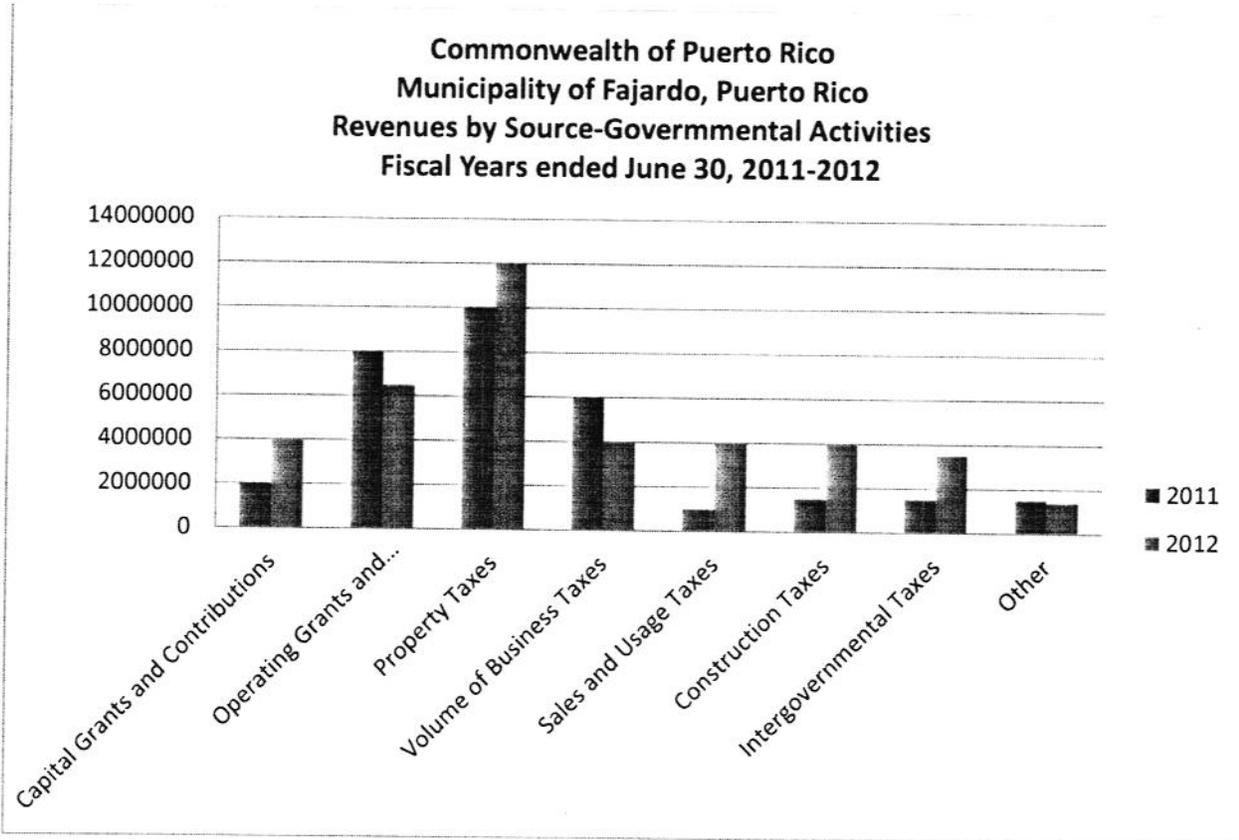
The following table summarizes the changes in net assets for the years ended June 30, 2012 and 2011:

	2012	2011
Revenues:		
Program Revenues:		
Capital Grants and Contributions.....	\$2,683,365	\$ -
Operating Grants and Contributions...	7,411,451	9,217,241
General Revenues:		
Property Taxes	12,454,886	11,397,583
Volume of Business Taxes	7,717,099	8,408,328
Sales and Usage Taxes.....	3,507,022	3,730,994
Construction Taxes.....	1,147,822	535,228
Intergovernmental.....	1,797,241	1,775,359
Other General Revenues	<u>5,258,913</u>	<u>995,870</u>
Total revenues	<u>41,977,799</u>	<u>36,060,603</u>
Expense		
General Administration	17,592,334	11,885,109
Public Safety.....	913,616	834,861
Public Works.....	2,942,026	2,803,382
Culture and Recreation	952,359	845,109
Health and Sanitation	337,745	194,315
Human Services and Welfare.....	1,322,988	1,302,247
Public Instruction	7,588,097	4,324,413
Urban Development	5,505,861	
Interest Cost	<u>513,663</u>	<u>513,663</u>
Total expenses	<u>37,668,689</u>	<u>22,703,099</u>
Changes in net assets	4,309,110	13,357,504
Net assets – beginning, as Restated*	<u>140,023,905</u>	<u>126,666,401</u>
Net assets – ending	<u>\$144,333,015</u>	<u>\$140,023,905</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF FAJARDO, PUERTO RICO
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2012

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

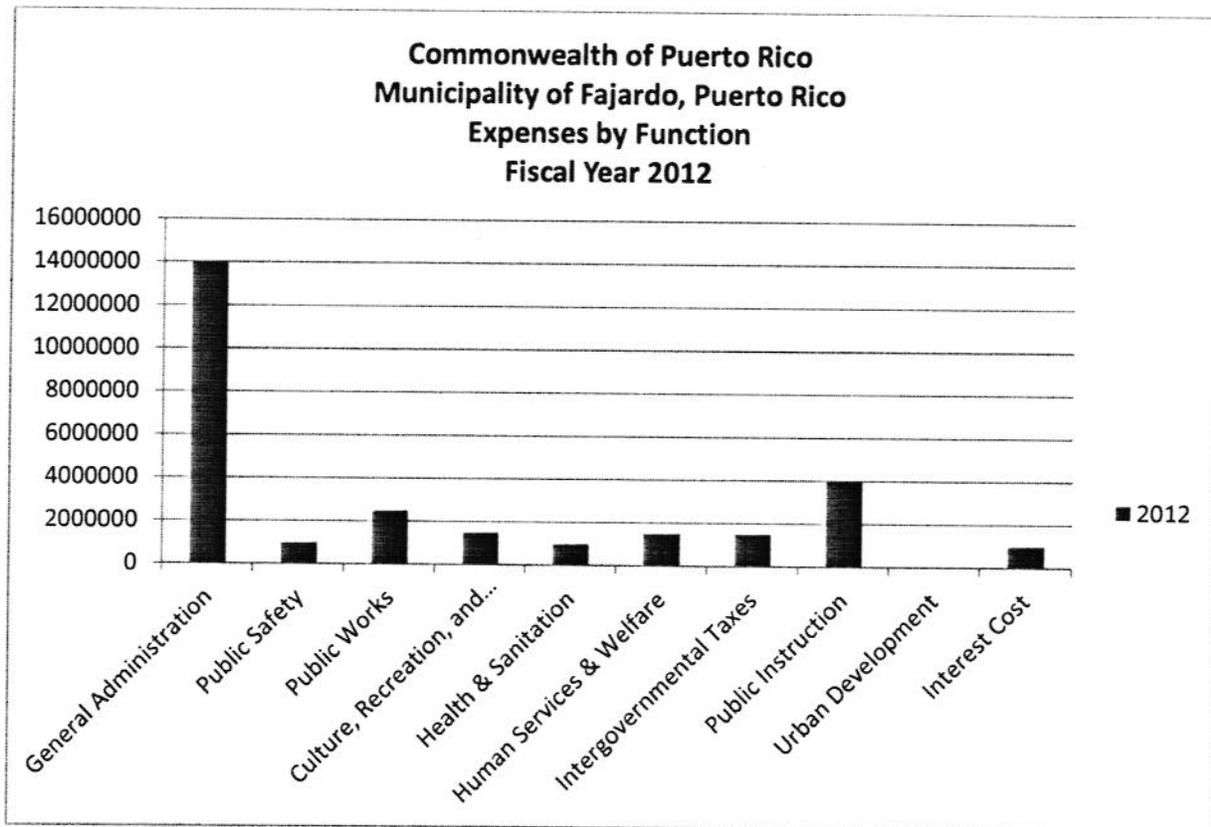
FIGURE 1



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF FAJARDO, PUERTO RICO
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

Figure 2 presents expenses by function of the governmental activities during the fiscal year 2011-2012:

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 \$5,917,196 or 4%, principally on capital grants and contributions, property taxes and construction taxes.

Expenses increased 22% or \$14,965,590 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, 2012**

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, 2012**

Functions/Programs	Total Cost of Services		Net Cost of Services	
	2012	2011	2012	2011
General Administration	\$17,592,334	11,885,109	\$(17,592,334)	\$8,775,884
Public Safety	913,616	834,861	(913,616)	834,861
Public Works	2,942,026	0	(2,942,026)	0
Culture and Recreation	952,359	845,109	(952,359)	845,109
Health and Sanitation	337,745	194,315	(337,745)	194,315
Human Services and Welfare	1,322,988	1,302,247	(1,322,988)	1,302,247
Urban Development	5,505,861	2,803,382	(3,081,229)	1,019,779
Other	8,101,760	4,838,076	(431,576)	513,663
	<u>\$37,668,689</u>	<u>\$22,703,099</u>	<u>\$(27,573,873)</u>	<u>\$13,485,858</u>

Some of the cost of governmental activities in 2012 was paid by those who directly benefited from the programs and other governments and organizations that subsidized certain programs with grants and contributions. The \$27,573,873 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, 2012, the governmental funds reported combined ending fund balances of \$86,725,174, a net increase of \$25,958,204 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, \$16,808,700 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.

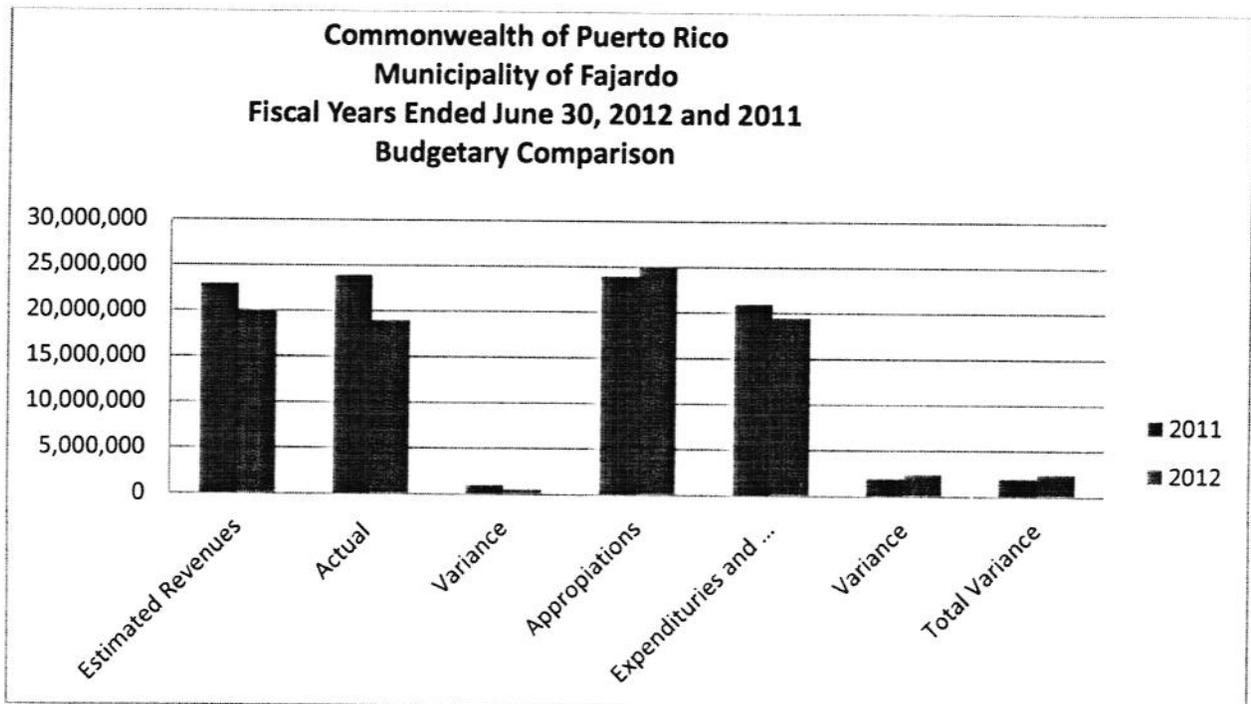
**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF FAJARDO, PUERTO RICO
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

The general fund is the operating fund of the Municipality. Unassigned fund balance of the general fund represents approximately 21% of total ending general fund balance. For the year ended June 30, 2012, the fund balance of the general fund increased by \$2,238,255 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 2011-2012 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 increase of \$7,996,476 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, 2012**

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

At the end of the fiscal year, the Municipality has invested \$94,322,856 (net of accumulated depreciation) in a broad range of capital assets, including buildings, land, and equipment. This amount represents a net decrease of \$4,550,836 or 5% from the prior year.

TABLE 4

Commonwealth of Puerto Rico Municipality of Fajardo, Puerto Rico Capital Assets (Net) As of June 30 2012		
	Governmental Activities	
	2012	2011
NON-DEPRECIABLE ASSETS:		
Land	\$42,356,505	\$ 42,123,225
Others	765,615	765,615
Total non depreciable capital assets	<u>43,122,120</u>	<u>42,888,840</u>
Depreciable assets:		
Buildings	44,457,881	44,457,881
Equipment and Vehicles	3,908,425	3,473,482
Heavy Equipment	5,479,365	5,254,979
Infrastructure	41,310,246	36,157,759
Total accumulated depreciation	<u>(43,955,181)</u>	<u>(42,460,921)</u>
Total	<u>\$ 94,322,856</u>	<u>\$ 89,772,020</u>

The Municipality acquired a total of \$352,148 of capital assets during the fiscal year 2012-2011 as follows:

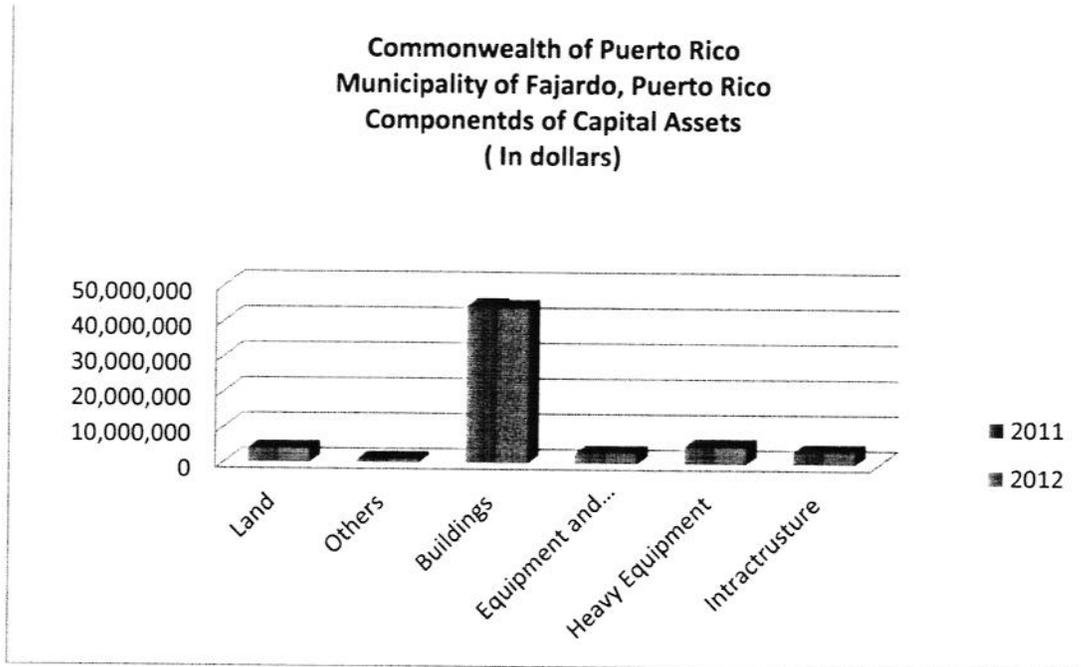
- Acquisition of Equipment and Vehicles – \$161,455
- Buildings and Improvements - \$190,693

Other projects related to repair and maintenance of roads (not capitalized) was developed during the fiscal year 2012.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF FAJARDO, PUERTO RICO
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

Figure 4 below present the components of capital assets during the fiscal years 2012 and 2011:

FIGURE 4



Long-Term Debts

At year-end, the Municipality had \$41,747,000 in general and special obligation bonds, an decrease of 116% with respect to prior year. The following is a summary of the Municipality's outstanding debts as of June 30, 2012 and 2011:

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF FAJARDO, PUERTO RICO
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

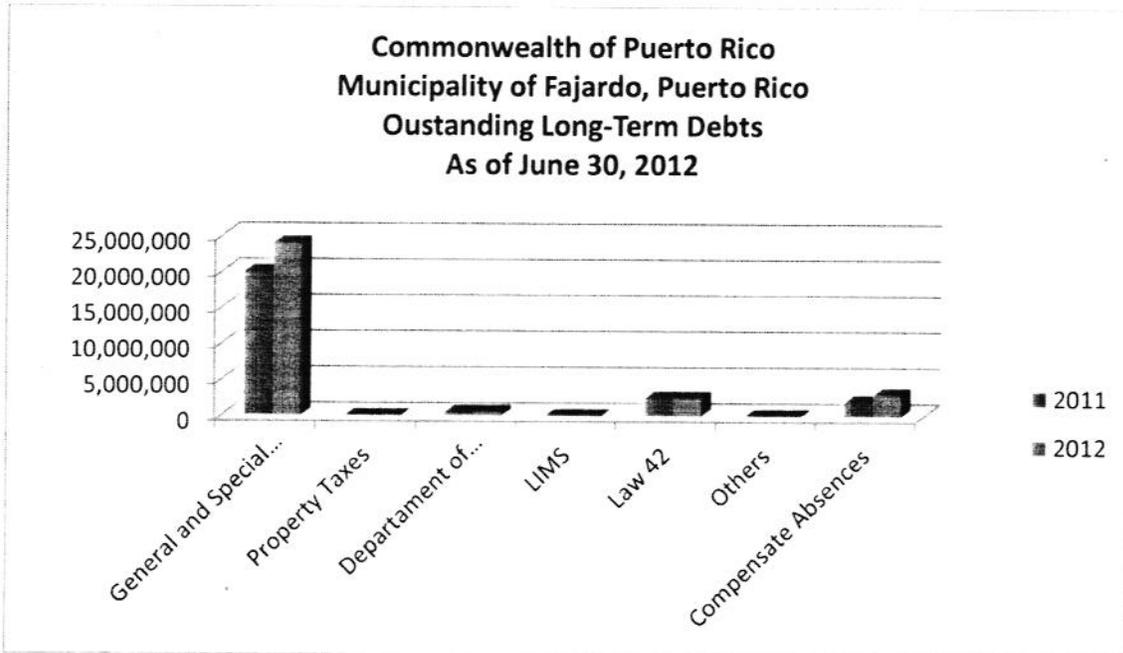
TABLE 5

Commonwealth of Puerto Rico Municipality of Fajardo, Puerto Rico Outstanding Long-term Debts As of June 30 2012		
	Governmental Activities	
	2012	2011
General and Special Obligation Bonds	\$41,747,000	\$19,348,000
LIMS		58,154
Law 42	200,329	205,089
Christmas bonus	275,974	257,364
Compensated Absences	1,818,818	900,397
Total	\$44,042,121	\$20,769,004

The increase in general and special obligations bonds is related to two bonds issuance made during the year amounting to \$23,535,000. 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 2012 and 2011:

FIGURE 5



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF FAJARDO, PUERTO RICO
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

The Municipality's selected and appointed officials considered many factors when setting the fiscal year 2011-2012 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 2012 are \$19 million, approximately \$1,000,000 thousand more than the fiscal year 2011. 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 2011-2012. 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, 2012

	<u>GOVERNMENTAL ACTIVITIES</u>
ASSETS:	
Cash and Investments (Note 3).....	\$ 59,230,597
Cash with Fiscal Agent (Note 3).....	34,651,182
Receivables (net):	
Property Taxes.....	675,327
Sales Taxes.....	342,730
Due from Governmental Units (Note 4).....	1,432,239
Other	4,098,018
Federal Grants (Note 6).....	6,852,129
Total Currents Assets	<u>107,282,222</u>
Capital Assets (Note 9):	
Land, Improvement, and Construction in Progress.....	43,122,120
Other Capital Assets [Net of Depreciation].....	51,200,736
Total Capital Assets.....	<u>94,322,856</u>
TOTAL ASSETS	<u>\$ 201,605,078</u>
LIABILITIES:	
Accounts Payable and Accrued Expenses.....	\$ 5,579,137
Accrued Interest.....	1,428,431
Due to Governmental Units (Note 7).....	45,759
Deferred Revenues (Note 8):	
Municipal license tax.....	6,176,615
Long-Term Liabilities (Note 10):	
Due Within One Year.....	3,327,674
Due in More than One Year.....	40,714,447
TOTAL LIABILITIES	<u>57,272,063</u>
NET ASSETS:	
Investment in Capital Assets, Net of Related Debt.....	85,414,444
Restricted for:	
Head Start.....	4,080,243
Capital Projects.....	6,804,555
Debt Service.....	18,784,635
Community Development Projects.....	1,237,890
Other Purposes.....	9,402,270
Unrestricted	18,608,978
TOTAL NET ASSETS	<u>\$ 144,333,015</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, 2012

Functions/Programs	Expenses	Program Revenues		Net (Expense) Revenues
		Operating Grants and Contributions	Capital Grants and Contributions	
Governmental Activities:				
Mayor and Municipal Legislature.....	\$ 1,951,953	\$ -	\$ -	\$ (1,951,953)
General Government.....	15,640,381			(15,640,381)
Public Safety.....	913,616			(913,616)
Public Works.....	2,942,026			(2,942,026)
Culture and Recreation.....	952,359			(952,359)
Health and Sanitation.....	337,745			(337,745)
Public Instruction.....	7,588,097	4,986,819	2,683,365	82,087
Human Services and Welfare.....	1,322,988			(1,322,988)
Urban Development.....	5,505,861	2,424,632		(3,081,229)
Interest on Long-Term Debt.....	513,663			(513,663)
Total Governmental Activities	37,668,689	7,411,451	2,683,365	(27,573,873)
General Revenues:				
Taxes:				
Property Taxes, levied for General Purposes.....				8,347,770
Property Taxes, levied for Debt Service.....				4,107,116
Volume of Business Taxes.....				7,717,099
Sales and Uses Taxes.....				3,507,022
License and Permits.....				1,147,822
Intergovernmental.....				1,797,241
Interest.....				151,718
Miscellaneous.....				5,107,195
Total General Revenues and Transfers.....				31,882,983
CHANGES IN NET ASSETS.....				4,309,110
Net Assets – Beginning of Year.....				140,023,905
NET ASSETS – ENDING OF YEAR.....				\$ 144,333,015

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, 2012

ASSETS:	GENERAL FUND	HEAD START FUND	SALES AND USAGE TAXES FUND	ARTS CENTER FUND	DEBT SERVICE FUND	LOAN \$21,490,000	OTHER GOVERNMENTAL FUNDS	TOTAL GOVERNMENTAL FUNDS
Cash and Investment (Note 3)	\$ 21,083,477	\$ 428,827	\$ 3,998,401	\$ -	\$ -	\$ 20,310,086	\$ 13,409,806	\$ 59,230,597
Cash with Fiscal Agent (Note 3)				8,853,170	\$20,916,542		4,881,470	34,651,182
Receivables					675,327			675,327
Property Taxes			342,739					342,739
Sales Tax		4,648,322						4,648,322
Federal Grants (Note 6)	113,056						2,203,807	6,852,129
Other Receivables	2,036,045						3,984,962	4,098,018
Due from Other Funds (Note 5)	1,432,239							2,036,045
Due from Governmental Units (Note 4)								1,432,239
Total Assets	\$ 24,664,817	\$ 5,077,149	\$ 4,341,140	\$ 8,853,170	\$ 21,591,869	\$ 20,310,086	\$ 24,480,045	\$ 109,318,276
LIABILITIES AND FUND BALANCES:								
Liabilities:								
Account Payable	\$ 620,754	\$ 355,664	\$ -	\$ -	\$ -	\$ -	\$ 4,602,719	\$ 5,579,137
Bonds Payable (Note 10)					2,353,000			2,353,000
Accrued Interest					454,234			454,234
Due to Governmental Entities (Note 7)	45,759	641,242					1,394,803	45,759
Due to Other Funds (Note 5)								2,036,045
Deferred Revenues (Note 8)								
Volume of Business Tax	6,176,615	3,744,505						6,176,615
Federal Grants							2,203,807	5,948,312
Total Liabilities	6,843,128	4,741,411	-	-	2,807,234	-	8,201,329	22,593,102
Commitments and Contingencies (Note 17)								
Fund Balances (Note 20)								
Restricted	1,012,989	335,738	4,341,140	8,853,170	18,784,635	20,310,086	16,278,716	68,903,485
Assigned	16,808,700							1,012,989
Unassigned								16,808,700
Total fund balances	17,821,689	335,738	4,341,140	8,853,170	18,784,635	20,310,086	16,278,716	86,725,174
Total Liabilities and Fund Balances	\$ 24,664,817	\$ 5,077,149	\$ 4,341,140	\$ 8,853,170	\$ 21,591,869	\$ 20,310,086	\$ 24,480,045	\$ 109,318,276

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, 2012

Total Fund Balances – Governmental Funds		\$ 86,725,174
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.....	\$ 43,122,120	
Depreciable Capital Assets.....	95,155,917	
Accumulated Depreciation.....	(43,955,181)	
Total Capital Assets.....		94,322,856
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.....	1,246,671	
Head Start Program.....	4,648,322	
Property taxes.....	1,156,139	
Christmas Bonus.....	275,974	
Total		7,327,106
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.....	(41,747,000)	
MRCC-Law Number 42.....	(200,329)	
Christmas Bonus.....	(275,974)	
Compensated Absences.....	(1,818,818)	
Total Long-Term Liabilities.....		<u>(44,042,121)</u>
Total Net Assets of Governmental Activities		<u>\$ 144,333,015</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, 2012

	GENERAL FUND	HEAD START FUND	SALES AND USAGE TAXES FUND	ARTS CENTER FUND	DEBT SERVICE	LOAN	OTHER GOVERNMENTAL FUNDS	TOTAL GOVERNMENTAL FUNDS
REVENUES:								
Property Taxes	\$ 8,347,770	\$ -	\$ -	\$ -	\$ 4,107,116	\$ -	\$ -	\$ 12,454,886
Volume of Business Taxes	7,717,059	-	-	-	920,868	-	-	7,717,099
Sales Taxes	-	-	3,507,022	-	-	-	-	4,427,890
Federal Assurances	1,797,241	4,896,819	-	-	-	-	2,683,365	7,580,184
Intergovernmental	1,147,822	-	-	-	-	-	-	1,797,241
Licenses and Permits	151,718	-	-	-	-	-	-	1,147,822
Interest	5,107,195	-	-	-	-	-	-	151,718
Miscellaneous	-	-	-	-	-	-	-	5,107,195
Total Revenues	24,268,845	4,896,819	3,507,022	-	5,027,984	-	2,683,365	40,384,035
EXPENDITURES:								
Current								
Mayor and Municipal Legislature	1,951,953	-	-	-	-	-	-	1,951,953
General Government	5,388,553	-	-	-	-	-	-	5,388,553
Public Safety	913,616	-	-	-	-	-	-	913,616
Public Works	2,942,026	-	-	-	-	-	-	2,942,026
Culture and Recreation	952,359	-	-	-	-	-	-	952,359
Health and Sanitation	337,745	-	-	-	-	-	-	337,745
Public Instruction	-	4,901,246	-	-	-	-	2,686,851	7,588,097
Human Services and Welfare	1,322,988	-	-	-	-	1,179,914	-	1,322,988
Capital Outlay	224,874	-	2,968,036	-	-	-	10,669,640	15,042,464
Debt Service	-	-	-	-	-	-	-	-
Principal	-	-	-	-	-	-	-	-
Interest and Other Charges	-	-	-	-	1,136,000	-	-	1,136,000
	-	-	-	-	385,030	-	-	385,030
Total Expenditures	14,034,114	4,901,246	2,968,036	-	1,521,030	1,179,914	13,356,491	37,960,831
Excess of Revenues Over (Under) Expenditures	10,234,731	(4,427)	538,986	-	3,506,954	(1,179,914)	(10,673,126)	2,423,204
OTHER FINANCING SOURCES (USES):								
Bond issuance	-	-	-	-	-	21,490,000	-	23,535,000
Transfer - In	(7,996,476)	-	-	-	2,337,450	-	5,659,026	7,996,476
Transfer - Out	-	-	-	-	-	-	-	(7,996,476)
Total Other Financing Sources and Uses	2,238,255	(4,427)	538,986	-	5,844,404	20,310,086	(2,969,100)	25,958,204
Fund Balance - Beginning	15,583,434	340,165	3,802,154	8,853,170	12,940,231	-	19,247,816	60,766,970
FUND BALANCE - ENDING	\$ 17,821,689	\$ 335,738	\$ 4,341,140	\$ 8,853,170	\$ 18,784,635	\$ 20,310,086	\$ 16,278,716	\$ 86,725,174

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10/24/12
10/23/12

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, 2012

Net Change in Fund Balances – Governmental Funds		\$ 25,958,204
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.....	\$ 9,339,876	
Depreciation Expense.....	<u>(1,494,260)</u>	
Excess of Capital Assets over Depreciation Expense.....		7,845,616
Revenues in the Statement of Activities that do not provide current financial resources are reported as revenues in the funds:		
CDBG.....	(1,237,989)	
Christmas Bonus.....	<u>(275,361)</u>	
Total of Revenues.....		(1,513,350)
Repayment of long-term principal is expenditure in the governmental funds, but issuing debt reduced long-term Liabilities in the Statement of Net Assets.		(3,959,353)
Governmental funds report issuance of long-term debt as other financial resources because provides current financial resources.....		(25,535,000)
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.....	275,361	
Increase in Compensated Absences.....	918,421	
Other.....	<u>319,211</u>	
Total Additional Expenses.....		<u>1,512,993</u>
Change in Net Assets of Governmental Activities		<u>\$ 4,309,110</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, 2012**

FINANCIAL REPORTING ENTITY

1. ORGANIZATION

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

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

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

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

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

The accompanying basic financial statements present the financial position and the results of operations of the **Municipality** and its various funds and fund types, and the cash flows

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF FAJARDO
NOTES OF THE BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

of the proprietary funds. The basic financial statements are presented as of June 30, 2012, and for the fiscal year then ended. The more significant of these accounting policies are described below and, where appropriate, subsequent pronouncements will be referenced.

A. Financial Reporting Entity

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

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, 2012, 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.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF FAJARDO
NOTES OF THE BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

Governmental Fund Financial Statements

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

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

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, 2012, 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.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF FAJARDO
NOTES OF THE BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

Government-wide Financial Statements

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

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF FAJARDO
NOTES OF THE BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

Governmental Fund Financial Statements

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

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

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

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.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF FAJARDO
NOTES OF THE BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

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

Loan \$21,490,000– This fund is used to account capital improvements through bond issuance.

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.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF FAJARDO
NOTES OF THE BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF FAJARDO
NOTES OF THE BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

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 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 \$64.1 million in the general fund were fully collateralized at June 30, 2012. The deposits at GDB of approximately \$29.1 million that are restricted principally for capital projects, and the \$20.9 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.

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H. Capital Assets

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

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

<u>CAPITAL ASSETS</u>	<u>YEARS</u>
Buildings	70
Improvements Other than Buildings	70
Infrastructure	10-70
Motor Vehicles	5
Machinery and Equipment	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.

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

K. 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

During fiscal year 2011, 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

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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.
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.

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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, 2012.

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.

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.

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O. Future Adoption of Accounting Pronouncements

The Governmental Accounting Standards Board (GASB) has issued the following statements that the Municipality has not yet adopted:

Statement Number	Statement Name	Adoption Required in Fiscal Year
60	Accounting and Financial Reporting for Service Concession Arrangements	2012-13
61	The Financial Reporting Entity: Omnibus- an amendment of GASB Statements No. 14 and 34	2012-13
62	Codification of Accounting and Financial Reporting Guidance Contained in Pre - November 30, 1989 FASB and AICPA Pronouncements	2012-13
63	Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position	2012-13
65	Items Previously Reported as Assets and Liabilities	2013-14
66	Technical Corrections - 2012- an amendment of GASB Statements No. 10 and 62	2013-14
67	Financial Reporting for Pension Plans - an amendment of GASB Statement No. 25	2013-14
68	Accounting and Financial Reporting for Pensions - and amendment of GASB Statement No. 27	2014-15

The impact of these statements on the Municipality's financial statements has not yet been determined.

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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, 2012, 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	0.35%	09/19/2012
Popular Bank	1110000050	<u>600,000</u>	0.35%	04/10/2012
		<u>\$ 3,200,000</u>		

4. DUE FROM GOVERNMENTAL UNITS

Due from governmental units for the fiscal year ended June 30, 2012 represents the following:

Christmas Bonus (Treasury Department)	\$ 275,974
Municipal Revenues Collection Center	<u>1,156,265</u>
	<u>\$ 1,432,239</u>

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5. INTERFUND TRANSACTIONS

Inter-fund receivables and payables balances at June 30, 2012 consisted of the following:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
General Fund	Other governmental funds	\$ 1,394,803
General Fund	Head Start Fund	<u>641,242</u>
		<u>\$ 2,036,045</u>

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

6. FEDERAL GRANTS RECEIVABLE

Represents grants and contributions due from federal agencies:

Health and Human Services - Head Start	\$ 4,648,322
Other governmental funds	<u>2,203,807</u>
	<u>\$ 6,852,129</u>

7. DUE TO OTHER GOVERNMENTAL UNITS

As of June 30, 2012, balance due to other governmental units of the General Fund for services rendered to the **Municipality**, consists of the following:

Employee's Retirement System	\$ 36,809
Puerto Rico Aqueduct and Sewer Authority	5,969
General Services Administration	<u>2,981</u>
	<u>\$ 45,759</u>

8. DEFERRED REVENUES

The deferred revenues of approximately \$6.2 million in the general fund related to the municipal license tax collected in fiscal years 2011-2012 that will be earned in fiscal year 2012-2013.

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9. CAPITAL ASSETS

Capital assets activities for the fiscal year ended June 30, 2012 was as follows:

<u>Governmental Activities</u>	<u>Balance July 1, 2011</u>	<u>Additions</u>	<u>Retirements</u>	<u>Balance June 30, 2012</u>
Capital Assets not being Depreciated:				
Land	\$ 42,123,225	\$ 233,280	\$ -	\$ 42,356,505
Non Depreciable Assets	765,615			765,615
Total Capital Assets not being depreciated	<u>42,888,840</u>	<u>233,280</u>		<u>43,122,120</u>
Capital Assets being depreciated:				
Building	44,457,881			44,457,881
Infrastructure	36,157,759	5,152,487		41,310,246
Motor Vehicles	3,473,482	434,943		3,908,425
Equipment	5,254,979	224,386		5,479,365
Total Depreciable Capital assets	<u>89,344,101</u>	<u>5,811,816</u>		<u>95,155,917</u>
Less Accumulated Depreciation:				
Building	14,938,093	677,995		15,616,088
Infrastructure	19,632,566	325,545		19,958,111
Motor Vehicles	4,765,797	189,997		4,955,794
Equipment	3,124,465	300,723		3,425,188
Total Accumulated Depreciation	<u>42,460,921</u>	<u>1,494,260</u>		<u>43,955,181</u>
Total Capital Assets being depreciated, net	<u>46,883,180</u>	<u>4,317,556</u>	-	<u>51,200,736</u>
Governmental Activities Capital assets, net	<u>\$89,772,020</u>	<u>\$ 4,550,836</u>	<u>\$ -</u>	<u>\$ 94,322,856</u>

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>

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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, 2012, 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.	205,000
\$21,490,000 Series 2011-2012, for construction purposes, payable in annual installments ranging from \$239,620 to \$88,313,000, excluding interests from 7.50%, until July 1, 2025.	21,490,000
\$2,045,000 Series for construction purposes, payable in annual installments ranging from \$22,802 to \$13,500, excluding interests from 7.50%, until July 1, 2018.	<u>2,045,000</u>
Total General and Special Obligations	<u>\$41,747,000</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>
2013	\$ 2,353,000	\$ 1,874,665
2014	2,536,000	2,752,927
2015	2,726,000	2,525,114
2016	2,913,000	2,373,229
2017	3,124,000	2,161,584
2018-2022	11,108,000	8,233,854
2023-2027	12,034,000	3,707,908
2028-2032	<u>4,953,000</u>	<u>935,095</u>
Total	<u>\$ 41,747,000</u>	<u>\$ 24,564,376</u>

B. ADVANCES FROM THE MUNICIPAL REVENUE COLLECTION CENTER (MRCC)

These amounts represent the balance owed to MRCC at June 30, 2012, as described in Note 12, and that will be repaid through financing to be obtained by the MRCC.

Annual maturity requirements for the advances from MRCC are as follows:

<u>Advances From MRCC</u>	<u>Principal</u>	<u>Interest</u>
2013	\$ 5,060	\$ 12,318
2014	5,378	12,000
2015	5,716	11,662
2016	6,076	11,303
2017	6,457	10,922
2018-2022	38,903	47,988
2023-2027	52,760	34,131
2028-2032	71,553	15,338
2033-2037	<u>8,426</u>	<u>261</u>
	<u>\$ 200,329</u>	<u>\$ 155,923</u>

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C. CHANGES IN GENERAL LONG-TERM DEBTS

Description	Balance July 01, 2011	Additions	Payments	Balance June 30, 2012	Amount Due Within One Year	Amount Due After Next Year
General Obligations						
Bonds	\$ 19,348,000	\$ 23,535,000	\$ 1,136,000	\$ 41,747,000	\$ 2,353,000	\$39,394,000
MRCC-Law 42	205,089		4,760	200,329	8,689	191,640
MRCC-LIMS	58,154		58,154			
Christmas bonus	257,364	275,974	257,364	275,974	275,974	-
Compensated absences	900,397	1,818,818	900,397	1,818,818	690,011	1,128,807
	<u>\$ 20,769,004</u>	<u>\$ 25,629,792</u>	<u>\$ 2,356,675</u>	<u>\$ 44,042,121</u>	<u>\$ 3,327,674</u>	<u>\$40,714,447</u>

11. DEBT SERVICE

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 (MRCC) 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 MRCC by May 15 of each year. The tax on real property is assessed by the MRCC. 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.

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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%	2.47%
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 MRCC and reported to the Municipality.

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

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 MRCC.

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 MRCC informs the Municipality of the estimated amount of property tax expected to be collected for the ensuring fiscal year. Throughout the year, the MRCC advances funds to the Municipality based on the initial estimated collections. The MRCC is required by law to prepare a settlement statement on a fiscal year basis, whereby a comparison is made between the amounts advanced to the Municipality and amounts actually collected from taxpayers. This settlement has to be completed on a preliminary basis not later than three months after fiscal year-end, and a final settlement made not later than six months after year end. If the MRCC remits to the Municipality property tax advances, which are less than the tax actually collected, a receivable from the MRCC is recorded at June 30. However, if advances exceed the amount actually collected by the MRCC, a payable to the MRCC is recorded at June 30. The advances from MRCC as of June 30, 2012, are presented as non-current liabilities in the government-wide financial statements.

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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, 2012. 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.

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.

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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 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.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF FAJARDO
NOTES OF THE BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

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 (10.275% 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 10.275% of gross salary. Contributions' requirements are established by law. The actuarially determined contribution requirement and contributions actually made for the year ended June 30, 2012 was approximately \$392,000.

Additional information on the ERS is provided in its financial statements for the year ended June 30, 2012, 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 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.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF FAJARDO
NOTES OF THE BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

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.

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.

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 the 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 waste and recycling program, capital improvements and health and public safety costs.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF FAJARDO
NOTES OF THE BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

The amount collected by 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 to 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, 2012, 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.

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 not a 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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF FAJARDO
NOTES OF THE BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

construction cost of \$ 50,000. In addition, for every \$ 1,000 in excess of the \$ 50,000 in total construction cost, \$ 5.00 rate will be collected.

20. FUND BALANCE

As of June 30, 2012, the fund balance is comprised of the following:

	General	Head Start Fund	Sales and usage taxes Fund	Arts and Center Fund	Debt Service	Loan \$21,490,000	Other Governmental Funds	Total Government Funds
Restricted:								
Public works	\$ -	\$ -	\$ 4,341,140	\$ -	\$ -	\$ -	\$ -	\$ 4,341,140
Education		335,738						335,738
Capital outlays				8,853,170		20,310,086	16,278,716	45,441,972
Debt service					18,784,635			18,784,635
Assigned :								
General								
Government	754,666							754,666
Public safety	12,503							12,503
Public works	181,903							181,903
Recreation	52,214							52,214
Health and welfare	11,703							11,703
Unassigned	16,808,700							16,808,700
Total	\$ 17,821,689	\$ 335,738	\$ 4,341,140	\$ 8,853,170	\$ 18,784,635	\$ 20,310,086	\$ 16,278,716	\$ 86,725,174

21. SUBSEQUENT EVENTS

In preparing these financial statements the Municipality has evaluated events and transactions for potential recognition or disclosure through March 1, 2013, the date the financial statements were available to be issued.

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, 2012

	Budget Amounts		Actual Amounts	Variance with
	Original	Final	(Budgetary Basis) (See Note A)	Final Budget
BUDGETARY FUND BALANCE, JULY 1, 2011	\$ 14,529,863	\$ 14,529,863	\$ 14,529,863	\$ -
Resources (Inflows):				
Property Taxes.....	8,347,768	8,347,768	8,347,770	2
Volume of Business Taxes.....	7,560,000	7,560,000	7,717,099	157,099
Sanitation.....	200,000	200,000	91,666	(108,334)
Intergovernmental Revenues.....	1,771,265	1,771,265	1,797,241	25,976
License and Permits.....	618,000	618,000	1,147,822	529,822
Rent.....	20,060	20,060	26,185	6,125
Interest.....	330,000	330,000	151,718	(178,282)
Miscellaneous.....	636,913	636,913	4,989,344	4,352,431
Prior year allocation		7,996,476	7,996,476	-
Total Resources (Inflows).....	19,484,006	27,480,482	32,265,321	4,784,839
Amounts Available for Appropriation.....	34,013,869	42,010,345	46,795,184	4,784,839
Charges to Appropriations (Outflows):				
Mayor and Municipal Legislature.....	2,498,917	2,751,717	1,951,953	799,764
General Government.....	8,935,713	9,481,524	5,388,553	4,092,971
Public Safety.....	1,037,895	1,040,985	913,616	127,369
Public Works.....	3,894,427	2,942,026	2,942,026	-
Culture and Recreation.....	1,009,467	1,090,967	952,359	138,608
Health and Sanitation.....	274,757	343,757	337,745	6,012
Human Services and Welfare.....	1,607,956	1,608,156	1,322,988	285,168
Capital Outlays.....	224,874	224,874	224,874	-
Transfer to Other Funds.....		7,996,476	7,996,476	-
Total Charges to Appropriations.....	19,484,006	27,480,482	22,030,590	5,449,892
BUDGETARY FUND BALANCE, JUNE 30, 2012	\$ 14,529,863	\$ 14,529,863	\$ 24,764,594	\$ 10,234,731

The accompanying notes to budgetary comparison schedule are 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, 2012

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	\$ 46,795,184
Difference – Budget to GAAP:	
Prior-Year allocation is not inflows of budgetary resources but are revenues for financial reporting purposes.....	(7,996,476)
The Fund Balance at the Beginning of Year is a budgetary resource but is not a Current-Year Revenue for financial reporting purposes.....	<u>(14,529,863)</u>
Total Revenues as Reported on the Statement of Governmental Funds Revenues, Expenditures and Changes in Fund Balance	<u>\$ 24,268,845</u>
Uses/Outflows of Resources:	
Actual Amounts (Budgetary Basis) "Total Charges to Appropriation" from the Budgetary Comparison Schedule	\$ 22,030,590
Difference – Budget to GAAP:	
Transfers to other funds are outflows of budgetary resources but are not expenditures for financial reporting purposes.....	<u>(7,996,476)</u>
Total Expenditures as Reported on the Statement of Governmental Funds Revenues, Expenditures and Changes in Fund Balance	<u>\$ 14,034,114</u>

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

Budgetary Fund Balance, June 30, 2012.....	\$ 24,764,594
Timing Differences:	
Change in Encumbrances.....	(65,182)
Restriction from Deferred Revenue.....	(6,176,615)
Cancelation of Prior Year Encumbrances	<u>(701,108)</u>
Fund Balance, June 30, 2012.....	<u>\$ 17,821,689</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, 2012

<u>Federal Grantor/Program Title</u>	<u>Federal CFDA Number</u>	<u>Federal Disbursements/ Expenditures</u>
U.S. Department of Agriculture		
USDA - Rural Development: Pass through Puerto Rico Department of Education Child and Adult Care Food Program (USDA)	10.558	\$ 381,743
Total U.S. Department of Agriculture		<u>381,743</u>
U.S. Department of Housing and Urban Development:		
Community Development Block Grants/ Entitlement Grants (CDBG)	14.218	923,592
Section 8 Housing Choice Voucher Program	14.871	544,791
Pass through Puerto Rico Family Department: Homelessness Prevention and Rapid Re-Housing Program (HRPR) - Recovery Act Funded	14.257	213,950
Pass-through Puerto Rico Health Department: Housing Opportunities for Persons with AIDS (HOPWA)	14.241	<u>62,624</u>
Total U.S. Department of Housing and Urban Development		<u>1,744,957</u>
U.S. Department of Health and Human Services:		
Pass-through Administration for the Childhood Care and Integral Development: Child Care and Development Block Grant	93.575	236,292
Head Start Program	93.600	4,901,246
ARRA - Head Start Program	93.708	<u>348,950</u>
Total U.S. Department of Health and Human Services		<u>5,486,488</u>
U.S. Department of Homeland Security:		
Disaster Grants - Public Assistance (Presidential Declared Disasters)	97.036	<u>24,488</u>
Total U.S. Department of Homeland Security		<u>24,488</u>
U.S. Department of Transportation		
Federal Transit - Formula Grants (Urbanized Area Formula Program) - ARRA	20.507	<u>249,324</u>
Total U.S. Department of Transportation		<u>249,324</u>
TOTAL EXPENDITURES OF FEDERAL AWARDS		<u>\$ 7,887,000</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, 2012**

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>7,887,000</u>
Federal expenditures per basic financial statements included within:	
Head Start Fund	\$ 4,901,246
Federal expenditures included in other governmental funds	<u>2,985,754</u>
Total	\$ <u>7,887,000</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, 2012, which collectively comprise the Municipality's basic financial statements and have issued our report thereon dated March 1, 2013. 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.

Ortiz, Rivera, Rivera & Co.

San Juan, Puerto Rico
March 1, 2013

The stamp E16559 was affixed
to the original of this report.



ORTIZ, RIVERA & RIVERA & CO.

CERTIFIED PUBLIC ACCOUNTANTS • VALUE ADDED SERVICES

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**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, 2012. 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, 2012.

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
March 1, 2013

Ortiz, Rivera, Rivera & Co.

The stamp E16560 was affixed to the original of this report.



ORTIZ, RIVERA, RIVERA & CO.

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**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF FAJARDO
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

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>
14.257	Homelessness Prevention and Rapid Re-Housing Program - Recovery Act
93.600	Head Start Program
93.708	Head Start Program (ARRA)

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF FAJARDO
SCHEDULE OF STATUS OF PRIOR YEAR
AUDIT FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

The Municipality of Fajardo has no prior year audit findings.