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**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA**

**FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT
(WITH ADDITIONAL REPORTS REQUIRED
UNDER THE OMB CIRCULAR A-133)**

FISCAL YEAR ENDED JUNE 30, 2003

Camille Hoy - 8631

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA



Financial Statements
Fiscal Year Ended
June 30, 2003

Honorable Martín Vargas Morales
Mayor

Prepared by:

Luis A. Pacheco Santiago
Director of Finance and Budget

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA**

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Independent Auditors' Report

Mayor and Municipal Legislature
Municipality of Guánica
Guánica, 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 Guánica, Puerto Rico, as of and for the year ended June 30, 2003, which collectively comprise the Municipality's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Municipality's management. Our responsibility is to express an opinion on these financial statements based on our audit.

Except as discussed in the following paragraphs, 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 misstatements. 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 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.

We were unable to obtain sufficient evidence to support existence, completeness and rights and obligations applicable to certain general capital assets in government activities and we were unable to satisfy ourselves by means of other auditing procedures.

We were unable to obtain sufficient evidence to support completeness and valuation applicable to due from (to) other funds between the General Fund, CDBG Capital Projects/Special Fund, State Legislative Joint Resolutions Fund and Other Governmental Funds due to the inadequacy of accounting records. We were unable to satisfy ourselves by means of other auditing procedures.

In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to obtain sufficient evidence to support the existence, completeness and rights and obligations applicable to certain general capital assets in government activities and had the records concerning due from (to) other funds between the General Fund, CDBG Capital Projects/Special Fund, State Legislative Joint Resolutions Fund and Other Governmental Funds been adequate, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of the governmental activities, each major fund, and the aggregate remaining fund information of the Municipality of Guánica as of June 30, 2003, and the respective changes in financial position, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As described in Note 1, the Municipality has implemented a new financial reporting model, as required by the provisions of Governmental Accounting Standards Board ("GASB") Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*; GASB Statement No. 37, *Basic Financial Statements - and Management Discussion and Analysis - for State and Local Governments: Omnibus - an amendment of GASB Statements No. 21 and 34*; GASB Statement No. 38, *Certain Financial Statement Note Disclosures*; and GASB Statement No. 41 *Budgetary Comparison Schedule - Perceptive Differences - an Amendment of GASB Statement No. 34* as of June 30, 2003.

The Management's Discussion and Analysis on pages 3 through 16 and the Budgetary Comparison Schedule – General Fund on page 66 are not a required part of the basic financial statements, but are supplementary information required by the accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued a report dated January 26, 2004 on our consideration of the Municipality's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Our audit was made for the purpose of forming opinions on the financial statements that collectively comprise the Municipality of Guánica's basic financial statements. The accompanying Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis as required by US Office of Management and Budget Circular A-133, "*Audits of State, Local Governments, and Non-Profit Organizations*" and is not a required part of the basic financial statements. Such information in that schedule has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly presented in all material respects in relation to the basic financial statements taken as a whole.



Rodriquez Rivera & Tugait

MANAGEMENT DISCUSSION AND ANALYSIS

Management of the Municipality of Guánica of the Commonwealth of Puerto Rico (the Municipality) provides this *Management's Discussion and Analysis* (MD&A) for the readers of the Municipality's basic financial statements. This narrative represents an overview and analysis of the financial activities of the Municipality for the fiscal year ended June 30, 2003. Because this MD&A is designed to focus on the current year activities, resulting changes and currently known facts, we encourage readers to consider the information presented in this MD&A in conjunction with the additional information furnished in the accompanying basic financial statements.

During fiscal year ended June 30, 2003, the Municipality implemented the new required financial reporting standards established by Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*, issued by the Governmental Accounting Standards Board (GASB No. 34). According to this statement, significant required changes in content and structure have been made in the accompanying basic financial statements as of and for the fiscal year ended June 30, 2003, which make them not easily comparable with prior years' financial statements. However, in future years, comparative analysis will be more meaningful and will go further in explaining the Municipality's financial position and results of operations.

FINANCIAL HIGHLIGHTS

a) Government-Wide Highlights

- **Assets** - The Municipality has reported assets amounting to \$16,543,950 in the accompanying statement of net assets, of which the most significant are capital assets, temporarily restricted cash, and intergovernmental receivables to \$8,539,502, \$4,323,819, and \$3,343,639 respectively. These assets account for \$16,206,960 or 98% of the Municipality's total assets.
- **Liabilities** - The Municipality has reported liabilities amounting to \$13,393,120 in the accompanying statement of net assets, of which the most significant are bonds and notes payable, deferred revenues, claims and judgments, accounts payable and intergovernmental payable amounting to \$5,849,856, \$2,468,292, \$2,205,488, \$1,710,909 and \$49,170 respectively. These liabilities account for \$12,283,715 or 92% of the Municipality's total liabilities.
- **Net assets** - The assets of the Municipality exceeded its liabilities by \$3,150,830 at June 30, 2003 which and is presented as "net assets" in the accompanying statement of net assets. Restricted net assets and unrestricted deficit amounted to \$1,743,497 and \$(3,362,144), respectively. Net assets invested in capital assets amounted to \$4,769,476.

- **Net change in net assets** - The Municipality's net assets increased by \$997,174 (47% decrease) during fiscal year ended June 30, 2003. Net assets at June 30, 2002 amounted to \$2,153,656. The decrease in net assets represents a negative result of operations and deterioration in the Municipality's overall financial position in comparison with the prior fiscal year.
- **Revenues** - The Municipality has reported total revenues amounting to \$10,327,102 in the accompanying statement of activities, of which the most significant are tax revenues, operating grants, grants and contributions not restricted, other revenues and special item-complain against PREPA, amounting to \$5,298,112; \$3,415,178; \$790,525; \$404,636, and \$332,017 respectively. These revenues account for \$10,240,468 or 99% of the Municipality's total revenues.
- **Expenses** - The Municipality has reported total expenses amounting to \$9,329,928 in the accompanying statement of activities, of which the most significant are categorized as general government, health and sanitation economic development and public housing and welfare amounting to \$4,034,251; \$1,966,228; \$1,207,385 and \$741,672, respectively. These expenses accounted for \$7,949,536 or 86% of the Municipality's total expenses.

b) Governmental Funds Highlights

- **Assets** - The Municipality's governmental funds have reported combined assets amounting to \$8,983,521 in the accompanying balance sheet – governmental funds, of which the most significant are intergovernmental receivables, unrestricted cash and receivables from other funds amounting to \$3,093,156, \$1,691,920, and \$1,880,160 respectively. These assets account for \$6,665,236 or 75% of the Municipality's combined governmental funds assets.
- **Liabilities** - The Municipality's governmental funds have reported combined liabilities amounting to \$5,173,058 in the accompanying balance sheet – governmental funds, of which the most significant are deferred revenues, due to other funds, accounts payables and mature bonds and notes payable amounting to \$2,980,853; \$1,092,807; \$772,089 and \$278,139, respectively. These liabilities account for \$5,123,888 or 99% of the Municipality's combined governmental fund liabilities.
- **Governmental fund balances** - The Municipality's governmental funds reported combined fund balances amounting to \$3,810,464, which represent reserved fund balances.

- **Net change in governmental fund balances** - The Municipality's governmental fund balances increased by \$25,896 (1% increase) during fiscal year ended June 30, 2003. Governmental fund balances at June 30, 2002, as restated, amounted to \$3,784,568. The increase represents the excess of revenues over expenditures and other financing sources (uses).
- **Revenues** - The Municipality has reported total revenues amounting to \$10,010,943 in the accompanying statement of activities, of which the most significant are tax revenues, operating grants, intergovernmental and federal grant contributions, amounting to \$5,243,969; \$1,843,164; \$1,608,648 and \$745,053 respectively. These revenues account for \$9,440,834 or 95% of the Municipality's total revenues.
- **Expenses** - The Municipality has reported total expenses amounting to \$9,985,047 in the accompanying statement of activities, of which the most significant are categorized as general government, health and sanitation, economic development and capital outlay amounting to \$3,258,752, \$1,984,737, \$1,258,120 and \$1,489,687, respectively. These expenses accounted for \$7,991,296 or 80% of the Municipality's total expenses.

OVERVIEW OF THE BASIC FINANCIAL STATEMENTS

This management's discussion and analysis is intended to serve as an introduction to the accompanying basic financial statements. The Municipality's basic financial statements include three components: (1) government-wide financial statements, (2) governmental fund financial statements, and (3) notes to the basic financial statements. This report also contains additional required supplementary information in addition to the basic financial statements themselves. These components are described below.

The new basic financial statements are the result of a significant change in the focus of financial reporting in comparison with the financial statements previously issued by the Municipality. The new basic financial statements focus on: (1) the Municipality as a whole (government-wide financial reporting) and, (2) the Municipality's major individual governmental funds discussed below. Both perspectives (government-wide and major governmental fund financial reporting) allow the user to address relevant questions, broaden a basis for comparison (year to year or government to government) and enhance the Municipality's accountability. The components of the basic financial statements are described below.

a) Government-Wide Financial Statements

The *government-wide financial statements* are designed to provide readers with a broad overview of the Municipality's operations and finance as a whole in a manner similar to private-sector business. These statements provide short-term and long-term information about the Municipality's financial position, which assist the Municipality's management to determine the economic condition at June 30, 2003. These financial statements are prepared using the flow of economic resources measurement focus and the accrual basis of accounting. This basically means that these financial statements follow methods that are similar to those used by most private businesses. They take into account all revenues and expenses connected with the fiscal year ended June 30, 2003 even if cash involved have not been received or paid. The government-wide financial statements are composed of: (1) the statements of net assets and (2) the statement of activities.

1. Statement of Net Assets

The statement of net assets presents all of the Municipality's assets and liabilities, with the difference between these two items reported as "net assets" (equity). Over time, increases or decreases in the net assets may serve as a useful indicator of whether the financial position of the Municipality is either improving or deteriorating.

2. Statement of Activities

The statement of activities presents information showing how the Municipality's net assets changed during the fiscal year ended June 30, 2003. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will not result in cash flows until future fiscal periods (such as uncollected taxes and earned but unused vacation leave). This statement also presents a comparison between direct expenses and program revenues for each function of the Municipality.

Both of the abovementioned financial statements present all of the Municipality's governmental activities, which are supported mostly by taxes and intergovernmental revenues (such as federal and state grants and contributions). All services normally associated with the Municipality fall into this category, including culture, recreation and education, general government, health and sanitation, public safety, public housing and welfare, and economic and urban development. The government-wide financial statements can be found immediately following this management's discussion and analysis.

b) Governmental Fund Financial Statements

The Municipality's governmental fund financial statements consist of: (1) the balance sheet – governmental funds and (2) the statement of revenues, expenditures and changes in fund balances – governmental funds. These financial statements report the financial position and results of operations of the Municipality's governmental funds, with an emphasis on the Municipality's major funds.

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The Municipality, like most other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. Each fund is considered an independent fiscal entity accounted for within a set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenue, and expenditures. 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 governmental fund financial statements focus on: (1) individual parts of the Municipality's government and (2) reporting the Municipality's operations in more detail than the government-wide financial statements. For financial reporting purposes, the Municipality classifies its funds within the following fund categories: (1) general fund, (2) debt service fund, (3) special revenue funds, and (4) capital projects funds (collectively known as the "governmental funds").

Governmental funds are used to account for all of the services provided by the Municipality. Governmental funds are used to account for essentially the same functions reported as governmental activities in the governmental-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on near-term inflows and outflows of expendable financial resources. They also focus on the balances of expendable financial resources available at the end of the fiscal year (June 30, 2003). This approach is known as using the flow of current financial resources measurement focus and the modified accrual basis of accounting. These statements provide a detailed short-term view of the Municipality's finances that assists in determining whether there will be adequate financial resources available to meet the current needs of the Municipality, that is, evaluating the Municipality's near-term financing requirements. Both the governmental funds' balance sheet and the governmental funds' statement of revenues, expenditures and changes in fund balances provide a reconciliation to facilitate this comparison between governmental funds and the governmental activities reported in the government-wide financial statements.

As previously mentioned, the Municipality has five major governmental funds. Each major fund is presented in a separate column in the governmental funds' balance sheet and the governmental funds' statement of revenues, expenditures and changes in fund balances. The four major governmental funds are: (1) the general fund, (2) CDBG Capital Projects/Special Fund, (3) EDA Capital Project Fund, (4) 2001-2002 \$1,740,000 Bond Issuance Fund and (5) State Legislature Joint Resolutions Fund.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the fund information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the Municipality's near-term financial decisions.

The Municipality has no activities that operate more like those of commercial enterprises nor have resources held for the benefit of parties outside the Municipality's government. Consequently, the Municipality has not reported proprietary funds nor fiduciary funds in the accompanying basic financial statements. The governmental funds financial statements can be found immediately following the government-wide financial statements.

c) Notes to Basic Financial Statements

The notes to the basic financial statements provide additional information that is essential for a full understanding of the data provided in the government-wide and the governmental fund financial statements. The notes to the basic financial statements can be found immediately following the basic financial statements.

d) Required Supplementary Information

The basic financial statements are followed by a section of required supplementary information (RSI) which consists of a Budgetary Comparison Schedule - General Fund.

INFRASTRUCTURE ASSETS

Historically, infrastructure assets, which are one of the Municipality's largest group of assets (consisting of roads, bridges, traffic signals, underground pipes [unless associated with a utility], etc.) have not been reported nor depreciated in governmental financial statements. According to GASB No. 34, the Municipality has valued and reported infrastructure assets in the accompanying government-wide financial statements. Additionally, under the provisions of GASB No. 34, the Municipality had the option to either: (a) depreciate these assets over their estimated useful life or (b) develop a system of asset management designed to maintain the service delivery potential to near perpetuity.

If the Municipality would have developed the asset management system (commonly known as the *modified approach*), then the Municipality would have to measure and demonstrate its maintenance of locally established levels of service standards at least every three years for each infrastructure asset category. Under the modified approach, the Municipality would have recorded its cost of maintenance in lieu of depreciation and amortization. As of July 1, 2002, the Municipality retroactively recorded the estimated historical costs of infrastructure assets in the accompanying government-wide financial statements. Also the Municipality elected to depreciate infrastructure assets instead of using the modified approach.

GOVERNMENT-WIDE FINANCIAL ANALYSIS

a) Net Assets

As noted earlier, net assets may serve over time as a useful indicator of the Municipality's financial position. Total assets and total liabilities at June 30, 2003 amounted to \$16,543,950 and \$13,393,120 respectively, for net assets of \$3,150,830 compared to net assets of \$4,181,702 at June 30, 2002.

The Municipality's net assets are reduced by unrestricted net liabilities amounting to \$1,023,338. A portion of the Municipality's net assets amounting to \$3,158,364 represents resources that are subject to external restrictions on how they may be used. Restrictions on these resources are mainly related to: (1) the financing of federal and state assisted programs, (2) the future acquisition or construction of capital assets, (3) the future payment of debt service and (3) other specific purposes.

The following is a condensed presentation of the Municipality's financial position, as reported in the government-wide financial statements:

	<u>Governmental Activities</u>
<i>Assets:</i>	
Current assets	\$ 3,651,773
Noncurrent assets:	
Capital assets, net	8,539,502
Other noncurrent assets	<u>4,352,675</u>
Total assets	<u><u>\$ 16,543,950</u></u>
<i>Liabilities:</i>	
Current liabilities	\$ 4,506,661
Noncurrent liabilities - long-term liabilities due after one year	<u>8,886,459</u>
Total liabilities	<u>13,393,120</u>
<i>Net assets (liabilities):</i>	
Invested in capital assets, net of related debt	4,769,476
Restricted	1,743,497
Unrestricted	<u>(3,362,143)</u>
Total net assets	<u><u>\$ 3,150,830</u></u>

The Municipality's current assets amounting to \$3,651,773 are mainly composed of intergovernmental receivables, cash and taxes receivable amounting to \$3,178,032, \$285,727 and \$161,406 respectively. The restricted cash represents resources legally designated for the payment of debt service, the acquisition and construction of major capital assets, and resources designated for the operations of federal and state funded programs.

The Municipality's noncurrent assets amounting to \$12,892,177 are substantially composed of capital assets, net of accumulated depreciation and amortization, and temporarily restricted cash amounting to \$8,539,502 and \$4,323,819.

The Municipality's current liabilities amounting to \$4,506,661 are mainly composed of deferred revenues, accounts payable, and intergovernmental payable amounting to \$2,468,292, \$278,290, and \$49,170 respectively. Deferred revenues principally consist of unearned revenues associated with municipal license taxes and intergovernmental grants and contributions related to state and federal funded programs.

The Municipality's noncurrent liabilities amounting to \$8,886,459 are mainly composed of the long-term portions of bonds and notes payable, claims and judgments, and accrued compensated absences amounting to \$5,849,856, \$2,205,488, and \$824,735 respectively.

The following is a condensed presentation of the Municipality's results of operations, as reported in the government-wide financial statements:

**Condensed Statement of Activities
Year Ended June 30, 2003**

<i>Program revenues:</i>	
Program-specific operating grants and contributions	\$ 3,415,178
Program-specific capital grants and contributions	16,178
Charges for services	68,022
Total program revenues	3,499,378
 <i>General revenues:</i>	
Property taxes	4,689,450
Municipal license taxes	608,662
Unrestricted intergovernmental grants and contributions	792,959
Special item – Puerto Rico Electric Power Authority	332,017
Other general revenues (various sources)	404,636
Total general revenues	6,827,724
Total revenues	10,327,102
 <i>Program expenses:</i>	
General government	4,034,251
Economic development	1,207,385
Public safety	675,141
Health and sanitation	1,966,228
Public housing and welfare	741,672
Culture, recreation and education	374,289
Interest on long-term obligations	330,962
Total expenses	9,329,928
 <i>Net changes in net assets</i>	 997,174
<i>Net assets - at beginning of year</i>	2,153,656
<i>Net assets - at end of year</i>	\$ 3,150,830

Governmental activities increased the Municipality's net assets by \$997,174. A comparison of the cost of services by function for the Municipality's governmental activities is shown below, along with the revenue used to cover the net expenses of the governmental activities.

Year Ended June 30, 2003

Net expenses:

General government	\$ 3,384,747
Economic development	(869,950)
Public safety	552,437
Public housing and welfare	209,319
Culture, recreation and education	374,289
Health and sanitation	1,966,228
Interest on long-term obligations	213,480
Total governmental activities' net expenses	<u>5,830,550</u>

General revenues:

Taxes	5,298,112
Unrestricted intergovernmental grants and contributions	790,525
Other revenues sources	739,087
Total governmental activities general revenues	<u>6,827,724</u>
Net increase in net assets	<u>\$ 997,174</u>

FINANCIAL ANALYSIS OF GOVERNMENTAL FUNDS

As discussed earlier, the Municipality uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. The focus of the Municipality's governmental funds is to provide information on near-term inflows, outflows, and balances of expendable resources. Such information is useful in assessing the Municipality's financing requirements. In particular, unreserved fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year.

At June 30, 2003, the Municipality's governmental funds reported combined fund balances of \$3,810,464, an increase of \$25,896 or .68% in comparison with the prior year. This fund balance have been already committed: (1) to liquidate contracts and purchase orders of the prior fiscal year (\$114,160), (2) to pay debt service (\$110,865), and (3) capital projects (\$1,176,609), and (4) for a variety of other restricted purposes (\$2,968,673).

The following is a condensed presentation of the Municipality's balance sheet and results of operations of governmental funds:

Condensed Balance Sheet - Governmental funds June 30, 2003

Assets:	
Total assets - major funds	\$ 7,974,745
Total assets - nonmajor funds	1,008,776
Total assets	<u>\$ 8,983,521</u>
Liabilities:	
Total liabilities - major funds	4,431,456
Total liabilities - nonmajor funds	741,603
Total liabilities	<u>5,173,059</u>
Fund Balances:	
Reserved - major funds	4,103,134
Reserved - nonmajor funds	267,173
Unreserved - major funds	(559,843)
Total fund balances	<u>\$ 3,810,464</u>

CAPITAL ASSETS

The accompanying statement of net assets reported total capital assets, at cost, amounting to \$14,514,307, of which \$939,572 represents infrastructure assets at June 30, 2003. The related accumulated depreciation and amortization of capital assets amounted to \$5,974,805 of which \$212,617 is related to infrastructure assets at June 30, 2003. The investment in capital assets includes land and land improvements, buildings and buildings improvements, machinery and equipment, licensed vehicles, furniture and fixtures, infrastructure and construction in progress.

The net book value of capital assets at June 30, 2003 is distributed by function/activity. Actual expenditures to purchase or construct capital assets were \$1,585,906 for the year. A significant portion of this amount was incurred in construction projects. Depreciation and amortization charges for the year totaled \$333,988.

REQUEST FOR INFORMATION

This financial report is designed to provide a general overview of the Municipality's finances for all of the Municipality's citizens, taxpayers, customers, investors and creditors. This financial report seeks to demonstrate the Municipality's accountability for the money it receives. Questions concerning any of the information provided in this report or requests for additional information should be addressed to: Municipality of Guánica, Department of Finance, P. O. Box 785, Guánica, Puerto Rico, 00653.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA
Statement of Net Assets
June 30, 2003

ASSETS

Current Assets:

Cash and cash equivalents (notes 1g and 2)	\$	285,727
Receivables, net of allowance for doubtful accounts (note 1h):		
Taxes:		
Property taxes (note 4)	\$	148,241
Municipal license taxes (note 3)		13,165
Total taxes receivable		<u>161,406</u>
Accrued interest		4,201
Intergovernmental (note 1h)		<u>3,178,032</u>
Total receivables		3,343,639
Inventories (note 1i)		6,876
Prepaid expenses (note 1i)		<u>15,531</u>
Total current assets		<u>3,651,773</u>

Non-current Assets:

Temporarily restricted cash and cash equivalents (notes 1g and 2)		4,323,819
Deferred charges, net of accumulated amortization (note 1k)		28,856
Capital assets, net of accumulated depreciation and amortization (notes 1l and 6)		<u>8,539,502</u>
Total non-current assets		<u>12,892,177</u>
Total assets	\$	<u>16,543,950</u>

LIABILITIES

Current liabilities:

Accounts payable and other accrued liabilities (note 7)	\$	1,710,909
Intergovernmental (note 1h)		49,170
Deferred revenues (note 1m)		2,468,292
Matured bonds and interest payable (note 7d)		<u>278,290</u>
Total current liabilities		4,506,661

Non-current liabilities:

Accrued compensated absences, excluding current portion (notes 1n and 7f)		824,735
Claims and judgments (notes 9)		2,205,488
Obligation under capital leases, excluding current portion (notes 7e and p)		6,380
Bonds, loans and notes payable, excluding current portion (notes 7o)		<u>5,849,856</u>
Total non-current liabilities		<u>8,886,459</u>
Total liabilities		<u>13,393,120</u>

NET ASSETS

Invested in capital assets, net of related debt		4,769,476
Restricted for (1c):		
Debt service		389,966
Capital projects		<u>1,353,531</u>
Total restricted net assets		<u>1,743,497</u>
Unrestricted (deficit)		<u>(3,362,144)</u>
Total net assets	\$	<u>3,150,830</u>

The accompanying notes to the basic financial statements are an integral part of this statement.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA
Statement of Activities
Year Ended June 30, 2003

Functions/Programs	Expenses	Program Revenues			Net Expenses and Changes in Net Assets
		Charges for services and rents	Operating Grants and Contributions	Capital Grants and Contributions	
Governmental activities (note 1c):					
General government	\$ 4,034,251	\$ 68,022	\$ 581,482	\$ -	\$ (3,384,747)
Economic development	1,207,385	-	2,061,157	16,178	869,950
Public safety	675,141	-	122,704	-	(552,437)
Public housing and welfare	741,672	-	532,353	-	(209,319)
Culture, recreation and education	374,289	-	-	-	(374,289)
Health and sanitation	1,966,228	-	-	-	(1,966,228)
Interest on bonds, notes, capital lease obligations and long-term debt	330,962	-	117,482	-	(213,480)
Total governmental activities	\$ 9,329,928	\$ 68,022	\$ 3,415,178	\$ 16,178	\$ (5,830,550)

General revenues:

Taxes:	
Property taxes (note 4)	\$ 4,689,450
Municipal license taxes (note 3)	608,662
Total taxes	<u>5,298,112</u>
Grant and contributions not restricted	790,525
Unrestricted investment earnings	2,434
Other revenues	404,636
Special item-Complain against PREPA (note 12)	<u>332,017</u>
Total general revenues and special items	<u>6,827,724</u>
Net change in net assets	997,174
Net assets-beginning of fiscal year, as restated (note 10)	<u>2,153,656</u>
Net assets-end of fiscal year	<u>\$ 3,150,830</u>

The accompanying notes to the basic financial statements are an integral part of this statement.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA
Balance Sheet
Governmental Funds
June 30, 2003

	Major Funds						Total
	General Fund	CDBG Capital/Special Projects Fund	EDA Capital Projects Fund	2001-2002 \$ 1,740,000 Bond Issuance Fund	State Legislative Joint Resolutions Fund	Other Governmental Funds	
ASSETS							
Cash and cash equivalents (note 2)	\$ 285,727	\$ -	\$ -	\$ -	\$ 665,356	\$ 740,837	\$ 1,691,920
Receivables, net of allowance for doubtful accounts:							
Taxes:							
Property taxes (note 4)	148,241	-	-	-	-	-	148,241
Municipal license tax (note 3)	13,165	-	-	-	-	-	13,165
Accrued interest or deposits (note 2)	4,201	-	-	-	-	-	4,201
Others	22,406	-	-	-	-	-	22,406
Intergovernmental, principally from the Governments of the Commonwealth of Puerto Rico and United States of America (note 1h)	458,418	1,466,893	900,000	-	-	267,845	3,093,156
Due from other funds (note 1i)	585,601	-	-	-	507,112	94	1,092,807
Restricted assets							
Cash and cash equivalents	-	11,826	139,144	-	1,729,190	-	1,880,160
Cash in fiscal agent	-	-	-	1,037,465	-	-	1,037,465
Total assets	\$ 1,517,759	\$ 1,478,719	\$ 1,039,144	\$ 1,037,465	\$ 2,901,658	\$ 1,008,776	\$ 8,983,521
LIABILITIES							
Account payable and accrued liabilities (note 5)	\$ 686,054	\$ 31,325	\$ -	\$ -	\$ 26,366	\$ 28,344	\$ 772,089
Matured bonds and interest payable (notes 7b, c and d)	-	-	-	-	-	278,139	278,139
Due to other funds (note 5)	507,206	267,695	-	-	62,929	254,977	1,092,407
Due to other governments (note 5)	49,170	-	-	-	-	-	49,170
Deferred revenues (note 1m)	721,011	1,179,699	900,000	-	-	180,143	2,980,853
Total liabilities	1,963,442	1,478,719	900,000	-	89,295	741,603	5,173,058
FUND BALANCES							
Reserved for:							
Encumbrances	114,160	-	-	-	-	-	114,160
Debt service	-	-	-	-	-	110,865	110,865
Capital projects	-	-	139,144	1,037,465	-	-	1,176,609
Other specified purposes	-	-	-	-	2,812,364	156,309	2,968,673
Unreserved (undesignated)	(559,843)	-	-	-	-	-	(559,843)
Total fund balances	(445,683)	-	139,144	1,037,465	2,812,364	267,173	3,810,464
Total liabilities and fund balances	\$ 1,517,759	\$ 1,478,719	\$ 1,039,144	\$ 1,037,465	\$ 2,901,658	\$ 1,008,776	\$ 8,983,521

The accompanying notes to the basic financial statements are an integral part of this statement.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
 Reconciliation of the Balance Sheet - Governmental Funds
 to the Statement of Net Assets
 June 30, 2003

Aggregate fund balance reported in the balance sheet - governmental funds	\$	3,810,463
Governmental activities' amounts reported in the statement of net assets and the balance sheet - governmental funds are different because:		
Add (Deduct):		
Each year the Municipality receives from the Puerto Rico Treasury Department a 50% reimbursement of the Christmas Bonus paid to its employees, subject to a limit		84,875
Capital assets used in governmental activities are not financial resources, therefore are not reported in the governmental funds (note 11 and 6)		8,539,502
Deferred revenues in the governmental funds that are recognized as revenues in the statement of activities (note 1m)		512,562
Debt issued by the Municipality have associated costs that are paid from current available resources in the governmental funds. However, these Costs are deferred in the statement of net assets		28,856
The following liabilities are not due (mature) in the current period, therefore are not reported in the governmental funds (note 7):		
Accounts payable and accrued liabilities		(958,717)
Intergovernmental payables		(2,235,857)
Bonds payable		(3,614,000)
Obligation under capital leases		(6,380)
Compensated absences		(824,735)
Claims and judgments		(2,185,742)
		(6,824,729)
Governmental activities' net assets reported in statement of net assets	\$	3,150,830

The accompanying notes to the basic financial statements are an integral part of this statement.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA
 Statement of Revenues, Expenditures and
 Changes in Fund Balances - Governmental Funds
 Year Ended June 30, 2003

	Major Funds						Total Funds
	General Fund	CDBG Capital/Special Projects Fund	EDA Capital Projects Fund	2001-2002 \$ 1,740,000 Bond Issuance Fund	State Legislative Joint Resolutions Fund	Other Governmental Funds	
REVENUES:							
Taxes:							
Property taxes (notes 4)	\$ 4,635,307	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 4,635,307
Municipal license taxes (note 3)	608,662	-	-	-	-	-	608,662
Total taxes	5,243,969	-	-	-	-	-	5,243,969
Intergovernmental revenue	71,176	-	-	-	725,000	812,472	1,608,648
Charges for services	68,022	-	-	-	-	-	68,022
Grants and contributions:	-	-	-	-	-	-	-
Federal grants and contributions	-	544,900	-	-	-	200,153	745,053
State contributions	855,152	-	-	-	988,712	-	1,843,864
Interest, fines, and penalties	2,434	23	87	77,238	37,945	19,529	137,256
Other revenues	338,841	-	9	-	-	25,281	364,131
Total revenues	6,579,594	544,923	96	77,238	1,751,657	1,057,435	10,010,943
EXPENDITURES:							
Current							
General government	2,717,302	-	-	-	-	541,450	3,358,752
Public safety	523,216	-	-	-	-	77	523,293
Economic development	440,121	-	-	-	780,155	37,844	1,258,120
Health and sanitation	1,863,048	-	-	-	-	121,689	1,984,737
Culture and education	225,919	-	-	-	-	-	225,919
Public housing and welfare	180,506	325,506	-	-	-	223,384	729,396
Capital outlays	22,173	219,417	67,902	694,754	42,737	442,704	1,489,687
Debt service:							
Principal (notes 7)	16,942	-	-	-	-	199,000	215,942
Interest on bonds and notes (notes 7)	96,541	-	-	-	-	202,660	299,201
Total expenditures	6,085,768	544,923	67,902	694,754	822,892	1,768,808	9,985,047
Excess (deficiency) of revenues over (under) expenditures	493,826	-	(67,806)	(617,516)	928,766	(711,373)	25,896
OTHER FINANCING SOURCES (USES):							
Operating transfer-in from other funds (note 1t)	123,257	-	-	-	-	149,884	273,141
Operating transfer-out to other funds (note 1t)	(149,884)	-	-	(77,238)	(29,588)	(16,431)	(273,141)
Total other financing sources (uses)	(26,627)	-	-	(77,238)	(29,588)	133,453	-
EXCESS (DEFICIENCY) OF REVENUES AND OTHER FINANCING SOURCES OVER (UNDER) EXPENDITURES AND OTHER FINANCING USES	467,199	-	(67,806)	(694,754)	899,178	(577,920)	25,896
FUND BALANCES AT BEGINNING OF YEAR AS RESTATED (NOTE 10)	(912,882)	-	206,951	1,732,219	1,913,185	845,095	3,784,568
FUND BALANCES AT END OF YEAR	\$ (445,683)	\$ -	\$ 139,144	\$ 1,037,465	\$ 2,812,364	\$ 267,173	\$ 3,810,464

The accompanying notes to the basic financial statements are an integral part of this statement.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA

Reconciliation of Statement of Revenues, Expenditures and Changes
in Fund Balances - Governmental Funds to the Statement of Activities
Year ended June 30, 2003

Net change in fund balances reported in statement of revenues, expenditures and changes in fund balances – governmental funds	\$ 25,896
Governmental activities' amounts reported in the statement of activities and the statement of revenues, expenditures and changes in fund balances - governmental funds are different because:	
Add (Deduct):	
The following revenues recorded in the statement of activities do not provide current financial resources, therefore are deferred in the governmental funds:	
Property taxes	54,143
Special item - Puerto Rico Electric Power Authority (note 12)	332,017
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 as depreciation and amortization expense. This the amount by which capital outlays exceeded depreciation and amortization expense	1,251,918
Repayment of principal of long-term obligations is an expenditure in the governmental funds, but the repayment reduces long-term liabilities in the statement of net assets (note 7)	215,942
Some expenses reported in the statement of activities do not require the use of current financial resources, therefore are not reported as expenditures in the governmental funds	<u>(882,742)</u>
Net change in net assets reported in statement of activities	<u>\$ 997,174</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Notes to Basic Financial Statements
June 30, 2003

1. Summary of Significant Accounting Policies

The Municipality of Guánica (the Municipality) is a local municipal government located in Puerto Rico and constituted with full legislative, fiscal and all other governmental powers and responsibilities not expressly assigned to the government of the Commonwealth of Puerto Rico (the Commonwealth).

The Municipality's governmental system consists of executive and legislative branches. The Constitution of the Commonwealth provides for the separation of powers of the executive, legislative and judicial branches. A Mayor elected every four years by the citizens exercises the executive power of the Municipality. The legislative power is exercised by the Municipal Legislature, which is also elected every four years. The General Justice Court System of the Commonwealth, which has jurisdiction over the Municipality, exercises the judiciary power.

The Municipality assumes responsibility for providing services related to public housing, welfare, public safety, health, sanitation, education, culture, recreation, urban and economic development, and many other general and administrative duties.

The accompanying basic financial statements present the financial position and the changes in financial position of the Municipality as a whole, and its various governmental funds as of and for the year ended June 30, 2003 in conformity with accounting principles generally accepted in the United States of America, as prescribed by the Governmental Accounting Standards Board (GASB).

a) *New Financial Reporting Model*

In June 1999, the GASB issued Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis - for State and Local Governments* (GASB No. 34). This statement establishes new financial reporting requirements for state and local governments. The Municipality adopted the provisions of GASB No. 34 as well as other statements referred to below as of July 1, 2002. These statements require the reporting of new financial information and restructure much of the information that governments have reported in the past. Comparability with financial statements issued in prior years has been affected significantly.

According to the new financial reporting model established by GASB No. 34, the minimum required financial statement presentation applicable to the Municipality is composed of the following elements: (1) Government-Wide Financial Statements (GWFS), (2) Fund Financial Statements, (3) Notes to Basic Financial Statements, and (4) Required Supplementary Information (RSI).

The RSI is a set of reports and information reported along with, but separate from, the Municipality's basic financial statements. In the accompanying basic financial statements, the required RSI is composed of the following elements: (1) Management Discussion and Analysis (MD&A) and, (2) Budgetary Comparison Schedule – General Fund.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Notes to Basic Financial Statements
June 30, 2003

The MD&A is a narrative report that introduces the accompanying basic financial statements and provides an analytical overview of the Municipality's financial activities for the year ended June 30, 2003, based on the Municipality's knowledge of the transactions, events and conditions reflected in the basic financial statements. The MD&A also highlights certain key fiscal policies that control the Municipality's operations.

As previously mentioned, other statements and interpretations were required to be adopted in conjunction with GASB No. 34. Therefore, the Municipality has also adopted the following pronouncements at July 1, 2002: (1) GASB Statement No. 37 - *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments: Omnibus*, (2) GASB Statement No. 38 - *Certain Financial Statement Note Disclosures*, (3) GASB Interpretation No. 6 - *Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements*, and (4) GASB Statement No. 41 Budgetary Comparison Schedule - *Perspective Differences - an Amendment of GASB Statement No. 34*.

GASB No. 34 also requires that the accounting for all governmental activities reported in the GWFS be based on applicable pronouncements issued by the Financial Accounting Standards Board (FASB) and its predecessor bodies, such as the Accounting Principles Board (APB), issued on or before November 30, 1989, provided those pronouncements do not conflict with or contradict GASB pronouncements. Accordingly, simultaneously with the adoption of GASB No. 34, the Municipality also adopted the following pronouncements: (1) APB Opinion No. 20 - *Accounting Changes*, (2) APB Opinion No. 21 - *Interest on Receivables and Payables*, (3) FASB Statement No. 5 - *Accounting for Contingencies*, and (4) FASB Statement No. 16 - *Prior Period Adjustments*. The Municipality has elected to not apply all Statements and Interpretations issued by FASB after November 30, 1989, in accordance with GASB No. 20.

The effects of implementing the aforementioned pronouncements have been reported as changes in accounting principles in the accompanying basic financial statements. Accordingly, the cumulative effects of the adoption of such pronouncements have been reported as restatements of fund balances/deficits at July 1, 2002 in the accompanying governmental fund financial statements (see note 10).

b) *Financial Reporting Entity*

The accompanying basic financial statements include all departments, agencies and municipal entities that: (1) are under the legal and administrative control of the Mayor, and (2) whose funds are under the legal custody and control of the Municipality's Director of Finance, as prescribed by Law No. 81 of August 30, 1991, as amended, known as the *Autonomous Municipalities Act of the Commonwealth of Puerto Rico*.

The Municipality's management has considered all potential component units for which it may be financially accountable and other legally separate organizations for which the nature and significance of their relationship with the Municipality may be such that exclusion of their financial statements from those of the Municipality would cause the Municipality's basic financial statements to be misleading or incomplete.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Notes to Basic Financial Statements
June 30, 2003

GASB Statement No. 14, - *The Financial Reporting Entity* (GASB No. 14), 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) the 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 Municipality's management has concluded that, based on the aforementioned criteria, there are no legally separate entities or organizations that should be reported as component units of the Municipality as of June 30, 2003 nor for the year then ended.

The GASB recently issued its Statement No. 39, *Determining Whether Certain Organizations are Component Units* (GASB No. 39). This statement is effective for the Municipality's next fiscal year and amended the provisions of GASB No. 14 to provide additional guidance to determine whether certain organizations for which the Municipality is not financially accountable should be reported as component units based on the nature and significance of their relationship with the Municipality. Generally, GASB No. 39 will require reporting, as a discretely presented component unit, an organization that raises and holds economic resources for the direct benefit of a governmental entity. Such organizations are legally separate, tax-exempt entities that meet all of the three specific criteria that address benefit, entitlement or access, and significance. At June 30, 2003, the Municipality has not adopted the provisions of GASB No. 39, however, the Municipality's management has concluded that the future adoption of GASB No. 39 will not have an impact on the Municipality's basic financial statements since no change in the Municipality's financial reporting entity is expected.

c) *Government-Wide Financial Statements*

The accompanying government-wide financial statements (GWFS) are composed of: (1) the statement of net assets and (2) the statement of activities. These financial statements do not report fund information but rather report information of all of the Municipality's non-fiduciary governmental activities. These statements are aimed at presenting a broad overview of the Municipality's finances through reporting its financial position and results of operations as a whole, using methods that are similar to those used by most private businesses.

The focus of the GWFS is not on compliance with budgets, regulatory requirements or on the use of available or currently expendable financial resources (referred to as fiscal accountability), but on operational accountability information about the Municipality as a single economic unit. Operational accountability is the Municipality's responsibility to report to the extent to which it has met its operating objectives efficiently and effectively, using all resources available for that purpose. It focuses on the Municipality's principal operating objective, which is to provide services to its citizens.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Notes to Basic Financial Statements
June 30, 2003

The accompanying statement of net assets provides short-term and long-term information about the Municipality's financial position and condition by presenting all of the Municipality's assets and liabilities, with the difference between these two items reported as "net assets" (equity) or "net liabilities" (deficit). This statement assists management in assessing the level of services that can be provided by the Municipality in the future, and its ability to meet its obligations as they become due. In addition, this statement reports the extent to which the Municipality has invested in capital assets, including infrastructure; and discloses legal and contractual restrictions on resources.

Net assets (liabilities) are classified in the accompanying statement of net assets within the following three categories:

- **Invested in Capital Assets, Net of Related Debt** – These consist of capital assets, net of accumulated depreciation and amortization and reduced by the outstanding balances of bonds, notes and any other debt that are attributed to the acquisition, construction, or improvement of those assets. For the purposes of determining the outstanding debt attributed to capital assets, the total long-term debt related to the acquisition, construction or improvement of capital assets have been reduced by any related unspent debt proceeds and any related un-amortized debt issuance costs.
- **Restricted Net Assets** – These consist of net assets restricted by external parties (such as creditors, grantors, contributors, laws or regulations of other governments, etc.), or net assets for which constraints are imposed by constitutional provisions or enabling legislation. Enabling legislation is defined as legislation that authorizes the Municipality to assess, levy, charge, or otherwise mandate payment of resources (from external resource providers). Enabling legislation establishes restrictions if it includes a legally enforceable requirement that those resources be used only for the specific purposes stipulated in the legislation.

The classification of restricted net assets is intended to identify resources that have been received or earned by the Municipality with an explicit understanding between the Municipality and the resource providers that the resources would be used for specific purposes. Grants, contributions and donations are often given under those kinds of conditions. Bond indentures also often limit the use of bond proceeds to specific purposes.

Internally imposed designations of resources, including earmarking, are not reported as restricted net assets. These designations consist of management's plans for the use of resources which are subject to change at the discretion of the Municipal Legislature.

- **Unrestricted Net Assets** – These consist of net assets that are neither externally or legally restricted, nor invested in capital assets. However, 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.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Notes to Basic Financial Statements
June 30, 2003

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

The accompanying statement of activities presents the results of the Municipality's operations by showing how the Municipality's net assets changed during the year ended June 30, 2003, using the net (expense) revenue format. This statement presents the cost of each function/program as well as the extent to which each of the Municipality's functions, programs, or other services either contributes to or draws from the Municipality's general revenues (such as property taxes, municipal license taxes, construction excise taxes, etc.).

A function/program describes a group of activities that are aimed at accomplishing a major service or regulatory responsibility. The functions/programs reported in the accompanying basic financial statements are: (1) general government, (2) urban and economic development, (3) public safety, (4) health and sanitation, (5) culture, recreation and education, and (6) public housing and welfare. The governmental operations of the Municipality's departments and operational units are classified within the following functions/programs in the accompanying basic financial statements:

General Government:

- Municipal Legislature
- Mayor's Office
- Department of Finance
- Department of Human Resources
- Department of Municipal Secretary
- Department of Internal Audit
- Department of Federal Programs
- Department of Public Relations

Urban and Economic Development:

- Department of Public Works

Public Safety:

- Department of Civil Defense
- Department of Municipal Police

Health and Sanitation

- Department of Health
- Department of Sanitation

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Notes to Basic Financial Statements
June 30, 2003

Culture, Recreation and Education:

Department of Culture and Tourism
Department of Recreation and Sports

Public Housing and Welfare:

Center for the Elderly

The statement of activities demonstrates the degree to which direct expenses of a given function/program or segments are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function, segment or operational unit. This statement reports revenues in two broad categories: (1) program revenues and (2) general revenues.

Program revenues are generated directly from a program itself or may come from parties outside the Municipality's taxpayers or citizenry. In the statement of activities, program revenues reduce the cost (expenses) of the function/program to arrive at the net cost of the function/program that must be financed from the Municipality's general revenues. The accompanying statement of activities separately reports the following categories of program revenues:

- **Charges for services** – These generally consist of exchange or exchange-like transactions involving charges to customers or applicants who purchase, use, or directly benefit from the goods, services, or privileges provided, or are otherwise directly affected by the services. These include fees charged for specific services, charges for licenses and permits, and fines and forfeitures, among others.

- **Program-specific capital and operating grants and contributions** – These consist of transactions that are either mandatory or voluntary nonexchange transactions with other governments, organizations, or individuals that restrict the resources for use in a particular program. Capital grants and contributions consist of capital assets or resources that are restricted for capital purposes – to purchase, construct, or renovate capital assets associated with a specific program. Operating grants and contributions consist of resources that are required to be used to finance the costs of operating a specific program or can be used either for operating or capital purposes of a specific program. Restricted capital and operating grants and contributions are program revenues because they are specifically attributable to a program and reduce the net expense of that program to the Municipality. They are reported net of estimated uncollectible amounts.

General revenues are the default category for revenues. It includes all revenues and gains that do not meet the definition of program revenues. Property taxes, municipal license taxes and construction excise taxes are reported as general revenues. All other non-tax revenues (including unrestricted investment earnings, grants and contributions and special items, among others) that do not meet the definition of program revenues are classified as general revenues. Resources that are dedicated internally by the Municipality are reported as general revenues rather than as program revenues. All general revenues are reported net of estimated uncollectible amounts which are recorded as reduction of revenues rather than as expenses.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Notes to Basic Financial Statements
June 30, 2003

The *general government* function/program reported in the accompanying statement of activities, includes expenses that are, in essence, indirect or overhead expenses of the Municipality's other functions/programs. Even though some of these costs have been charged to other funds in the governmental fund financial statements as indirect cost allocations permitted under some federal programs, the Municipality has reported these indirect expenses as direct expenses of the general government function. Accordingly, the Municipality does not allocate general government (indirect) expenses to other functions.

The effects of all interfund governmental activities (revenues, expenditures and other financing sources/uses among funds) have been removed from the accompanying statements of net assets and activities.

The Municipality classifies all of its activities as governmental activities in the accompanying GWFS. These are activities generally financed through taxes, intergovernmental revenues, and other nonexchange revenues that can be used to support the Municipality's programs or services. These governmental activities are also generally reported in the governmental fund financial statements.

The accompanying GWFS do not report fiduciary activities, which are those in which the Municipality would be holding or managing net assets for specific individuals or other external parties in accordance with trust agreements or other custodial arrangements. In addition, the Municipality has no significant operations or activities that are financed and operated in a manner similar to private business enterprises, where the costs of providing goods or services to the general public is financed primarily through user charges. Accordingly, the accompanying GWFS do not report fiduciary nor business-type activities.

d) *Governmental Fund Financial Statements*

The accompanying governmental fund financial statements (GFFS) are composed of: (1) the balance sheet – governmental funds and (2) the statement of revenues, expenditures and changes in fund balances – governmental funds. These financial statements report the financial position and results operations of the Municipality's governmental funds by presenting sources, uses, and balances of current financial resources. These financial statements often have a budgetary orientation and focus primarily on: (1) the Municipality's major funds, as defined below, (2) the fiscal accountability, and (3) the individual parts of the Municipality's government. Fiscal accountability represents the Municipality's responsibility to justify that its actions in the current year have complied with public decisions concerning the raising and spending of public moneys in the short term (usually one budgetary cycle or one year).

Each governmental fund is considered an independent fiscal entity accounted for within a set of self-balancing accounts that comprise its assets, liabilities, fund equity or deficit, revenue, and expenditures. The accompanying GFFS segregate governmental funds according to their intended purpose and are used in demonstrating compliance with legal, financial and contractual provisions. The minimum number of governmental funds is maintained consistent with legal and self-imposed managerial requirements established by the Municipality. For financial reporting purposes, the Municipality classifies its governmental funds within the following categories:

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Notes to Basic Financial Statements
June 30, 2003

- **General Fund** – The general fund is the Municipality’s chief operating and major fund, as defined below, used to account for all financial resources and governmental activities, except for financial resources required to be accounted for in another fund type. It is presumed that the Municipality’s governmental activities have been reported in the general fund except for transactions for which one of the following compelling reasons has required the use of another fund: (1) legal requirements, (2) GAAP requirements, or (3) the demands of sound financial administration requiring the use of a fund other than the general fund.
- **Special Revenue Funds** – The special revenue funds are major and nonmajor funds used by the Municipality to account for revenues derived from grants or other revenue sources (other than major capital projects) that are either self-restricted by the Municipality or legally restricted by outside parties for use in specific purposes. The uses and limitations of each special revenue fund are specified by municipal ordinances or federal and state statutes.

However, resources restricted to expenditure for purposes normally financed from the general fund are reported in the Municipality’s general fund provided that all applicable legal requirements are appropriately satisfied. In this case, a special revenue fund to account for such kind of transactions will be used only if legally mandated.

- **Debt Service Fund**– The debt service fund is a non-major fund, as defined below, used by the Municipality to account for the accumulation of resources for, and the payment of, principal and interest for: (1) bonds and notes for which debt service payments are legally mandated to be accounted for in a debt service fund, and/or (2) general long-term debt for which the Municipality is being accumulating financial resources in advance, to pay principal and interest payments maturing in future years. General long-term debts for which debt service payments do not involve the advance accumulation of resources (such as capital leases, compensated absences, claims and judgments, notes payable to CRIM and federal government and federal cost disallowances are accounted for in the general fund. Long-term debt’s principal and accrued interests due on July 1 of the following fiscal year are accounted for as fund liabilities in the debt service fund at June 30, if resources are available at June 30 for its payment.
- **Capital Projects Funds** – Capital projects funds are major and non-major funds, as defined below, used to account for the financial resources used in the acquisition or construction of major capital facilities, other assets and permanent improvements. Significant capital outlays financed from general obligation bond proceeds are accounted for also in the capital projects funds.

The use of the capital projects funds has been reserved for major capital acquisitions or construction activities that would distort financial resources trend data if not reported separately from the other Municipality’s operating activities. The routine purchases of minor capitalizable assets (such as vehicles and other minor capital assets) have been reported in the fund from which financial resources were used for the purchase.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
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Prior to GASB No. 34, the Municipality was required to report governmental fund financial statements that presented a single aggregated column for each fund type. Each column presented the combined total of all funds of a particular type. Fund types are still reported in certain cases, but they are no longer the focus of the accompanying governmental fund financial statements. Under GASB No. 34, the focus of the governmental fund financial statements is on major funds, which generally represent the Municipality's most important funds. Accordingly, the Municipality is required to segregate governmental funds among major and nonmajor categories within the governmental fund financial statements. Major individual governmental funds are reported as individually as separate columns in the governmental fund financial statements, while data from all nonmajor governmental funds are aggregated into a single column, regardless of fund type.

By definition, the Municipality's general fund is always considered a major governmental fund for financial reporting purposes. In addition, any other fund is considered a major fund for financial reporting purposes if its total assets, liabilities, revenues or expenditures of that individual governmental fund are at least 10 percent of the corresponding element total (assets, liabilities, revenues or expenditures) for all governmental funds. For the purposes of applying the aforementioned major fund criteria, no eliminations of interfund balances have been made. Total revenues for these purposes means all revenues, including operating and nonoperating revenues (net of allowances), except for other financing sources. Total expenditures for these purposes means all expenditures, including operating and nonoperating expenditures, except for other financing uses.

Based on the aforementioned criteria, the Municipality's major governmental funds reported in the accompanying governmental fund financial statements are: (1) the general fund, (2) the state legislative joint resolutions fund (a special revenue fund), (3) EDA capital projects fund, and (4) the CDBG capital projects/special fund and (4) the \$1,740,000 bond issuance fund (a capital projects fund).

The state legislative joint resolutions special revenue fund is a major fund used to account for financial resources derived from operating grants awarded each year by the Commonwealth's Senate and House of Representatives (the Commonwealth's Legislature). The purpose of the amounts awarded by the Commonwealth's Legislature vary from year to year, but are generally restricted to (1) partially subsidize certain qualifying administrative and operational activities of the Municipality, (2) provide specific multipurpose services to citizens, and (3) finance the acquisition or construction of capital assets approved by the Commonwealth's Legislature.

The EDA capital projects fund is a major fund used to account for grants received by the Municipality under the Public Works and Economic Development Program, administered by the Economic Development Administration of the U.S. Department of Commerce (EDA). Resources in this fund are used to finance activities directed to promote long-term economic development in areas experiencing substantial economic distress through construction activities of essential public infrastructure and the development of facilities necessary to generate higher-skill, higher-wage jobs and private investment.

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The CDBG capital projects/special fund is a major fund used to account for grants received by the Municipality under the Community Development Block Program (CDBG), administered by the U.S. Department of Housing and Urban Development. Resources in this fund are used to perform activities directed to develop viable urban communities, by providing decent housing and suitable living environment, and by expanding economic opportunities, principally for persons of low and moderate income.

The \$1,740,000 bond issuance fund is a major capital projects fund to account for bond proceeds used to finance permanent improvements to Ensenada Square and the construction of Puig Bridge.

As previously discussed, the Municipality has no assets held in a trustee or agency capacity for others, nor has significant operations or activities that are financed and operated in a manner similar to private business enterprises, where the costs of providing goods or services to the general public is financed primarily through user charges. As a result, the Municipality does not report fiduciary nor proprietary funds in the accompanying basic financial statements.

e) *Measurement Focus and Basis of Accounting*

Government-Wide Financial Statements – The accompanying GWFS are prepared using the economic resources measurement focus and the accrual basis of accounting. Subject to the additional rules and limitations detailed below, revenues (including investment earnings) are generally recorded when earned and expenses are generally recorded when a liability is incurred, regardless of the timing of related cash flows.

All revenues, expenses, gains, losses, assets and liabilities resulting from exchange and exchange-like transactions are generally recorded when the exchange takes place. In exchange transactions, each party to the transaction receives and gives up essentially equal values. An exchange-like transaction is one in which there is an identifiable exchange and the values exchanged, though related, may not be quite equal. Nevertheless, the exchange characteristics of the exchange-like transaction are strong enough to justify treating it as an exchange for accounting purposes (examples include fees for licenses and permits, charges for services, and miscellaneous revenues, which are recorded as revenues when collected because they are generally not measurable until actually received).

All revenues, expenses, gains, losses and assets resulting from nonexchange transactions are recorded using the criteria set forth by GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions* (GASB No. 33). GASB No. 33 established accounting and reporting standards for nonexchange transactions involving cash and financial or capital resources (for example, most taxes, grants and private donations). In a nonexchange transaction, the Municipality gives (or receives) value without directly receiving (or giving) equal value in return. This is different from an exchange transaction, in which each party receives and gives up essentially equal values. According to GASB No. 33, the Municipality groups its nonexchange transactions into the following four classes in the accompanying basic financial statements: (a) derived tax revenues, (b) imposed nonexchange revenues; (b) government mandated nonexchange transactions; and (c) voluntary nonexchange transactions.

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In the case of derived tax revenue transactions (such as municipal license taxes), which result from assessments the Municipality places on exchange transactions, receivables and deferred revenues are recorded when the underlying exchange has occurred (that generally is, when the taxpayers' net sales or revenues subject to tax take place).

In the case of imposed nonexchange revenue transactions (such as property taxes), which result from assessments made by the Municipality on nongovernmental entities, including individuals, other than assessments on exchange transactions, receivables are generally recorded in the period when an enforceable legal claim has arisen. Property taxes are generally recorded as revenues (net of amounts considered not collectible) in the period when resources are required to be used or the first period that the use of the resources is permitted.

Government-mandated nonexchange transactions (such as federal and state grants and contributions) result when a government at one level (such as the federal or state government) provides resources to another government (such as the Municipality), and the provider government requires the recipient government to use those resources for a specific purpose or purposes established in the provider's enabling legislation. In these type of transactions, receivables and revenues are generally recorded when all eligibility requirements imposed by the provider have been met. For the majority of grants, resources must be expended by the Municipality on the specific purpose or project before the provider reimburses any amounts. Revenue is, therefore, generally recognized as qualifying reimbursable expenditures are incurred.

Voluntary nonexchange transactions (such as donations and certain grants and entitlements) result from legislative or contractual agreements, other than exchanges, entered into willingly by two or more parties. In these type of transactions, receivables and revenues are generally accounted for in the same manner as government-mandated nonexchange transactions discussed above.

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

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

The measurement focus and the basis of accounting used in the accompanying GWFS differ significantly from the measurement focus and basis of accounting used in the preparation of the accompanying GFFS. Therefore, the accompanying GFFS include reconciliation's with brief explanations to better identify the relationship between the GWFS and the GFFS.

Governmental Fund Financial Statements - The accompanying GFFS are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are generally recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current year or soon enough thereafter to pay liabilities of the current year. For this purpose, the Municipality considers most revenues to be available if collected within 90 days after June 30, 2003, except for property taxes for which the

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availability period is 60 days. Revenue sources not meeting these availability criteria or collected in advance are recorded as deferred revenues at June 30, 2003. The principal revenue sources considered susceptible to accrual include property taxes, municipal license taxes, intergovernmental grants and contributions, and investment earnings. These principal revenue sources meet the measurability and availability criteria in the accompanying GFFS.

In a manner similar to the GWFS, but subject to and limited by the availability criteria discussed above, all revenues, expenses, gains, losses, assets and liabilities resulting from exchange and exchange-like transactions are also generally recorded when the exchange takes place. Accordingly, fees for licenses and permits, charges for services, and miscellaneous revenues are recorded as revenues when collected because they are generally not measurable until actually received.

All revenues, expenses, gains, losses and assets resulting from nonexchange transactions are recorded using the previously discussed criteria set forth by GASB No. 33, but subject to and limited by the availability criteria discussed above. Accordingly, municipal license tax receivables and revenues are generally recorded when the underlying exchange has occurred. Property tax receivables are also generally recorded in the period when an enforceable legal claim has arisen while property tax revenues (net of amounts considered not collectible) are also generally recorded in the period when resources are required to be used or the first period that the use of the resources is permitted. Receivables and revenues from federal and state grants and contributions, donations and entitlements are also generally recorded when all eligibility requirements imposed by the provider have been met (generally as qualifying reimbursable expenditures are incurred).

Investment earnings are recorded when earned only if collected within 90 days after year-end since they would be considered both measurable and available.

As previously discussed, on July 1, 2002, the Municipality adopted the provisions of GASB Interpretation No. 6, *Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements* (GASBI No. 6), which modifies the recognition criteria for certain expenditures and liabilities reported under the modified accrual basis of accounting and clarifies a number of situations in which the Municipality should distinguish between governmental fund liabilities and general long-term liabilities.

Pursuant to the provisions of GASBI No. 6, expenditures and related liabilities are generally recorded in the accompanying governmental fund financial statements in the accounting period in which the liability is incurred, as under the accrual basis of accounting, but only to the extent that they are normally expected to be liquidated with expendable financial resources.

Modifications to the accrual basis of accounting include:

- Employees' accumulated vacation, sick leave and compensatory time (compensated absences) is recorded as expenditure when utilized. The amount of the unpaid compensated absences has been reported only in the GWFS.
- Principal and interest on bonds and notes payable are recorded when they mature (when payment is due), except for principal and interest due in July 1 of the following fiscal year, which are recorded when resources are available in the debt service funds (generally June 30).

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- Obligations under capital leases, solid waste landfill closure and post closure care costs, amounts subject to judgments under litigation and other long-term obligations are recorded only they mature (when the payment is due).
- Accounts payable and accrued liabilities not expected to be liquidated with available financial resources are recorded in the government-wide financial statements but not in the governmental funds.
- Executory purchase orders and contracts are recorded as a reservation of fund balance.

Liabilities outside the bounds of these exceptions or modifications are reported as governmental fund liabilities when incurred (including salaries, professional services, supplies, utilities, etc.) since these liabilities normally are paid in a timely manner and in full from current financial resources.

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

Under the new financial reporting model established by GASB No. 34, all general capital assets and the unmatured long-term liabilities (determined using the modified accrual basis of accounting) are no longer reported in account groups within the governmental fund balance sheet but are now incorporated into the GWFS.

f) Stewardship, Compliance and Accountability

Budgetary Control

According to the Autonomous Municipalities Act of the Commonwealth of Puerto Rico, the Mayor and its Administrative Cabinet prepare each fiscal year an annual budget for the Municipality's general fund and debt service fund. Such legally adopted budget is based on expected expenditures by program and estimated resources by source for both funds. The annual budget is developed using elements of performance-based program budgeting and zero-based budgeting, and includes an estimate of revenues and other resources for the ensuing fiscal year under laws and regulations existing at the time the budget is prepared.

The Mayor must submit an annual budgetary resolution project (the project) to the Commissioner of Municipal Affairs of Puerto Rico (the Commissioner) and the Municipal Legislature no later than each May 10 and May 15, respectively. The Commissioner preliminarily verifies that the project complies with all the applicable laws and regulations and may provide comments and suggestions to the Mayor on or before each June 13.

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The Municipal Legislature has 10 business days up to no later than June 13 to discuss and approve the project with modifications. The Municipal Legislature may amend the budget submitted by the Mayor but may not increase any items so far to cause a deficit without imposing taxes or identifying other sources of revenue to cover such deficit. After the Municipal Legislature modifies and preliminarily approve the project, the modified project is sent back to the Mayor for his approval or rejection within 6 days. The Mayor may decrease or eliminate any line item but may not increase or insert any new line item in the budget. The Mayor may also veto the budget in its entirety and return it to the Municipal Legislature with his objections. If the project is rejected by the Mayor, the Municipal Legislature will have up to 8 days to adopt or reject the recommendations or objections of the Mayor. The approved project is sent again to the Mayor, which then would have 3 days to sign and approve it.

If a budget is not adopted prior to the end of the deadlines referred to above, the annual budget for the preceding fiscal year, as approved by the Legislature and the Mayor, is automatically renewed for the ensuing fiscal year until the Municipal Legislature and the Mayor approve a new budget. This permits the Municipality to continue making payments for its operations and other purposes until the new budget is approved.

The annual budget may be updated for any estimate revisions as well as year-end encumbrances and may include any additional information requested by the Municipal Legislature. The Mayor may request subsequent amendments to the approved budget, which is subject to the approval of the Municipal Legislature

For day to day management control, expenditures plus encumbrances may not exceed budgeted amounts at the expenditure-type level of each cost center (activity within a program within a fund). The Mayor may transfer unencumbered appropriations within programs within funds. Appropriation control is by program within a fund. The Municipal Legislature may transfer amounts among programs within and between funds.

Under the laws and regulations of the Commonwealth, the appropriations made for any fiscal year shall not exceed the total revenue, including available surplus, estimated for said fiscal year unless the imposition of taxes sufficient to cover said appropriations is provided.

g) *Unrestricted and Restricted Deposits*

The Municipality's deposits are composed of cash on hand and demand deposits in commercial banks and the Government Development Bank for Puerto Rico (GDB), a governmental bank and a major component unit of the Commonwealth, who is statutorily designated as fiscal agent of the Municipality.

The Municipality follows the practice of pooling cash. The balance in the pooled cash account is available to meet current operating requirements and any excess is invested in certificates of deposit with original maturities of more than three months.

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Under the laws and regulations of the Commonwealth, public funds deposited by the Municipality in commercial banks must be fully collateralized for the amounts deposited in excess of the federal depository insurance generally provided by the Federal Deposits Insurance Corporation (FDIC). All securities pledged as collateral are held in the Municipality's name by agents designated by the Secretary of the Treasury of the Commonwealth.

Restricted cash for major special revenue and capital projects funds, represent the balance of interest and noninterest bearing accounts restricted to finance the operations of federal and state funded programs and the acquisition and construction of major capital improvements, respectively.

Restricted cash in other governmental funds represents: (1) property tax collections retained and restricted for the payment of the Municipality's debt service, (2) resources restricted to finance the operations of all federal and state funded programs, and (3) resources restricted for the acquisition and construction of capital improvements.

h) Unrestricted and Restricted Accounts Receivable

In the accompanying GWFS, receivables consist of all revenues earned but not collected at June 30, 2003. Major receivable balances for the governmental activities include municipal license taxes, property taxes and intergovernmental receivables.

Tax receivables in the general fund represent uncollected property taxes and municipal license taxes. Tax receivables in the debt service fund consist of uncollected property taxes which are restricted for the payment of the Municipality's debt service, as established by law (see notes 3 and 4).

Intergovernmental receivables are composed of: (1) amounts owed to the Municipality for reimbursement of expenditures incurred pursuant to state and federally funded programs (recorded in the special revenue fund), (2) a lawsuit settlement amount (recorded in the general fund) due from the Puerto Rico Electric Power Authority (PREPA), pursuant to a claim filed in the San Juan Superior Court requesting the payment by PREPA of the full contributions in lieu of taxes and electric energy sales set aside for prior fiscal years (see notes 12), and (3) other miscellaneous intergovernmental reimbursements and contributions.

These accounts receivables are stated net of estimated allowances for uncollectible accounts, which are determined, based upon past collection experience, historical trends, current economic conditions and the periodic aging of accounts receivable

Activity between funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as either "due to/from other funds" (i.e. the current portion of interfund loans) or "advances to/from other funds" (i.e., the non-current portion of interfund loans). All other outstanding balances between funds are reported as "due to/from other funds." Advances between funds, as reported in the GFFS, are offset by a fund balance reserve account in applicable governmental funds to indicate that they are not available for appropriation and are not expendable available financial resources.

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i) Inventories and Other Current Assets

Inventories and other current assets recorded consist of materials, supplies, food and medicine inventories held for consumption; and prepaid expenses amounting to \$6,876 and \$15,530, respectively. Generally, inventories are stated at cost using the first-in, first-out method (FIFO) in the GWFS. Inventories and prepaid expenses in the GFFS are recorded as expenditures (consumption method) when purchased (paid) rather than capitalized as an asset. Only significant amounts of inventory or prepaid expenses at the end of the year, if any, would be capitalized in the GFFS.

j) Investments

Investments are composed of certificates of deposit with original maturities exceeding three months but not exceeding one year. Investments are held with commercial banks and are recorded at cost (which approximates fair value).

k) Deferred Charges

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

l) Capital Assets

Capital assets used in governmental activities include land and land improvements, buildings, structures and building improvements, machinery and equipment, furniture and fixtures, licensed vehicles, construction in progress, and infrastructure. These assets are capitalized and reported in the accompanying GWFS. Infrastructure assets are generally immovable in nature and include roads, bridges, streets and sidewalks, drainage systems and other similar assets. The Municipality has no collection of works of art or historical treasures.

The Municipality defines capital assets as assets with an individual cost of \$500 or more at the date of acquisition or construction, and with a useful lives extending beyond one year. All assets with individual costs under \$500 or with useful lives not exceeding one year, are charged directly to expense in the government-wide statement of activities. In the governmental funds, all capital assets are recorded as expenditures.

In the government-wide statement of net assets, all capital assets are recorded at cost or estimated historical cost if actual cost was unavailable, except for donated capital assets, which are recorded at their estimated fair value at the date of donation. Estimated historical costs based on deflated current costs were used to value a significant portion of the infrastructure and certain land, buildings, structures and building improvements constructed or acquired prior to June 30, 2002. The method to deflate the current costs using an approximate price index was used only in the case of certain items for which their historical cost documentation was not available. Actual historical costs were used to value the infrastructure, land, building, structures, building improvements, construction in progress, machinery and equipment and licensed vehicles constructed or acquired during the year ended June 30, 2003.

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Major outlays for capital assets and improvements are capitalized in the GWFS as projects are constructed. The costs of normal maintenance and repairs that do not add value to the asset or materially extend capital asset lives are not capitalized.

Depreciation and amortization expense is recorded only in the government-wide statement of activities. However, there is no depreciation or amortization recorded for land and construction in progress. Depreciable capital assets are generally depreciated or amortized over their estimated useful lives under the straight-line method, except for machinery and equipment held under capital leases which is depreciated over the shorter of its estimated useful life or the lease term. The estimated useful lives of major capital asset categories are:

	<u>Years</u>
Land improvements	20
Buildings, structures and building improvements	50
Infrastructure	20 to 50
Motor vehicles	8
Furniture and fixtures	5 to 20
Machinery and equipment, excluding those held under capital leases	5 to 20

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

m) Deferred Revenues

The Municipality reports deferred revenue on its GFFS and GWFS. In the GFFS, deferred revenue arises when:

- Potential revenue does not meet both the “measurable” and “available” criteria for revenue recognition in the current period. As previously discussed, available is defined as due (or past due) at June 30, and collected within 90 days thereafter to pay obligations due at June 30, or;
- Resources are received by the Municipality before it has a legal claim to them. In subsequent periods, when the revenue recognition criterion is met, or when the Municipality has a legal claim to the resources, the liability for deferred revenue is removed and revenue is recognized.

Deferred revenues at the government-wide level arise only when the Municipality receives resources before it has a legal claim to them.

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n) *Compensated Absences*

Compensated absences are accounted for under the provisions of Statement No. 16, *Accounting for Compensated Absences*, issued by GASB (GASB No. 16). Compensated absences include paid time off made available to employees in connection with vacation, sick leave and compensatory time. The liability for compensated absences recorded in the government-wide statement of net assets is limited to leave that: (1) is attributable to services already rendered on or before June 30, 2003, and (2) is not contingent on a specific event (such as illness) that is outside the control of the Municipality and the employee. The liability for compensated absences, include salary-related costs, which are directly and incrementally related to the amount of salary paid to the employee (such as employer's share of Social Security taxes, Medicare taxes, employer contributions to the employees' retirement systems and others).

The vacation policy of the Municipality provides for the accumulation of regular vacations at a rate of 2.5 days per month (30 days per year). Employees accumulate regular sick leave at a rate of 1.5 days per month (18 days per year). Compensatory time is accumulated by employees at a rate of 1.5 times the overtime worked. All vacation and sick leave days accumulated by employees in excess of 30 days and 90 days, respectively, are paid to employees each year if not consumed, as required by law. In the case of compensatory time, the excess of 240 hours is paid to employees each year, if not consumed.

Upon termination of employment, an employee receives compensation for all accumulated unpaid regular vacation leave at the current rate. In the case of regular sick leave, if the employee terminates his or her employment with the Municipality before reaching 10 years of services, such regular sick leave days is not paid to the employee. Upon termination of employment, an employee does not receive compensation for compensatory time, if not consumed. After 10 years of services any regular sick leave balance is paid to the employee. Accumulated vacation time is fully vested to the employees at any time.

The liability for compensated absences is reported in the statement of net assets. A liability for compensated absences is reported in the GFFS only if they have matured, for example, as a result of employee resignations and retirements.

o) *Long-term Debt*

The long-term liabilities reported in the GWFS include the Municipality's general obligation and public improvements bonds, long-term notes, obligation under capital leases, compensated absences, and legal claims and judgments.

All long-term debt to be repaid from governmental resources is reported as liabilities in the government-wide statement of net assets, except for principal and interest payment on bonds due in July 1 of the following fiscal year, which is recorded in the GFFS when resources are available in the debt service fund (generally at June 30). In the GFFS, long-term debt is generally not reported as liabilities. The face amount of the debt issued is reported as other financing sources.

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In the GWFS debt issuance costs are reported as deferred charges and are amortized under the straight-line method over the life of the debt while in the GFFS are recognized as expenditures as during the current period.

On July 1, 2002, the Municipality adopted the provisions of APB Opinion No. 21, *Interests on Receivables and Payables* (APB No. 21), to account for certain non-interest bearing notes payable to the Puerto Rico Treasury Department (see note 7). According to APB No. 21, the Municipality has recorded these notes at present value with an imputed interest rate that approximates the rate that would have been used, using the same terms and conditions, if it had been negotiated by an independent lender. In the accompanying statement of net assets, this note payable is reported net of the applicable unamortized discount, which is the difference between the present value and the face amount of the note. The note discount is amortized over the life of the note using the effective interest method. Amortization of the note discount is recorded as part of interest expense in the statement of activities. In the GFFS, note discounts are recognized as other financing uses during the current period.

p) Leases

The Municipality classifies its lease agreements either as operating or capital leases. Capital lease agreements are non-cancelable and involve substance over form, the transfer of substantially all benefits and risks inherent in the ownership of the leased property, while operating leases do not involve such transfer. Accordingly, a capital lease involves the recording of an asset and a related lease liability at the inception of the lease. According to GAAP, the Municipality classifies a lease agreement as a capital lease if at its inception, the lease meets one or more of the following four criteria:

- By the end of the lease term, ownership of the leased property is transferred to the Municipality.
- The lease contains a bargain purchase option.
- The lease term is substantially (75% or more) equal to the estimated useful life of the leased property.
- At the inception of the lease, the present value of the minimum lease payments, with certain adjustments, is 90% or more of the fair value of the leased property.

Although the Municipality is prevented legally from entering into obligations extending beyond the current year budget, most capital lease agreements entered by the Municipality contain fiscal funding clauses or a cancellation clause that makes the continuation of the agreements subject to future appropriations. Leases that meet at least one of the aforementioned four criteria and have fiscal funding or cancellation clauses have been recorded as capital leases in the accompanying GWFS, since the likelihood of invoking the provision is considered to be remote. The lease agreements of the Municipality do not include contingent rental payments nor escalation clauses.

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In the GWFS, the obligation under capital leases is recorded at the lesser of the estimated fair value of the leased property or the present value of the minimum lease payments, excluding any portion representing executory costs and profit thereon to be paid by the lessor. Subsequently, a portion of each minimum lease payment is allocated to interest expense and the balance is applied to reduce the lease liability using the effective interest method.

In the GFFS, the net present value of the minimum lease payments at the inception of the capital lease is recorded as (1) expenditure and (2) other financing source. Minimum lease payments are recorded as expenditures in the GFFS.

q) *Accounting for Pension Costs*

For the purpose of applying the requirements of GASB Statement No. 27, *Accounting for Pensions by State and Local Government Employers* (GASB No. 27), the Commonwealth of Puerto Rico is considered to be the sponsor of the Employees' Retirement System of the Government of Puerto Rico and Its Instrumentalities (ERS) and System 2000, the two retirement systems in which the employees of the Municipality participate. Accordingly, the Municipality is considered a participant and not a sponsor of these retirement systems since substantially all of the participants in the aforementioned pension trust funds are part of the financial reporting entity of the Commonwealth of Puerto Rico. Accordingly, no portion of the net pension obligation (NPO) related to ERS and System 2000 has been allocated to the Municipality in the accompanying basic financial statements. The basic financial statements of the Commonwealth of Puerto Rico accounts for the total amount of the net pension obligation of ERS and System 2000, including any amount that may be allocated to the Municipality.

The Municipality accounts for pension costs from the standpoint of a participant in a multiple-employer cost-sharing plan. Accordingly, pension costs recognized in the accompanying basic financial statements are equal to the statutorily required contributions, with a liability recorded for any unpaid required contributions. In the GFFS the statutory contributions and the related liability are accounted for under the modified accrual basis of accounting while in the GWFS, are recorded under the accrual basis of accounting.

r) *Risk Management*

The Municipality carries commercial insurance covering casualty, theft, tort claims, and other losses. Insurance policies are negotiated by the Commonwealth's Department of Treasury (the Department of Treasury) on behalf of all of municipalities of Puerto Rico. The Department of Treasury pays the insurance premiums on behalf of the Municipality and then is reimbursed each year through monthly equal payments deducted from the Municipality's gross property tax collections made by the Municipal Revenue Collection Center (known as "CRIM", by its Spanish Acronyms), a governmental entity responsible for billing and collecting property taxes on behalf of all municipalities of Puerto Rico.

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The Municipality carries insurance coverage for death and bodily injuries caused by automobile accidents. This insurance is obtained through the Automobile Accidents Compensation Administration (known as "AACA", by its Spanish Acronyms), a component unit of the Commonwealth. This insurance is compulsory for all licensed vehicles used on public roads and highways in Puerto Rico. The annual premium is \$35 per licensed motor vehicle, which is paid directly to AACA.

The Municipality provides workers' compensation insurance coverage to its employees through the State Insurance Fund Corporation, a component unit of the Commonwealth. This insurance covers workers against injuries, disability or death because of work or employment-related accidents, or because of illness suffered as a consequence of their employment. Workers' compensation insurance premiums are also paid through monthly deductions made by CRIM from the Municipality's gross property tax collections.

The Municipality provides unemployment compensation, non-occupational disability, and drivers' insurance coverage to its employees through various insurance programs administered by the Commonwealth's Department of Labor and Human Resources (DOL). These insurance programs cover workers against unemployment and provide supplementary insurance coverage for temporary disability, or death because of work or employment-related accidents, or because of illness suffered as a consequence of their employment. Unemployment compensation, non-occupational disability and drivers' insurance premiums are paid directly to DOL on a quarterly basis.

The Municipality also provides medical insurance coverage to all employees. The current insurance policies have not been canceled or terminated at June 30, 2003. In the past three years, the Municipality has not settled claims that exceeded insurance coverage.

s) Reservations of Fund Balances

Reservations of fund balances represent portions of fund balances that are legally segregated for specific future uses or are not appropriated for expenditure. The Municipality has the following types of reservations of fund balances:

- **Encumbrances** – Represent future expenditures under purchase orders, contracts and other commitments. These committed amounts represent reservations of unexpired appropriations and generally will become liabilities in future periods as the goods or services are received.
- **Capital Projects** – Represent the reservation of amounts to be used for future expenditures for capital projects under contracts and other commitments. These committed amounts generally will become liabilities in future periods as the projects are completed.
- **Debt Service** – Represent fund balances available to finance future debt service payments.
- **Other Specified Purposes** – Represents resources set aside for use under federal and state grant programs accounted for in special revenue funds.

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t) Interfund Transactions

Permanent reallocations of resources between the Municipality's funds are classified as interfund transfers. The Municipality has the following types of transactions recorded among funds in the GFFS:

- **Operating Transfers** – Represent legally required transfers that are reported when incurred as “operating transfers-in” by the recipient fund and as “operating transfer-out” by the disbursing fund.
- **Intra-Entity Transactions** – Represent transfers between the funds of the Municipality that are reported as interfund transfers with receivables and payables presented as amounts due to and due from other funds.
- **Advances** – Represent the amounts advanced among the funds of the Municipality, which are not considered to be currently available financial resources.

u) Reclassifications

As part of the adoption of GASB No. 34, the Municipality revised the classifications of its governmental funds, which resulted in the reclassification of the CDBG capital projects fund and the downtown Guánica reconstruction fund (two funds reported as special revenue funds in the prior year's financial statements) to major capital projects and non-major special revenue fund categories, respectively. The beginning fund balance effects of these reclassifications, by fund type, is as follows:

Fund classification, as reported in 2002 financial statements	Fund classification, as restated	Fund balance, as reported in 2002 financial statements
Special revenue fund	Major capital projects fund	\$ 206,951
Special revenue fund	Non-major special revenue fund	\$ 39,290

The effects of the governmental fund reclassifications referred to above have been reported as restatements of fund balances at July 1, 2002 in the accompanying GFFS (see note 15). The Municipality has also made certain reclassifications to the information presented in the prior year financial statements to be consistent with the current year's basic financial statements presentation.

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v) *Use of Estimates*

The preparation of the accompanying basic financial statements in conformity with GAAP requires management to make significant estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the basic financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

w) *Future Adoption of Accounting Pronouncements*

The GASB issued GASB Statement No. 39, *Determining Whether Certain Organizations are Component Units* (GASB No. 39), which is effective for the fiscal year beginning on July 1, 2003 and GASB Statement No. 40, *Deposit and Investment Risk Disclosure* – an amendment of GASB Statement No. 3, effective for fiscal year ending June 30, 2005. The Municipality has not adopted the requirements of these statements at June 30, 2003.

2. Deposits and Investments

The Municipality maintains its deposits of cash with various commercial banks located in Puerto Rico and GDB. The balances deposited in commercial banks are insured by the Federal Deposit Insurance Corporation (“FDIC”) up to a maximum of \$100,000 per depositor. Under the laws and regulations of the Commonwealth, public funds deposited in commercial banks must be fully collateralized for the amounts deposited in excess of federal depository insurance. All securities pledged as collateral are held by the Secretary of the Treasury’s agents in the Municipality’s name.

The Municipality’s bank balances of deposits with financial institutions are categorized to provide an indication of the level of custodial risk assumed by the Municipality at year-end. Risk categories are described as follows:

- Category 1:** Insured or collateralized with securities held by the Secretary of the Treasury’s agents in the Municipality’s name.
- Category 2:** Collateralized with securities held by pledging financial institution’s trust department or agent in the Municipality’s name.
- Category 3:** Uncollateralized (This includes any bank balance that is collateralized with securities held by the pledging financial institution, or by its trust department or agent but not in the Municipality’s name.

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The carrying amount of deposits with financial institutions at June 30, 2003 consists of the following:

	<u>Major Funds</u>					<u>Total</u>
	<u>General fund</u>	<u>EDA capital projects fund</u>	<u>\$1,740,000 bond issuance fund</u>	<u>CDBG capital Projects/Special fund</u>	<u>State legislative joint resolutions fund</u>	
Unrestricted:						
Cash in commercial banks	\$ 285,727	\$ -	\$ -	\$ -	\$ -	\$ 285,727
Restricted:						
Cash in commercial banks	-	139,144	-	11,826	2,361,689	2,742,675
Cash in GDB, as fiscal agent	-	-	1,037,465	-	-	1,581,144
Total	\$ 285,727	\$ 139,144	\$ 1,037,465	\$ 11,826	\$ 2,361,689	\$ 4,609,546

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The bank balance of deposits with financial institutions at June 30, 2003 consists of the following:

	<u>Carrying Amount</u>	<u>Bank Balance</u>
Deposits in commercial banks	\$ 3,028,403	\$ 3,118,870
Deposits in governmental banks	1,581,143	1,581,143
Total	<u>\$ 4,609,546</u>	<u>\$ 4,700,013</u>
Bank balances of deposits:		
Category 1		\$ 3,118,870
Category 2		-
Category 3		1,581,143
Total bank balances		<u>\$ 4,700,013</u>

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Pursuant to the Statement of Investment Guidelines for the Government of the Commonwealth of Puerto Rico, the Municipality may invest in obligations of the Commonwealth, obligations of the United States of America, certificates of deposit, commercial paper, bankers' acceptances, or in pools of obligations of the municipalities of Puerto Rico, among other things.

The Municipality's investments are categorized to provide an indication of the level of custodial credit risk assumed by the Municipality at year-end. Risk categories are described as follows:

- Category 1:** Insured or registered, or securities held by the Municipality or the Secretary of the Treasury' agents in the Municipality's name.
- Category 2:** Uninsured and unregistered, with securities held by the counterparty's trust department or agent in the Municipality's name.
- Category 3:** Uninsured and unregistered, with securities held by the counterparty or by its trust department or agent, but not in the Municipality's name.

Custodial credit risk classifications for short-term investments are as follows:

	<u>Category 1</u>	<u>Category 2</u>	<u>Category 3</u>	<u>Carrying Amount</u>	<u>Bank Balance</u>	<u>Estimated Fair Value</u>
Unrestricted – non-negotiable certificates of deposit	<u>\$ 1,729,190</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,729,190</u>	<u>\$ 1,729,190</u>	<u>\$ 1,729,190</u>

The carrying amount of investments in certificates of deposit approximate its estimated fair value due to the short-term nature of these investments, the lack of restrictions over them. In addition, these investments bear interests at the prevailing market rates for these types of investments. These interests are unrestricted and are used by the Municipality to support its programs.

3. Municipal License Taxes

The Municipality is authorized by law to impose and collect municipal license taxes on all trade or business activities operated by any natural or legal person within the territorial area of Guánica. This is a self-assessed tax based on the business volume in gross sales. The Municipality establishes the applicable tax rates. At June 30, 2003, the municipal tax rates imposed by the Municipality were 1.50% for financing institutions and 0.50% for any other taxpayers. Any taxpayers that have been granted with partial tax exemptions under any of the incentive tax laws of the Commonwealth ultimately pay municipal license taxes at reduced tax rates, generally between 60% and 90% under standard rates.

Each taxpayer must asses his/her corresponding municipal license tax by declaring his/her volume of business through a tax return every April 15 based on the actual volume of business generated in the preceding calendar year. Taxpayers with a sales volume of \$1 million or more must include audited financial statements with their returns. The tax can be paid by the taxpayer in two equal installments due

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on July 15 and January 15, subsequent to the filing of the declaration. The first installment of the tax covers the six-month period ended December 31, subsequent to the filing date of the declaration, while the second installment of the tax covers the six-month period ended June 30 of the subsequent calendar year. If a taxpayer elects to pay the tax in full on the filing date of the declaration (generally April 15), a 5% discount is granted automatically on the tax amount due. Any municipal license taxes collected in advance (that is, pertaining to a future period) are recorded as deferred revenues.

4. Property Taxes

The Municipality is authorized by law to impose and collect personal and real property taxes. Under the laws and regulations of the Commonwealth, personal property taxes can be imposed to any natural or legal person that at January 1 of each year is engaged in trade or business and is the owner of personal property used in trade or business.

Personal property taxes are self-assessed by taxpayers every year generally using the book value of personal property assets owned by the taxpayer at January 1 and reporting such taxable value through a personal property tax return filed on May 15 subsequent to the assessment date. The total personal property tax rate in force was 6.23% (of which taxpayers pay 6.03% and 0.20% is reimbursed by the Department of Treasury) at June 30, 2003. Real property taxes are assessed by CRIM. The assessment on real property is made every January 1 and is based on estimated current values of the property deflated at 1957 market prices. The total real property tax rate in force was 8.23% (of which 8.03% is paid by taxpayers and 0.20% is also reimbursed by the Department of Treasury) at June 30, 2003.

Residential real property occupied by its owner is exempt by law from property taxes on the first \$15,000 of the assessed value (at 1957 market prices). For such exempt amounts, the Department of Treasury assumes payment of the basic tax (4% and 6% for personal and real property, respectively) to the Municipality, except for property assessed of less than \$3,500 (at 1957 market prices), for which no payment is made.

CRIM is responsible for the billing and collections of real and personal property taxes on behalf of the Municipality. Prior to the beginning of each fiscal year, CRIM informs the Municipality of the estimated amount of property tax expected to be collected for the ensuing fiscal year. Throughout the year, CRIM advances funds to the Municipality based on the initial estimated collections. CRIM is required by law to prepare a settlement statement on a fiscal year basis, whereby a comparison is made between the amounts advanced to the Municipality and amounts actually collected from taxpayers. This settlement has to be completed on a preliminary basis not later than December 31. If CRIM remits to the Municipality property tax advances, which are less than the tax actually collected, an additional property tax receivable is recorded at June 30. However, if advances exceed the amount actually collected by CRIM, an intergovernmental payable is recorded at June 30. For the fiscal year ended June 30, 2003, the actual property tax collections exceed the advances remitted by CRIM in the amount of \$108,177, which are recorded within property taxes receivables at June 30, 2003.

Law No. 83 of August 30, 1991, as amended, provides for the levy of an annual special tax of 1.03% of the assessed value of all real and personal property not exonerated from taxation. Such special tax is levied by the Commonwealth but is collected by CRIM. Collections of this special tax are remitted to the Commonwealth's debt service fund for payment of debt service on general obligations of the Commonwealth.

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In addition, 1.40% of the total personal and real property taxes collected by CRIM is restricted for the Municipality's debt service requirements and is retained by GDB for such purposes.

The Additional Lottery System of the Commonwealth (the "Additional Lottery") is an operational unit reported as an enterprise fund of the Commonwealth, which currently operates several betting alternatives to the citizens of Puerto Rico. The Additional Lottery is required every year to distribute a portion of its excess of revenues over expenses as follows:

- i. Thirty five percent (35%) of its net earnings (defined as the excess of revenues over expenses less an amount earmarked for the Fund for Rent and Home Improvement Subsidy Program for the Low-Income Qualifying Elderly) is earmarked to the municipalities of the Commonwealth, of which a maximum of \$26 million, on an annual basis, is distributed to the Municipal Equalization Fund held by CRIM to cover operating expenses and permanent improvements of the municipalities.
- ii. An additional amount not exceeding \$16 million, on an annual basis, is distributed to the Municipal Equalization Fund, provided it is within the 35% corresponding to the municipalities of the Commonwealth. When the accumulated municipal appropriations from the municipalities' Puerto Rico Health Reform are covered up to June 30, 1997, these resources will be assigned to the Health Insurance Administration, a component unit of the Commonwealth.

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5. Interfund Receivables, Payables and Transfers

The composition of interfund balances at June 30, 2003 and for the year then ended is as follows:

Due To:	Major Funds		Total
	General fund	State legislative joint resolutions fund	
Major funds:			
General fund	\$ -	\$ 507,206	\$ 507,206
CDBG capital projects fund	267,695	-	267,695
State legislative joint resolutions special revenue fund	62,929	-	26,62,929
Non-major funds:			
Debt service fund	613	-	613
Special revenue funds	254,364	-	254,364
Total	\$ 585,601	\$ 507,206	\$ 1,092,807
Transfer from:			
Transfers to	General fund	Debt service fund	Total
Major funds:			
General fund	\$ -	\$ 149,884	\$ 149,884
\$1,740,000 bond issuance fund	77,238	-	77,238
State legislative joint resolutions special revenue fund	26,931	-	26,931
Nonmajor fund:			
Debt service fund	2,657	-	2,657
Capital projects fund	16,431	-	16,431
Total	\$ 123,257	\$ 149,884	\$ 273,141

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The principal purposes of interfund balances due from/to are:

- Recognize in the general fund interfund loans due from the CDBG capital projects fund and the non-major special revenue funds amounting to \$267,695 and \$317,906, respectively.
- Recognize in the state legislative joint resolutions fund interfund loans due from the general fund amounting to \$507,206.

The principal purpose of interfund transfers is to make the routinary transfer of resources amounting to \$149,884 from the general fund to the debt service fund to cover debt service payments.

Interfund receivables and payables represent the pending settlements of the aforementioned transfers.

6. Capital Assets

Capital assets activity for the year ended June 30, 2003 is as follows:

	Balance at July 1, 2002, as restated	Additions/ depreciation and amortization expense	Balance at June 30, 2003
Cost Basis:			
Capital assets, not subject			
To depreciation and amortization:			
Land	\$ 430,773	\$ -	\$ 430,773
Construction in progress	236,286	1,520,850	1,757,136
Total cost basis of capital assets, not subject to depreciation and amortization	667,059	1,520,850	2,187,909
 Capital assets, subject to depreciation and amortization:			
Land improvements	2,347,748	42,737	2,390,485
Buildings, structures and building improvements	7,253,093	-	7,253,093
Infrastructure	939,572	-	939,572
Machinery and equipment under capital leases	21,318	7,532	28,850
Other machinery and equipment	844,988	14,787	859,775
Licensed vehicles	854,623		854,623
Total cost basis of capital assets subject to depreciation and amortization	12,261,342	65,056	12,326,398
Total cost of capital assets	\$ 12,928,401	\$ 1,585,906	\$ 14,514,307

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Accumulated depreciation and amortization:

Land improvements	\$ 1,681,348	\$ 63,631	\$ 1,744,979
Buildings, structures and building improvements	2,548,813	125,975	2,674,788
Infrastructure	171,888	40,729	212,617
Machinery and equipment under capital leases	10,585	5,734	16,319
Other machinery and equipment	596,647	39,403	636,050
Licensed vehicles	631,536	58,516	690,052
Total accumulated depreciation and amortization	<u>5,640,817</u>	<u>333,988</u>	<u>5,974,805</u>
Capital assets, net	<u>\$ 7,287,584</u>	<u>\$ 1,251,918</u>	<u>\$ 8,539,502</u>

Depreciation and amortization expense was charged to functions in the accompanying government-wide statement of activities as follows:

General government	\$ 122,817
Public safety	4,799
Public housing and welfare	3,919
Health and sanitation	38,729
Culture and education	141,809
Urban and economic development	<u>21,915</u>
Total depreciation and amortization expense	<u>\$ 333,988</u>

7. Long-Term Obligations

The general long-term debt activity for the year ended June 30, 2003 was as follows:

	Balance at June 30, 2002, as restated	Borrowings/ additions	Payments/ deductions	Discount accretion	Balance at June 30, 2003	Due Within One Year
Bonds payables	\$ 3,813,000	\$ -	\$ (199,000)	\$ -	\$ 3,614,000	\$ 224,000
Notes payable:						
Puerto Rico Treasury Department	519,387	-	(46,199)	36,460	509,648	10,452
Puerto Rico Labor Department	417,318	-	(50,213)	-	367,105	106,011
CRIM (Law 42)	1,061,453	-	(7,203)	-	1,054,250	13,314
CRIM (Delinquent Accounts)	251,724	-	(7,263)	-	244,461	16,098
Payment plan with PRASA		53,129	-		53,129	41,798
Compensated absences	717,157	107,577	-	-	824,734	475,247
Claims and judgments	2,060,512	144,976	-	-	2,205,488	2,060,488
Obligation under capital leases	11,948	7,532	(5,836)	-	13,644	7,264
Total	<u>\$ 8,852,499</u>	<u>\$ 313,214</u>	<u>\$ (315,714)</u>	<u>\$ 36,460</u>	<u>\$ 8,886,459</u>	<u>\$ 2,954,672</u>

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Historically, the general fund has been used to liquidate compensated absences, claims and judgments, federal cost disallowances, obligations under capital leases and any other long-term liabilities other than long-term debt.

a) Debt Limitation

The Municipality's Legislature is legally authorized to determine the contracting of debts of the Municipality. Nevertheless, the laws and regulations of the Commonwealth also provide that:

- Direct obligations of the Municipality (evidenced principally by bonds and notes) are backed by the full faith, credit and taxing power of the Municipality; and
- Direct obligations are not to be issued by the Municipality if the amount of the principal of, and interest on, such bonds and notes (and on all such bonds and notes issued thereafter) which are payable in any fiscal year, together with any amount paid by the Municipality in the preceding fiscal year on account of bonds or notes guaranteed by the Municipality, exceed 10% of the total assessed value of the property located within the Municipality plus the balance of the ad Val Orem taxes in the debt service fund, for bonds payable to be repaid with the proceeds of property taxes restricted for debt service.

In addition, before any new bonds or notes are issued, the revenues of the debt service fund should be sufficient to cover the projected debt service requirement.

b) Bonds Payable

The Municipality issues general obligation, special obligation and public improvement bonds to finance for the acquisition and construction of capital assets, as well as, to cover certain operating needs, including the payment to suppliers.

The laws and regulations of the Commonwealth provide that public debt of the Municipality will constitute a first claim on the available revenue of the Municipality. Public debt includes general obligation bonds, public improvement bonds and notes payable. The good faith, credit and taxing power of the Municipality are irrevocably pledged for the prompt payment of the principal and interest of the general obligation bonds, public improvement bonds and notes payable.

The Municipality levies an annual additional special tax of 1.40% of the assessed value of personal and real property. The proceeds of this additional special tax are deposited in a sinking fund established at GDB whereby sufficient funds must be set aside to redeem the bonds in minimum annual or biannual principal and interest payments. The proceeds of this special tax are recorded in the debt service fund.

For financial reporting purposes, the outstanding amounts of bonds represent the total principal to be repaid. Bonds and notes payable is composed as follows at June 30, 2003:

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<u>General obligation bonds:</u>	<u>Outstanding Amount</u>
1997 serial bonds due in annual principal installments ranging from \$35,000 to \$50,000; plus interest due in semiannually installments at variable rates (4.86% to 6.71% at June 30, 2003) through July, 1, 2004	\$ 50,000
2002 serial bonds due in annual principal installments ranging from \$10,000 to \$40,000; plus interest due in semiannually installments at variable rates (2.70% to 5.60%) through July, 1, 2026	510,000
	560,000
<u>Special obligation bonds:</u>	
1986 serial bonds due in annual principal installments of \$14,000; plus interest due in semiannually installments at variable rates (5.00% to 8.50%) through July, 1, 2006	42,000
1999 serial bonds due in annual principal installments ranging from \$10,000 to \$20,000; plus interest due in semiannually installments at variable rates (5.00% to 7.81%) through July, 1, 2009	95,000
2002 serial bonds due in annual principal installments ranging from \$10,000 to \$130,000; plus interest due in semiannually installments at variable rates (5.00% to 6.00%) through July, 1, 2026	1,700,000
	1,837,000
<u>Public improvement bonds:</u>	
1981 serial bonds due in annual principal installments ranging from \$5,000 to \$13,000; plus interest due in semiannual installments at rates of 5.00% through July, 1, 2006	38,000
1983 serial bonds due in annual principal installments ranging from \$3,000 to \$8,000; plus interest due in semiannual installments at rates of 5.00% through July, 1, 2006	24,000
1995 serial bonds due in annual principal installments ranging from \$20,000 to \$80,000; plus interest due in semiannual installments at variable rates (4.70% to 6.63%) through July, 1, 2016	900,000
1999 serial bonds due in annual principal installments ranging from \$25,000 to \$50,000; plus interest due in semiannual installments at variable rates (5.00% to 7.81%) through July, 1, 2009	255,000
	1,217,000
Total all bonds	\$ 3,614,000

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Interest rates on serial bonds subject to variable interest rates are reviewed periodically by GDB and are based on GDB's weighted average rate for its commercial paper program, not to exceed 8%.

Annual debt service requirements of maturity for bonds payable are as follows:

<u>Year Ending June 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2004	\$ 224,000	\$ 212,268	\$ 436,268
2005	190,000	199,563	389,563
2006	200,000	189,017	389,017
2007	170,000	177,946	347,946
2008	180,000	168,390	348,390
2009-2013	785,000	695,484	1,480,484
2014-2018	770,000	447,150	1,217,150
2019-2023	620,000	254,201	874,201
2024-2028	475,000	57,300	532,300
Total	<u>\$ 3,614,000</u>	<u>\$ 2,401,319</u>	<u>\$ 6,015,319</u>

At June 30, 2003, accrued interest payable on bonds amounted to \$99,139.

c) Notes Payable to Puerto Rico Treasury Department

On November 4, 1999, the Municipality entered into a financing agreement with the Puerto Rico Treasury Department to pay the debt related to the excess of property tax advances over collections made by CRIM. The original face amount of the note was \$1,159,503, which is due in monthly principal installments of \$3,850, at an implicit interest rate of 7.08% through November 2024. Outstanding balance at June 30, 2003 is net of the unamortized discount of \$484,306. The outstanding principal and accrued interest balances of the note payable to CRIM amounted to \$509,648 and \$3,007, respectively, at June 30, 2003. The principal and interests maturities are as follows. The principal and interest maturities are as follows:

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<u>Year Ending June 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2004	\$ 10,452	\$ 35,748	\$ 46,200
2005	11,216	34,984	46,200
2006	12,036	34,164	46,200
2007	12,917	33,283	46,200
2008	13,862	32,338	46,200
2009-2013	86,085	144,917	231,002
2014-2018	122,522	108,480	231,002
2019-2023	174,383	56,619	231,002
2024-2028	66,175	3,778	69,953
Total	<u>\$ 509,648</u>	<u>\$ 484,311</u>	<u>\$ 993,959</u>

d) Notes Payable to CRIM

On January 26, 2000, the Public Law 42 was enacted which authorized CRIM to obtain up to \$200 million, and for a term not exceeding 30 years, to allow for the financing of a debt that the municipalities of Puerto Rico have with CRIM, arising from the final settlements of property tax advances versus actual collections through fiscal year 1999-2000. The amounts that the Municipalities will collect from the additional property taxes resulting from the increases in the subsidy from the Commonwealth to the municipalities are assigned through this law to repay such loan. The increase in this subsidy was the result of the Public Law 238, enacted on August 15, 1999.

In addition, in June 2002 the Municipality entered into a repayment agreement with GDB and CRIM to repay the remaining \$1,061,453 of excess of property tax advances from fiscal years 2000 and 2001. CRIM retains the principal and interest from the property tax advances. The amounts retained by CRIM are remitted to GDB on July 1 of each year through July 1, 2032. The repayment agreement bears interest at variable rates (6.21% at June 30, 2003). The outstanding principal and accrued interest balances of the note payable to CRIM amounted to \$1,054,250 and \$5,418, respectively, at June 30, 2003. The principal and interest maturities are as follows:

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<u>Year Ending June 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2004	\$ 13,314	\$ 65,113	\$ 78,427
2005	14,164	64,263	78,427
2006	15,069	63,358	78,427
2007	16,033	62,394	78,427
2008	17,058	61,369	78,427
2009-2013	103,105	289,028	392,133
2014-2018	140,546	251,587	392,133
2019-2023	191,586	200,547	392,133
2024-2028	261,158	130,975	392,133
2029-2033	282,217	38,029	320,246
Total	\$ 1,054,250	\$ 1,226,663	\$ 2,280,913

e) Lease Obligations

The Municipality is obligated under capital leases with third parties that expire through 2008 for the acquisition of equipment. At June 30, 2003, the capitalized costs and the related accumulated amortization of the leased equipment amounted to \$28,850 and \$16,319, respectively, which are accounted for in the accompanying government-wide statement of net assets within capital assets. Amortization charge applicable to capital leases and included within depreciation expense of capital assets amounted to \$5,734. The present value of the future minimum capital lease payments at June 30, 2003 reported in the accompanying government-wide statement of net assets is as follows:

<u>Year ending June, 30</u>	<u>Amount</u>
2004	\$ 8,027
2005	2,302
2006	1,782
2007	1,782
2008	1,337
Total future minimum lease payments	15,230
Less: amount representing future interest cost at 8.00%	1,586
Present value of minimum lease payments	13,644
Less:	
Current portion of obligation under capital leases	7,264
Obligation under capital leases, excluding current portion	<u>\$ 6,380</u>

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f) Compensated Absences

At June 30, 2003, the composition of the liability for compensated absences is composed as follows:

	Due Within One Year	Due After One Year	Total
Vacation	\$ 251,966	\$ 98,952	\$ 350,918
Sick leave	178,348	247,035	425,383
Compensatory time	48,433	-	48,433
Total	\$ 478,747	\$ 345,987	\$ 824,734

8. Employees' Retirement Systems

a) Plan Description

The Municipality's employees participate in the Employees' Retirement System of the Government of Puerto Rico and Its Instrumentalities ("ERS"). The ERS is the administrator of a multi-employer (as related to the Municipality's reporting entity) defined pension plan (the "System") established by the Commonwealth. The System was created under Act No. 447 (the "Act") 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, the Municipality and other municipalities of the Commonwealth of Puerto Rico.

The System is independent, thus assets may not be transferred to another system or used for any other purpose other than for benefit each system's participants. The System issue publicly available financial reports that include its basic financial statements and required supplementary information for each of them, including required six-year trend information. Those reports may be obtained by writing to the administrator of the System.

The System provides for retirement, death and disability benefits. Death and disability retirement benefits are available to members for occupational and non-occupational death and disabilities. Retirement benefits depend upon age at retirement and number of years of credited service. Benefits vest after 10 years of plan participation.

Retirement benefits are determined by the application of stipulated benefit ratios to the member's average compensation. Average compensation is computed based on the highest 36 months of compensation recognized by ERS. The annuity, for which a plan member is eligible, is limited to a minimum of \$200 per month and a maximum of 75% of the average compensation.

On September 24, 1999, an amendment to Act No. 447 of May 15, 1951, which created the System, was enacted with the purpose of establishing a new pension program ("System 2000"). System 2000 became effective on January 1, 2000. Employees participating in the current system as of December 31, 1999, had the option to either stay in the defined benefit plan or transfer to the new program. Persons employed on or after January 1, 2000, are only allowed to become members of System 2000.

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System 2000 is a hybrid defined contribution plan, also known as cash balance plan. Under this new plan, there is a pool of pension assets, which are invested by the System, together with those of the current defined benefit plan.

Benefits at retirement are not guaranteed by the Commonwealth of Puerto Rico or the Municipality. The annuity is based on a formula which assumes that each year the employees' contribution (with a minimum of 8.275 percent of the participant' salary up to a maximum of 10%) will be invested in an account which will either: (1) earn a fixed rate based on the two-year Constant Maturity Treasury Note; (2) earn a rate equal to 75% of the return of ERS's investment portfolio (net of management fees); or (3) earn a combination of both alternatives.

Participants receive periodic account statements similar to those of defined contribution plans showing their accrued balances. Disability pensions are not being granted under System 2000. The employer's contributions (9.275% of the participant' salary) will be used to fund the current plan.

System 2000 reduced the retirement age from 65 years to 60 for those employees who joined the current plan on or after January 1, 2000.

On August 12, 2000, Act No. 174 was approved to allow certain participants of ERS to be eligible for early retirement upon attaining at least age 55 with 25 years of service, provided they made their election on or before April 1, 2001. Those who elected early retirement under this law will receive monthly benefits of 75% (if 25 or more years of service and age 55, or 30 or more years of service and age 50) or benefits of 65% (if 25 years of service by less than age 55) of their average compensation which is computed based on the highest 36 months of compensation recognized by ERS. In the cases, the sponsor contribution with respect to the participants covered until the participants reach the normal retirement age.

Historically, the Commonwealth of Puerto Rico has reported ERS and System 2000 in its basic financial statements. Accordingly, the Commonwealth of Puerto Rico is currently assuming any actuarial deficiency that may exist or arise related to the Municipality's participating employees since the System does not allocate any actuarial deficiencies pertaining to municipal employees participating in the System. The Municipality is only required by law to make statutory contributions in the rates detailed below.

b) Funding Policy

Contribution requirements are established by law and are as follows:

Municipality and other employers	9.275% of applicable payroll
Employees:	
Hired on or before March 31, 1990	5.775% of monthly gross salary up to \$550
	8.275% of monthly gross salary up to \$550
Hired on or before April 1, 1990	8.275% of monthly gross salary

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On August 12, 2000, Act No. 174 was approved to allow certain participants of the ERS to be eligible for early retirement upon attaining at least age 55 with 25 years of service, provided they made their election on or before April 1, 2001. Those who elected early retirement under this law will receive monthly benefits of 75 percent (if 25 or more year of service and 55, or 30 or more years or services and age 50) or benefits of 65 percent (if 25 years of service by less than age 55) of their average compensation which is computed based on the highest 36 months of compensation recognized by the System. In these cases, the employer (including the Municipality) is responsible for contributing to the System the amount needed to cover the benefit payments and employer contribution with respect to the participants covered until the participants reaches the normal retirement age.

Historically, the Commonwealth has reported the System as a single-employer plan (as relates only to the financial reporting entity of the Commonwealth) in its comprehensive annual financial report. Accordingly, the Commonwealth will assume any actuarial deficiency that may exist or arise related to the Municipality's participating employees since the System does not allocate any actuarial deficiencies pertaining to municipal employees participating in the System. The Municipality is only required by law to make statutory contributions in the rates mentioned above. As a result, no net pension obligation nor net pension asset that may be allocable to the Municipality's participating employees, if any, has been recorded in the accompanying basic financial statements.

The Municipality's actual contribution for the current and the previous two fiscal years, which is equal to the required contribution, follows:

Fiscal Year Ended	Law No. 447	System 2000
2003	\$ 80,633	\$ 20,775
2002	\$ 84,251	\$ 21,768
2001	\$ 94,457	N/A

9. Commitments and Contingencies

a) Commitments

As of June 30, 2003, the Municipality has several outstanding or planned non-cancelable construction projects amounting to \$4,086,940, of which \$2,442,634 have been incurred and paid as of June 30, 2003, and \$1,644,306 remain outstanding to incur through the end of each project. These projects are evidenced by contractual commitments with contractors and are accounted for in the capital projects fund.

The Municipality has reported in the general fund, outstanding encumbrances amounting to \$114,159.62 that the Municipality intends to honor and will continue to be liquidated under the current year's budget during a lapse period that extends into the subsequent fiscal year.

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The Municipality leases office equipment under operating lease agreements, which generally have terms of one year or less and are automatically renewed for the same terms. Rental expenses amounted approximately \$10,065. Management believes that the summary of the future minimum rental commitments under noncancelable equipment leases with terms exceeding one year is not significant.

b) Contingencies

I. Litigation

The Municipality is defendant in numerous claims and legal proceedings pertaining to matters incidental to the performance of routine governmental operations. Under Act No. 104 of June 25, 1995, as amended, persons are authorized to sue the Municipality only for causes of actions set forth in said Act to a maximum amount of \$75,000 or \$150,000 if it involves actions for damages to more than one person or where a single injured party is entitled to several causes of action. Under certain circumstances, as provided in Act No. 9 of November 26, 1975, as amended, the Municipality may provide its officers and employees with legal representation, as well as assume the payment for any judgment that may be entered against them. There is no limitation on the payment of such judgments.

With respect to pending and threatened litigation, the Municipality has reported liabilities amounting to \$2,205,488 for awarded and anticipated unfavorable judgments at June 30, 2003. This amount was included as a long-term obligation in the accompanying statement of net assets, and represents the amount estimated as a probable liability or a liability with a fixed or expected due date, when will require future available financial resources for its payment. Management believes that the ultimate liability in excess of amounts recorded in the accompanying statement of net assets, if any, would not be material to the basic financial statements taken as a whole.

II. Federal and State grants

- a. Projects financed by Federal and State Grants are subject to audits by grantors and other governmental agencies in order to determine its expenditures to comply with the conditions of such grants. An audit report dated August 1, 2000 of the Governor's authorized Representative (GAR) for Federal Emergency Management Agency funds related to Hurricane Georges disclosed questioned costs in the amount of \$745,182. The Municipality appealed the audit results to the GAR. The final outcome of this matter is indeterminable. It is the Municipality's opinion that no other unrecorded liabilities will arise from audits previously performed or to be performed.
- b. The Municipality receives other financial assistance from the federal government in the form of grants and entitlements. Receipt of grants is generally conditioned upon compliance with terms and conditions of the grant agreements and applicable federal laws and regulations, including the expenditure of resources for eligible purposes. Accordingly, expenditures financed by these programs are subject to financial and compliance audits by the appropriate grantor.

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Disallowance as a result of these audits may become liabilities of the Municipality. If expenditures are disallowed due to noncompliance with grant programs regulations, the Municipality may be required to reimburse the grantor. Management believes that the Municipality will be able to comply with the terms of corrective action plans, if any, that may be requested by the federal grantors. Consequently, the accompanying basic financial statements do not include any provision or reserve for possible disallowed costs arising from the federal funds disbursed during fiscal year ended June 2003.

10. Accounting Changes, Changes in Reporting Entity and Restatements

During current year, the Municipality implemented new accounting standards and an interpretation issued by GASB. GASB No. 34, as amended by GASB No. 37, establishes new financial reporting standards for state and local governments. This statement's requirements represent a significant change in the financial reporting model used by state and local governments, including statement formats and changes in fund types and elimination of account groups. In addition to fund financial statements, governments are required to report government-wide financial statements, prepared using the accrual basis of accounting and the economic resources measurement focus. As a result, fund reclassifications and adjustments to the fund equities reported in the prior financial statement balances were required.

GASB No. 38 requires certain note disclosures when GASB No. 34 is implemented. The provisions of this new standard have been incorporated into the basic financial statements and notes.

GASB Interpretation No. 6 clarifies the application of existing standards for distinguishing the respective portions of certain types of liabilities that should be reported as (1) governmental fund liabilities and (2) general long-term liabilities of the Municipality. The provisions of this interpretation have been incorporated into the basic financial statements and notes.

These new standards caused most of the accounting changes, changes in reporting entity, and restatements described on the ensuing discussion below. Changes and restatements for reasons other than the adoption of the above pronouncements are also explained below. The following schedule reconciles the June 30, 2002 fund balance as previously reported by the Municipality to the beginning fund balance, as restated:

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June 30, 2003

	June 30, 2002, fund balance, as previously reported	Fund adjustments	Fund reclassifications	June 30, 2002, fund balance, as restated
<i>Major funds:</i>				
General fund	\$ (1,830,433)	\$ 917,551	\$ -	\$ (912,882)
CDBG capital/special projects fund	-	-	-	-
EDA capital projects fund	-	-	206,951	206,951
\$1,740,000 bond issuance fund	1,732,219	-	-	1,732,219
State legislative joint resolutions				
special revenue fund	1,875,522	37,663	-	1,913,185
Total major funds	<u>1,777,308</u>	<u>955,214</u>	<u>206,951</u>	<u>2,939,473</u>
<i>Non-major funds:</i>	<u>1,231,997</u>	<u>(179,951)</u>	<u>(206,951)</u>	<u>845,095</u>
Total governmental funds	<u>\$ 3,009,305</u>	<u>\$ 775,263</u>	<u>\$ -</u>	<u>\$ 3,784,568</u>

The following schedule reconciles the balances previously reported at June 30, 2002 in the general fixed assets account group, the general long-term debt account group:

	June 30, 2002, balances, as previously reported	Change in reporting entity	Change in basis of accounting	Reclassification and adjustments	June 30, 2002, balances, as restated
<i>Account groups:</i>					
General fixed assets account					
group/capital assets, net	<u>\$ 13,536,328</u>	<u>\$ -</u>	<u>\$ 607,927</u>	<u>\$ -</u>	<u>\$ 12,928,401</u>
General long-term debt					
account group:					
Obligation under capital					
leases	-	-	-	11,948	11,948
CRIM loan (law 42)	1,061,453	-	-	-	1,061,453
Department of Treasury	1,040,153	-	-	(520,766)	519,387
Compensated absence	515,093	-	-	202,064	717,157
Department of Labor	281,693	-	-	135,625	417,318
Delinquency account (law					
146)	251,724	-	-	-	251,724
Judgments and claims	40,000	-	-	2,020,512	2,060,512
PREPA payment plan	10,993	-	-	(10,993)	-
Bonds and notes payable	3,813,000	-	-	-	3,813,000
Totals:	<u>\$ 7,014,109</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,838,390</u>	<u>\$ 8,852,499</u>

COMMONWEALTH OF PUERTO RICO
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The cost basis of capital assets of the Municipality have been adjusted as of the beginning of the year as part of the adoption of GASB No. 34 to: (1) recognize infrastructure assets, (2) recognize changes in capitalization thresholds, (3) record capital assets previously not accounted for and (4) to eliminate nonexisting and impaired capital assets. These adjustments were the result of a physical inventory taking of capital assets across all the Municipality's departments. The capital assets were also adjusted as of the beginning of the year to record the accumulated depreciation and amortization as part of the adoption of GASB No. 34.

11. Subsequent Events

On December 1, 2003, the Municipality entered into a financing agreement with the Department of Treasury of the Commonwealth in the amount of \$2,000,000 for the payment of an awarded unfavorable judgment related to a civil claim filed in the Puerto Rico District of the United States Court (the Court) by several employees of the Municipality. The note is payable in 120 monthly, non-interest bearing, installments ranging from \$4,167 to \$62,500. On December 15, 2003, the Municipality consigned in the Court, the final payment of the legal claim.

12. Special Item

On December 2000, the Municipality and other municipalities of Puerto Rico filed a complaint against the Puerto Rico Electric Power Authority (PREPA), a component unit of the Commonwealth, in the San Juan Superior Court requesting the payment by PREPA of the full contributions in lieu of taxes and electric energy sales set aside for prior fiscal years. The complaint challenged the application by PREPA of the "net revenue" formula which reduced the amount available to pay contributions in lieu of taxes and energy sales set aside for the Municipality. On March 18, 2003, the Board of Directors of PREPA approved a resolution by which PREPA agreed to settle the claims with all municipalities. Accordingly, PREPA offered to pay \$125 million to all municipalities to settle the claim, which are divided in \$68 million in cash and \$57 million in the construction of electric infrastructure projects on behalf of the municipalities. Of such amounts, the Municipality will receive \$458,419 in cash and \$384,263 in construction projects. At June 30, 2003, an intergovernmental receivable from PREPA amounting to \$458,419 has been recorded in the general fund and the statement of net assets to recognize the settlement to be collected by the Municipality from PREPA. This transaction falls under the definition of special item set forth by GASB No. 34, as it is a transaction of unusual and infrequent nature within the control of the Municipality's management. Accordingly, the accompanying statement of activities include a special item of \$332,017 recorded within general revenues in the government-wide statement of activities, which represents the net benefit to be collected from PREPA, after deducting professional fees amounting to \$126,402 (recorded within accounts payable in the statement of net assets) to be paid to the Municipality's legal counselors. In the accompanying governmental funds' balance sheet, a deferred revenue of \$458,419 has been recorded at June 30, 2003 since the receivable from PREPA is not considered current available financing resources at June 30, 2003.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Notes to Basic Financial Statements
June 30, 2003

REQUIRED
SUPPLEMENTARY INFORMATION

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
 Budgetary Comparison Schedule - General Fund
 Year ended June 30, 2003

	Budgeted Amounts		Actual amounts (budgetary basis) (see note A)	Variance with final budget-positive (negative)
	Original	Final		
Revenues:				
Property taxes (notes 4)	\$ 4,541,208	\$ 4,541,208	\$ 4,541,208	\$ -
Municipal license taxes (note 3)	594,423	594,423	608,662	14,239
Intergovernmental	764,067	764,067	926,327	162,260
Interest Income	20,000	20,000	103,600	83,600
Charges for services	100,000	100,000	68,022	(31,978)
Other revenues	39,000	39,000	129,198	90,198
Total revenues:	<u>6,058,698</u>	<u>6,058,698</u>	<u>6,377,017</u>	<u>318,319</u>
Expenditures:				
Current:				
General government	2,742,030	3,021,730	2,829,283	192,447
Urban and economic development	657,238	555,258	527,991	27,267
Public safety	364,931	375,690	367,121	8,570
Health and sanitation	388,413	244,479	228,503	15,976
Culture, recreation and education	500,930	471,994	460,090	11,903
Public housing and welfare	1,216,567	1,203,654	1,194,097	9,558
Debt service:	188,589	185,892	181,634	4,258
Total expenditures	<u>6,058,698</u>	<u>6,058,698</u>	<u>5,788,719</u>	<u>269,979</u>
Net change in fund balance	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 588,298</u>	<u>\$ 588,298</u>

Explanation of Differences:

Sources/inflows of financial resources:

Actual amounts (budgetary basis) "available for appropriations" from the budgetary comparison schedule	\$ 6,377,017
Differences - budget basis to GAAP:	
Adjustments to receivables to convert to modified accrual basis	96,535
Resources considered revenues for budgetary purposes but are not revenues for financial reporting purposes	(123,257)
Resources considered revenues for financial reporting but not for budgetary purposes	<u>229,299</u>
Total revenues as reported on the statement of revenues, expenditures and changes in fund balances - governmental funds	<u>\$ 6,579,594</u>

Uses/outflows of financial resources:

Actual amounts (budgetary basis) "total charges to appropriations" from the budgetary comparison schedule	\$ 5,788,719
Differences - budget basis to GAAP:	
Adjustments to payables to convert to modified accrual basis	(187,575)
Transfers to other funds are outflows of budgetary resources but are not expenditures for financial reporting purposes	149,883
Outflows of budgetary resources used for financing expenditures that are not expenditures for budgetary purposes	<u>334,741</u>
Total expenditures as reported on the statement of revenues, expenditures and changes in fund balances - governmental funds	<u>\$ 6,085,768</u>

The accompanying note to required supplemental information is a integral part of this schedule.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Notes to Budgetary Comparison Schedule - General Fund
June 30, 2003

NOTE A - Budgetary Basis of Accounting

The Municipality's annual budget is prepared under the budgetary basis of accounting, which is not in accordance with GAAP.

Under the budgetary basis of accounting, revenue is generally recognized when cash is received. Short-term and long-term borrowings may be used to finance budgetary excess of expenditures over revenues.

Under the budgetary basis of accounting, the Municipality uses encumbrance accounting to record the full amount of purchase orders, contracts and other commitments of appropriated resources as deductions from the appropriation prior to actual expenditure. In the governmental funds, encumbrance accounting is a significant aspect of budgetary control. Accordingly, expenditures are generally recorded when the related expenditure is incurred or encumbered. Available appropriations and encumbrances are established to lapse one year after the end of the fiscal year. Amounts required to settle claims and judgments against the Municipality, and certain other liabilities, are not recognized until they are encumbered or otherwise processed for payment. Unencumbered appropriations and encumbrances lapse at year-end. Other appropriations, mainly capital projects appropriations, are continuing accounts for which the Municipal Legislature has authorized that an unspent balance from the prior year be carried forward and made available for current spending.

The accompanying Budgetary Comparison Schedule - General Fund, provides information about the general fund's original budget, the amendments made to such budget, and the actual general fund's results of operations under the budgetary basis of accounting for the fiscal year ended June 30, 2003.

Except for the general fund, the Municipality legally does not adopt budgets for its major special revenue and capital projects funds. Accordingly, the accompanying basic financial statements nor required supplementary information include statements or revenues and expenditures - budget and actual - budgetary basis, or budgetary comparison schedules, respectively, for these major funds.

SUPPLEMENTAL INFORMATION

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA
Schedule of Expenditures of Federal Awards
Year ended June 30, 2003

Federal Grantor/Pass-Through Grantor/Program Title	Federal CFDA Number (note B)	Pass-Through Grantor's Number (note C)	Expenditures (note A)
<u>U.S. Department of H.U.D.</u>			
Major Program:			
Passed through the Office of Commissioner of Municipal Affairs:			
Community Development Block Grant - State's Program	14.228	AF - 25 AB - 25 FD - 25	\$ 544,923
Nonmajor program:			
Direct Program:			
Section 8 Housing Choice Vouchers Program	14.871	N/A	<u>190,373</u>
			735,296
<u>U.S. Department of Agriculture</u>			
Nonmajor program:			
Passed through the P.R. Department of Education:			
Child and Adult Care Food Program	10.558	N/AV	5,010
<u>U.S. Department of Health and Human Services</u>			
Nonmajor program:			
Passed through the P.R. Department of Family - Families and Children Administration:			
Child Care and Development Block Grant	93.575	2003-030	142,226
<u>Federal Emergency Management Agency</u>			
Nonmajor program:			
Passed through the Puerto Rico Governor Office - (Governor's Authorized Representative-GAR)			
Public Assistance Grants	83.544	DR-PR-1247	9,500
<u>U.S. Department of Justice</u>			
Nonmajor program:			
Passed through the P.R. Department of Justice:			
Public Safety Partnership and Community Policy Grant (COPS)	16.710	2000SHWX0527 1996UMWX0704	121,689
<u>U.S. Department of Commerce</u>			
Nonmajor Program:			
Direct Program:			
Grant for Public Works and Economic Development	11.300	N/A	<u>67,902</u>
Total federal awards expenditures:			<u>\$ 1,081,623</u>

The accompanying notes are an integral part of this schedule.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Notes to Schedule of Expenditures of Federal Awards

June 30, 2003

NOTE A - Summary of Significant Accounting Policies

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of the Municipality and is presented on the modified accrual basis of accounting. Expenditures are recognized when the related liability is incurred. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, "Audits of States, Local Governments and Nonprofit Organizations".

NOTE B - Federal CFDA Number

The Catalog of Federal Domestic Assistance (CFDA) Number is a program identification number. The first two digits identify the federal department or agency that administers the program and the last three numbers are assigned by numerical sequence.

NOTE C - Pass-through Grantor's Number

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

NOTE D - Reconciliation of Expenditures Presented in the Schedule of Expenditures of Federal Awards to the Expenditures Presented in the Basic Financial Statements

Description	CDBG Capital/Special Projects Fund	EDA Capital Projects Fund	Other Governmental Funds
14.228	\$ 544,923	\$ -	\$ -
14.871	-	-	190,373
10.558	-	-	5,010
93.575	-	-	142,226
83.544	-	-	9,500
16.710	-	-	121,689
11.300	-	67,902	-
Total federal awards expenditures:	544,923	67,902	468,798
Total non-federal awards expenditures:	-	-	1,300,010
Total expenditures, fund statements:	\$ 544,923	\$ 67,902	\$ 1,768,808

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

Mayor and Municipal Legislature
Municipality of Guánica
Guánica, Puerto Rico

We have audited the financial statements of the Municipality of Guánica as of and for the year ended June 30, 2003, and have issued our report thereon dated January 26, 2004 which is qualified since we were unable to obtain sufficient evidence to support existence, completeness and rights and obligations applicable to certain general capital assets and since we were unable to obtain sufficient evidence to support completeness and valuation applicable to due from (to) other funds between the General Fund, CDBG Capital Projects/Special Fund, State Legislative Joint Resolutions Fund and Other Governmental Funds because of the inadequacy of accounting records. Except as discussed in the preceding sentence, 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.

Compliance

As part of obtaining reasonable assurance about whether Municipality of Guánica's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed an instance of noncompliance that is required to be reported under *Government Auditing Standards* which is described in the accompanying Schedule of Findings and Questioned Costs as item **2003 II-1**. We also noted certain immaterial instances of noncompliance that we have reported to management in a separate letter dated January 26, 2004.

Internal Control over Financial Reporting

In planning and performing our audit, we considered Municipality of Guánica's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect Municipality of Guánica's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements.

Reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs as items 2003 II-2, 2003 II-3, 2003 II-4.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider items 2003 II-2, 2003 II-3 and 2003 II-4 in the accompanying Schedule of Findings and Questioned Costs to be material weaknesses. We also noted other matters involving the internal control over financial reporting that we have reported to management in a separate letter dated January 26, 2004.

This report is intended for the information of the management of the Municipality, Commonwealth and Federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than the specified parties. However, this report is a matter of public record and its distribution is not limited.



Rodriguez, Ximena E-lon RVP

**REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH
MAJOR PROGRAM AND INTERNAL CONTROL OVER COMPLIANCE IN
ACCORDANCE WITH OMB CIRCULAR A -133**

Mayor and Municipal Legislature
Municipality of Guánica
Guánica, Puerto Rico

Compliance

We have audited the compliance of Municipality of Guánica with the types of compliance requirements described in the *U. S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that is applicable to its major federal programs for the year ended June 30, 2003. Municipality of Guánica'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 its major federal program is the responsibility of Municipality of Guánica's management. Our responsibility is to express an opinion on Municipality of Guánica'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 Guánica'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 Guánica's compliance with those requirements.

As described in items **2003 III-1**, **2003 III-2** and **2003 III-3** in the accompanying Schedule of Findings and Questioned Costs, the Municipality of Guánica did not comply with the requirements regarding *cash management, reporting and special tests and provisions – compliance with 24 CFR 85.20* that are applicable to *Community Development Block Grant – State's Program*. Compliance with such requirements is necessary, in our opinion, for Municipality of Guánica to comply with the requirements applicable to that program.

In our opinion, except for the noncompliance described in the preceding paragraph, the Municipality of Guánica complied, in all material respects, with the requirements referred to above that are applicable to its major federal program for the year ended June 30, 2003.

Internal Control over Compliance

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

We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, on our judgment could adversely affect the Municipality of Guánica's ability to administer a major federal program in accordance with applicable requirements of laws, regulations, contracts and grants. Reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs as items 2003 III-1 to 2003 III-4.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we considered items 2003 III-1, 2003 III-2 and 2003 III-3 to be a material weakness. We noted certain immaterial instances of noncompliance that we have reported to management of the Municipality of Guánica in a separate letter dated January 26, 2004.

This report is intended for the information of the management of the Municipality, Commonwealth and Federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than the specified parties. However, this report is a matter of public record and its distribution is not limited.

1944058



Rodriguez, Liema & Toro

**COMMONWEALTH OF PUERTO RICO
Municipality of Guánica**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

Year ended June 30, 2003

I. Summary of audit results:

Part I - Financial Statements

- | | | |
|--|--|---|
| 1. Type of audit report: | <input type="checkbox"/> Unqualified opinion | <input checked="" type="checkbox"/> Qualified opinion |
| | <input type="checkbox"/> Adverse opinion | <input type="checkbox"/> Disclaimer of opinion |
| 2. Reportable conditions identified that are not considered material weakness: | <input checked="" type="checkbox"/> Yes | <input type="checkbox"/> None reported |
| 3. Reportable conditions reported as a material weakness: | <input checked="" type="checkbox"/> Yes | <input type="checkbox"/> No |
| 4. Material noncompliance disclosed: | <input checked="" type="checkbox"/> Yes | <input type="checkbox"/> No |

Part II - Federal Awards

- | | | |
|---|---|--|
| 1. Reportable conditions reported: | <input checked="" type="checkbox"/> Yes | <input type="checkbox"/> No |
| 2. Reportable conditions identified that are not considered material weakness: | <input checked="" type="checkbox"/> Yes | <input type="checkbox"/> None reported |
| 3. Type of report on compliance for major programs: | <input type="checkbox"/> Unqualified opinion | <input checked="" type="checkbox"/> Qualified opinion |
| | <input type="checkbox"/> Adverse opinion | <input type="checkbox"/> Disclaimer of opinion |
| 4. Audit findings required to be reported under Section 510(a) of OMB Circular A - 133: | <input checked="" type="checkbox"/> Yes | <input type="checkbox"/> No |
| 5. Major programs: | <u>CFDA Number(s)</u>
14.228 | <u>Name of Federal Program or Cluster</u>
Community Development Block Grant - State's Program |
| 6. Dollar threshold used to distinguish Type A and Type B programs: | <input checked="" type="checkbox"/> \$300,000 | |
| 7. Low-risk auditee: | <input type="checkbox"/> Yes | <input checked="" type="checkbox"/> No |

COMMONWEALTH OF PUERTO RICO
Municipality of Guánica

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - Continued

Year ended June 30, 2003

II. Findings related to the financial statements reported in accordance with GAGAS:

Reference Number: 2003 II-1
Area: Accounting Records and Reports
Type: Material noncompliance

Condition and criteria: As required by the Autonomous Municipal Law of 1981, as amended, the Municipality should provide adequate resources to amortize the general fund deficit. The June 30, 2003 financial statements disclosed that the general fund ended with a cumulative fund balance deficit of \$445,683.

Cause and effect: This matter is caused primarily to inadequate revenue projections on previous years, inadequate controls over appropriations and interfund advances not collected in current and previous years.

Recommendation: Procedures should be established to assure compliance with requirements of the Municipal Law. The Municipality should establish a deficit reduction plan assigning the necessary budgetary credits in the annual budget as required by law and controlling and collecting interfund advances.

COMMONWEALTH OF PUERTO RICO
Municipality of Guánica

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - Continued

Year ended June 30, 2003

II. Findings related to the financial statements reported in accordance with GAGAS:

Reference Number: 2003 II-2
Area: Accounting Records and Reports
Type: Material Weakness

Condition and criteria: The Municipality has not properly implemented and established internal controls and procedures to maintain adequate, complete and reconciled set of accounting records and reports. Our audit revealed the following:

- a. The general ledger is not reconciled with other accounting records or supporting reports on a monthly basis, including federal programs records.
- b. The Municipality does not prepare the Form 4(a) Cash report properly reconciled on a monthly basis with the general ledger and corresponding bank conciliations. Several accounts included in the yearly "Consolidated Form 4(a) Cash Report" related to general fund, and Commonwealth's and federal grants accounts disclosed inappropriate revenues, expenditures and cash ending balances.

Cause and effect: There are no proper reconciliation procedures to assure adequacy and completeness between different accounting records and reports including general ledger, orders and contract register, federal programs' records, bank reconciliations, monthly and annual reports and other financial information maintained by Commonwealth's agencies including the Government Development Bank of Puerto Rico and the Municipal Revenue Collection Center (CRIM). In addition, accounting records included excess and erroneous costs charged and interfund loans or advance payments not properly adjusted. As a result, we could not conclude about certain balances at the financial statements including due from (to) balances between general and other funds. Several funds included in the financial statements were prepared using other alternative procedures.

COMMONWEALTH OF PUERTO RICO
Municipality of Guánica

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - Continued

Year ended June 30, 2003

II. Findings related to the financial statements reported in accordance with GAGAS:

Reference Number: 2003 II-2 (continued)

Recommendation:

A complete and immediate review of controls and procedures over financial records and reports should be performed by the Municipality in order to provide management with a complete, accurate and reliable set of accounting records and reports. Those procedures should include, at least, the following:

- a. Reconciliation of Form 4(a) Cash report on a monthly basis with funds subsidiary records and bank reconciliations.
- b. Reconciliation procedures between the general ledger and other accounting records including revenue register, the orders and contracts register and federal programs records.
- c. Reconciliation of accounts with information provided by Commonwealth's agencies including Governmental Development Bank of Puerto Rico and the Municipal Revenue Collection Center (CRIM).

COMMONWEALTH OF PUERTO RICO
Municipality of Guánica

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - Continued

Year ended June 30, 2003

II. Findings related to the financial statements reported in accordance with GAGAS:

Reference Number: 2003 II-3
Area: **Interfund Transactions**
Type: **Material Weakness**

Condition and criteria:	Funds are advanced from general current bank account to other funds for salaries, fringe benefits and other costs incurred by several special accounts, which subsequently should be reimbursed by the applicable Commonwealth and federal agencies. Our tests disclosed that the Municipality has not adequate controls and procedures over recording of advances and reimbursements. Also, there are no adequate follow up over amounts to be reimbursed to assure proper and timely repayment of advances.
Cause and effect:	Several amounts are not being reimbursed or not timely reimbursed by the applicable agencies. The Municipality has suffered significant losses for uncollectible amounts, which has increased the general fund deficit and severely affected its cash flow.
Recommendation:	The Municipality must immediately establish control procedures to minimize advances and control the timely reimbursement of funds. A complete review of uncollected balances since previous years should be performed to identify and claim uncollected funds from Commonwealth and Federal agencies.

COMMONWEALTH OF PUERTO RICO
Municipality of Guánica

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - Continued

Year ended June 30, 2003

II. Findings related to the financial statements reported in accordance with GAGAS:

Reference Number: 2003 II-4
Area: Capital Assets
Type: Material Weakness

Condition and criteria:

The Municipality performed a review of capital assets inventory records in order to comply with requirements of GASB Statement Number 34. Our tests disclosed the following:

- a. From a sample of 32 property items from different categories in order to verify proper ownership, valuation and reasonability of depreciation expense we noted that,
 - (1) In 23 cases the municipal personnel could not provide us of evidence of property title or other appropriate documentation as evidence of ownership.
 - (2) In 31 cases municipal personnel could not provide us with evidence of determination of asset cost.
 - (3) In 1 case the cost of the item was understated by a significant amount.
 - (4) In 4 cases the item classification in the inventory list was erroneous.
 - (5) In 2 cases the useful life determined was not reasonable.
- b. During the year the Municipality acquired 2 land lots from the Puerto Rico Land Authority for a total amount of \$74,000. These lots were not found in the Municipal inventory records.

COMMONWEALTH OF PUERTO RICO
Municipality of Guánica

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - Continued

Year ended June 30, 2003

II. Findings related to the financial statements reported in accordance with GAGAS:

Reference Number: 2003 II-4 (continued)

Cause and effect: Even though a review process was performed on this area, the Municipality does not have sufficient documentation to properly support assets ownership and other areas including costs of certain assets.

Recommendation: The Municipality should coordinate among its departments specific procedures in order to gather information about capital assets ownership, costs and completeness. This process should be started immediately in order to perform the corresponding corrections in the financial statements.

COMMONWEALTH OF PUERTO RICO
Municipality of Guánica

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - Continued

Year ended June 30, 2003

III. Findings and questioned costs related to federal awards:

<i>Reference Number:</i>	<u>2003 III-1</u>
<i>Agency:</i>	U. S. Department of Housing and Urban Development
<i>Pass-through Entity:</i>	Office of Commissioner of Municipal Affairs (OCAM)
<i>Program:</i>	Community Development Block Grant – State’s Program
<i>CFDA Number:</i>	14.228
<i>Regulation/Requirement:</i>	Cash Management
<i>Type:</i>	Material noncompliance, Material Weakness
<i>Questioned Costs:</i>	\$ -0-

Condition and criteria:

Our tests to a sample of 8 bank deposits related to grant funds requested to the pass-through agency (from a total population size of 17 deposits) disclosed the following:

- a. In 6 cases the corresponding fund disbursements were issued on a period between 7 days to 1 year after funds were deposited.
- b. In 3 cases checks were issued before the corresponding requisitions were made and sent to the pass-through agency. These disbursements were financed with excess funds from previous requisitions.
- c. In 1 case (pertaining to Program year 1996) we were unable to test for compliance since accounting records were incomplete and not sufficient information was available (See related Finding No. **2003 III-3**).

Cash management regulations require the Municipality to minimize the time between the receipt of funds and the corresponding disbursement.

Cause and effect:

The Municipality has not established adequate internal control procedures in order to assure that funds are disbursed soon after related funds are deposited and to avoid maintenance of excess funds in bank accounts. As a result, the Municipality is not in compliance with applicable cash management regulations.

Recommendation:

The Municipality should establish specific procedures to assure that disbursements are issued soon after the related deposits are made. These procedures should include reconciliation procedures between program general ledger and related subsidiary ledgers as well with the Municipality’s centralized accounting records.

COMMONWEALTH OF PUERTO RICO
Municipality of Guánica

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - Continued

Year ended June 30, 2003

III. Findings and questioned costs related to federal awards:

Reference Number: 2003 III-2
Agency: U. S. Department of Housing and Urban Development
Pass-through Entity: Office of Commissioner of Municipal Affairs (OCAM)
Program: Community Development Block Grant – State’s Program
CFDA Number: 14.228
Regulation/Requirement: Reporting
Type: Material noncompliance, Material Weakness
Questioned Costs: \$ -0-

Condition and criteria: Our evaluation of a sample of 8 quarterly reports, (from a population of 15 reports corresponding to program years reporting disbursements) submitted to the pass-through entity during the fiscal period disclose the following:

- a. In three cases the Municipality could not provide evidence of timely submission.
- b. In three cases the amounts included in the reports do not reconcile with the amounts posted in the program accounting records.

Reports of Federal awards submitted to Federal awarding agencies or pass-through entities must include all activity of the reporting period, must be supported by underlying accounting or performance records, must be submitted within required dates and should be fairly presented in accordance with program requirements.

Cause and effect: The Municipality has not following established adequate procedures to document timely submission of reports and the program accounting records are inadequate (See related Finding No. 2003 III-3). As a result, the Municipality is not in compliance with applicable reporting regulations.

Recommendation: The Municipality should assign to specific personnel the responsibility of documenting reports submission and should perform a review of the accounting records. Reports should be submitted to the pass-through entity after a review and reconciliation with accounting records.

COMMONWEALTH OF PUERTO RICO
Municipality of Guánica

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - Continued

Year ended June 30, 2003

III. Findings and questioned costs related to federal awards:

Reference Number: 2003 III-3
Agency: U. S. Department of Housing and Urban Development
Pass-through Entity: Office of Commissioner of Municipal Affairs (OCAM)
Program: Community Development Block Grant – State’s Program
CFDA Number: 14.228
Regulation/Requirement: Special Tests and Provisions - tests to accounting records for compliance with 25 CFR 85.20
Type: Material noncompliance, Material Weakness
Questioned Costs: \$ -0-

Condition and criteria:

Program accounting records maintained by the Federal Programs Office of the Municipality are not balanced and complete. Several transactions, related to assets, liabilities, revenues and expenditures, has not been recorded in the general ledger, the cash receipts and cash disbursement journals. In addition, amounts do not reconcile with centralized accounting records. Program accounting records reported \$404,344 in expenditures versus \$544,923 as reported by the centralized accounting records in the financial statements.

As stated by 25 CFR 85.20 (b) (2)...“grantees and sub grantees must maintain records which adequately identify the source and application of funds provided for financially-assisted activities. These records must contain information pertaining to grant or sub grant awards and authorizations, obligations, unobligated balances, assets, liabilities, outlays or expenditures, and income.”

Cause and effect:

Internal controls over recording and reconciliation of accounting records at the Federal Programs Office are inadequate. Also, there are no proper procedures for verification and reconciliation of accounting data between the Finance Department and the Federal Programs Office. As indicated by personnel of this Office, personnel turnover is one of the reasons for this situation.

COMMONWEALTH OF PUERTO RICO
Municipality of Guánica

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - Continued

Year ended June 30, 2003

III. Findings and questioned costs related to federal awards:

Reference Number: 2003 III-3 (continued)

Recommendation:

A complete review of the program records should be performed to assure that all transactions are adequately posted. As part of this process, records should be reconciled with centralized accounting records and pass-through entity records. Personnel should be trained in accounting matters and verification controls should be established between the Federal Programs Office and the Finance Department.

COMMONWEALTH OF PUERTO RICO
Municipality of Guánica

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - Continued

Year ended June 30, 2003

III. Findings and questioned costs related to federal awards:

Reference Number: 2003 III-4
Agency: U. S. Department of Housing and Urban Development
Pass-through Entity: Office of Commissioner of Municipal Affairs (OCAM)
Program: Community Development Block Grant – State’s Program
CFDA Number: 14.228
Regulation/Requirement: Special Tests and Provisions - tests for compliance with materials donation program
Type: Reportable Condition
Questioned Costs: \$ -0-

Condition and criteria: Our tests to a sample of 6 participants files (from a population of 26 files) of the materials donation program disclosed that the following documents were missing from files:

- a. Evidence of family income – one case
- b. Copy of ID card – one case
- c. Copy of social security card – one case
- d. Requisition of materials (estimate) – one case
- e. Evidence of the receipt of the materials – three cases
- f. Final inspection not completed - three cases

Program regulations require that these documents should be requested to participants or prepared by Federal Programs Office personnel.

Cause and effect: Established internal controls related to participants files documentation are not been followed by Federal Programs Office personnel.

Recommendation: Personnel of the Federal Programs Office should strictly follow established procedures for requesting and preparation of information to be included in participants files. Information of evidence of materials receipt and use is critical to measure program performance. The internal auditor should perform an audit of participant files to identify and request missing information.

COMMONWEALTH OF PUERTO RICO
Municipality of Guánica

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

Year ended June 30, 2003

I. Findings related to the financial statements reported in accordance with GAGAS:

Fiscal year ended June 30,	Finding No.	Condition	Status
2002	2002 II-1	The Municipality has not properly implemented and established internal controls and procedures to maintain adequate, complete and reconciled set of accounting records and reports.	Situation prevails. See current year finding <u>2003 II-2.</u>
2002	2002 II-2	Our tests disclosed that the Municipality has not established adequate controls and procedures over the recording of advances and reimbursements. Also, there is no adequate follow up over amounts to be reimbursed to assure proper and timely repayment of advances.	Situation prevails. See current year finding <u>2003 II-3.</u>
2002	2002 II-3	Our tests over the budget and costs control procedures disclosed that the general fund ended with an operational deficit of \$295,214 and a cumulative fund balance deficit of \$1,830,433.	Situation prevails. See current year finding <u>2003 II-3.</u>

COMMONWEALTH OF PUERTO RICO
Municipality of Guánica

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS - Continued

Year ended June 30, 2003

I. Findings related to the financial statements reported in accordance with GAGAS:

Fiscal year ended June 30,	Finding No.	Condition	Status
2002	2002 II-4	The Municipality has not established adequate controls and procedures to assure the completeness, existence and valuation of fixed assets inventories.	Situation prevails. See current year finding <u>2003 II-4</u> .
2002	2002 II-5	Our examination of internal controls and procedures over a sample of 23 cash disbursements revealed several internal controls and/or compliance deficiencies.	Finding remains unclear by the Office of Commissioner of Municipal Affairs. Other matters related to this area were reported to management in a separate letter dated January 26, 2004.
2002	2002 II-6	Our examination of internal controls and procedures over a sample of 12 employee's files revealed several deficiencies.	Finding remains unclear by the Office of Commissioner of Municipal Affairs. Other matters related to this area were reported to management in a separate letter dated January 26, 2004.

COMMONWEALTH OF PUERTO RICO
Municipality of Guánica

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS - Continued

Year ended June 30, 2003

II. Findings and questioned costs related to federal awards:

Fiscal year ended June 30,	Program	No.	Condition	Status
2002	US Department of HUD: Community Development Block Grant State's Program CFDA No. 14.228	2002 III-1	Municipalities are required to request from contractors a certification stating that Entity's Principals are not suspended or debarred from doing business with State or Federal Government or this requirement may be included as a contract clause. Our examination of the only construction contract financed with federal funds disclosed that such clause was not included in contract nor a certification was obtained from contractor.	Finding remains unclear by the Office of Commissioner of Municipal Affairs. No construction contract financed with CDBG funds has been formalized during the fiscal 2002-2003.
2002	US Department of HUD: Community Development Block Grant State's Program CFDA No. 14.228	2002 III-2	Our tests to a sample of 6 participant's files of housing rehabilitation program financed with SBGP funds disclosed documents missing from the files.	Situation prevails. See current year finding <u>2003 III-4</u> .
2002	US Department of HUD: Community Development Block Grant State's Program CFDA No. 14.228	2002 III-3	Condition and criteria: In our examination of controls and procedures used in the administration of federal funds, we noted that for a sample of six (6) receipts and deposits tested, in five (5) cases disbursements were made between seven (7) and twenty-seven (27) days after related funds were deposited by OCAM.	Situation prevails. See current year finding <u>2003 III-1</u> .

COMMONWEALTH OF PUERTO RICO
Municipality of Guánica

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS - Continued

Year ended June 30, 2003

II. Findings and questioned costs related to federal awards:

Fiscal year ended June 30,	Program	No.	Condition	Status
2002	US Department of HUD: Community Development Block Grant State's Program CFDA No. 14.228	2002 III-4	Our examination disclosed that the Municipality has not performed adequate procedures to close Program Years 1994 and 1997.	Finding remains unclear by the Office of Commissioner of Municipal Affairs. No evidence of correction has been submitted by the Municipality.
2002	US Department of HUD: Community Development Block Grant State's Program CFDA No. 14.228	2002 III-5	SBGP program general ledgers are not balanced and complete. Salaries and fringe benefits expenditures amounts are recorded as reimbursed to the general fund instead as when incurred. Also, transactions related to assets and liabilities arising from interfund transactions are not recorded.	Situation prevails. See current year finding <u>2003 III-3</u> .
2000	Federal Emergency Management Agency: Public Assistance Grant CFDA No. 83.544	2000 III-2	Our compliance test of internal controls and procedures related with the administration of Public Assistance Grant program disclosed that in 1 case a disbursement voucher and its supporting documentation was not provided for examination.	Finding and Questioned Costs for \$300,727 remain unclear by grantor.

COMMONWEALTH OF PUERTO RICO
Municipality of Guánica

COMMENTS TO SCHEDULE OF FINDINGS AND QUESTIONED COSTS

FINDING 2003 II-1

Actually the Municipality does not have the resources and funds to eliminate the totally deficit in the next fiscal year. We have established a deficit reduction plan assigning the budgetary credits in the annual budget that permits our economic situation, without affecting the necessary services to our citizen.

FINDING 2003 II-2

We are in process to actualize the reports Form 4(a), bank reconciliations and general ledger to reconcile the records to provide a complete, accurate and reliable set of accounting records and reports.

FINDING 2003 II-3

The Municipality has established control procedures to minimize advances and control the reimbursement of funds to correct this situation and to avoid it happen again.

FINDING 2003 II-4

The municipality have taken all necessary measures to gather the necessary evidence, documentation and information of the capital assets to record the cost properly. We are going to coordinate with our GASB 34 consultants so that they provided the evidence of the determination of the cost of the assets, determine a reasonable useful life and that properly clasify the assets been mentioned.

FINDING 2003 III-1

The Municipality has established the necessary control procedures to assure that this situation do not repeat in the future.

FINDING 2003 III-2

We have intructed the personnel that document all submission of the reports of the program and that reconcile the amounts posted in the program accounting records.

COMMONWEALTH OF PUERTO RICO
Municipality of Guánica

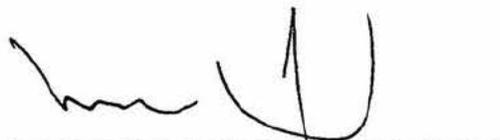
COMMENTS TO SCHEDULE OF FINDINGS AND QUESTIONED COSTS – Continued

FINDING 2003 III-3

We have intructed the HUD and Finance Department personnel that implement control procedures for the adequately recording of transactions and the reconciliation of the accounting records

FINDING 2003 III-4

Personnel of the Federal Programs Office has been instructed to gather the missing evidence or documentation of the indicated participants files and that these documents should be requested to all participants in order to comply with the law and regulations of the Program.



Hon. Martín Vargas Morales
Mayor



Luis A. Pacheco Santiago
Finance Director

