

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

MUNICIPIO DE GUANICA
AUDITORIA 2003-2004
30 DE JUNIO DE 2004

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**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA**

**BASIC FINANCIAL STATEMENTS AND
SUPPLEMENTAL SCHEDULE**

With Independent Auditors' Report Thereon
June 30, 2004

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Basic Financial Statements and
Supplemental Schedule
June 30, 2004**

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Report of Independent Certified Public Accountants

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, 2004, 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.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. 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 opinion.

In our opinion, 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, 2004, 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.

The Management's Discussion and Analysis and the Budgetary Comparison Schedule – General Fund 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 to 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.

2022312



Rodríguez Rivera & Toro LLP

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
MANAGEMENT'S 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, 2004. 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). In this statement the condensed Statements of Activities, Balance Sheet, and Statement of Operations for the fiscal year ended June 30, 2004 are presented in a comparative approach to financial statements of fiscal year ended June 30, 2003.

FINANCIAL HIGHLIGHTS

a) Government-Wide Highlights

- **Assets** – The Municipality has reported assets amounting to \$19.1 million in the accompanying statement of net assets, of which the most significant are capital assets, cash and cash equivalents, and tax receivables amounting to \$13.2 million, \$3.2 million, and \$1.3 million, respectively.
- **Liabilities** – The Municipality has reported liabilities amounting to \$12.0 million in the accompanying statement of net assets, of which the most significant are bonds and notes payable, deferred revenues, compensated absences, and accounts payable amounting to \$7.3 millions, \$1.8 millions, \$0.9 millions and \$1.3 millions respectively.
- **Net assets** – The assets of the Municipality exceeded its liabilities by \$7.1 millions at June 30, 2004, which is presented as “net assets” in the accompanying statement of net assets. Restricted net assets and unrestricted deficit amounted to \$2.1 millions and \$6.4 millions, respectively. Net assets invested in capital assets amounted to \$11.3 millions.
- **Net change in net assets** – The Municipality's net assets increased by \$2.9 millions during fiscal year ended June 30, 2004. Net assets at June 30, 2003 (as restated) amounted to \$4.1 millions. The increase in net assets represents a positive result of operations and an improvement in the Municipality's overall financial position in comparison with the prior fiscal year.
- **Revenues** – The Municipality has reported total revenues amounting to \$12.6 millions in the accompanying statement of activities, of which the most significant are tax revenues, intergovernmental grants and contributions and taxes amounting to \$9.3 millions and \$2.7 millions, respectively.

- *Expenses* – The Municipality has reported total expenses amounting to \$9.7 millions in the accompanying statement of activities.

b) Governmental Funds Highlights

- *Assets* – The Municipality’s governmental funds have reported combined assets amounting to \$7.0 millions in the accompanying balance sheet – governmental funds, of which the most significant are cash, due from other funds, taxes receivable and grants and contributions amounting to \$3.2 millions, \$1.1 millions, \$1.0 millions and \$1.2 millions, respectively.
- *Liabilities* – The Municipality’s governmental funds have reported combined liabilities amounting to \$4.6 millions in the accompanying balance sheet – governmental funds, of which the most significant are deferred revenues, due to other funds and advances, and accounts payable amounting to \$1.9 millions, \$ 1.1 millions and \$1.2 millions respectively.
- *Governmental fund balances* – The Municipality’s governmental funds reported combined fund balances amounting to \$2.4 millions, of which \$2.2 millions and \$0.2 millions represent reserved and unreserved fund balances, respectively.
- *Net change in governmental fund balances* – The Municipality’s governmental fund balances decreased by \$1.3 millions during fiscal year ended June 30, 2004. Governmental fund balances at June 30, 2003, as restated, amounted to \$3.7 millions. The decrease in net assets represents the excess of expenditures and other financing uses over revenues and other financing sources.
- *Revenues* – The Municipality’s governmental funds have reported combined revenues amounting to \$12.4 millions in the accompanying statement of revenues, expenditures and changes in fund balances – governmental funds, of which the most significant are intergovernmental grants and contributions, property taxes and construction excise taxes amounting to \$9.3 millions, \$1.6 millions and \$0.7 millions, respectively.
- *Expenditures* – The Municipality’s governmental funds have reported combined expenditures amounting to \$14.5 millions in the accompanying statement of revenues, expenditures and changes in fund balances – governmental funds, of which the most significant are categorized as capital outlays; general government; public housing and welfare; health and sanitation; urban and economic development and public safety amounting to \$4.5 millions, \$3.0 millions, \$2.0 millions, 1.9 millions, \$1.3 millions and \$0.9 millions respectively.

USING THIS ANNUAL REPORT

This annual report consist of a series of new financial statements with a change in the focus from the previous financial statements. The new focus is on both the Municipality as a whole (government-wide) and the major individual funds. Both perspectives (government-wide and major fund) 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.

OVERVIEW OF THE BASIC FINANCIAL STATEMENTS

The Municipality's financial statements include three components: (1) the government-wide financial statements, (2) the fund financial statements, and (3) the notes to the financial statements (collectively known as the basic financial statements). This report also contains additional required supplementary information (budgetary schedules) in addition to the basic financial statements themselves. These components are described below:

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 the end of the fiscal year. 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 businesses. They take into account all revenues and expenses connected with the fiscal year ended June 30, 2004 even if cash involved have not been received or paid. The government-wide financial statements include: (1) the statements of net assets and (2) the statement of activities.

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.

Statement of Activities

The statement of activities presents information showing how the Municipality's net assets changed during the fiscal year ended June 30, 2004. 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 the governmental activities of the Municipality, which consist mostly by taxes and intergovernmental revenues (such as federal grants). Most services provided by the Municipality fall into this category, including culture and education, general government, health and sanitation, public safety, public housing and welfare, etc.

Fund Financial Statements

The Municipality's fund financial statements, which 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.

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 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 spendable resources. They also focus on the balances of spendable resources available at the end of the fiscal year (June 30, 2004). 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.

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.

For financial reporting purposes the Municipality has three major funds: (1) the general fund, (2) the State Legislative joint resolutions fund and (3) the debt service fund.

Notes to the Basic Financial Statements

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

Required Supplementary Information

The basic financial statements are followed by a section of required supplementary information consisting of a budgetary comparison between actual operating results with the original budget and the final amended budget for the general fund.

INFRASTRUCTURE ASSETS

Historically, a government's largest group of assets (infrastructure – roads, bridges, traffic signals, underground pipes [unless associated with a utility], etc.) have not been reported nor depreciated in governmental financial statements. GASB 34 requires that these assets be valued and reported within the governmental column of the Government-Wide Financial Statements. Additionally, the government must elect 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 government develops the asset management system (modified approach) which periodically (at least every third year), by category, measures and demonstrates its maintenance of locally established levels of service standards, the government may record its cost of maintenance in lieu of depreciation. The information about the condition and maintenance of condition of the government infrastructure assets should assist financial statement users in evaluating a local government and its performance over time.

As of July 1, 2002, the Municipality retroactively recorded the historical costs of infrastructure assets. Also the Municipality elected to depreciate infrastructure assets instead of using the modified approach.

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE

Net Assets

As noted earlier, net assets may serve over time as a useful indicator of the Municipality's financial position. In the case of the Municipality, net assets (excess of assets over liabilities) amounted to \$8.4 millions at June 30, 2004, compared to \$5.0 millions at the end of the previous year, as restated.

The largest portion of the Municipality's net assets are invested in capital assets net of their related debt (\$11.3 millions). The Municipality's net assets is also composed of net assets amounting to \$2.1 millions that are restricted for (1) future debt service payments, (2) the future acquisition or construction of capital assets and (3) other purposes, mainly the financing of federal and state assisted programs. In addition, the Municipality's net asset are reported net of an unrestricted deficit of \$5.2 millions.

The unrestricted deficit is the consequence of previous budgets which did not provide funding for incurred long-term obligations such as compensated absences and others. Historically, such obligations have been budgeted on a pay as you go basis without providing funding for their future liquidation. Consequently, the Municipality cannot draw from its existing assets to provide services to its citizens and depends on its taxing ability to continue its operations.

The portion of the Municipality's net assets invested in capital assets such as land, buildings, equipment, etc., less any outstanding related debt used to acquire those assets., are used by the Municipality to provide services to its citizens; consequently these assets are not available for future spending. Although the Municipality's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from the debt service fund, since the capital assets themselves cannot be used to liquidate these liabilities.

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

Condensed Statement of Net Assets:

Current assets	\$ 5,856,423
Noncurrent assets	<u>13,269,520</u>
Total assets	<u>19,125,943</u>
Current liabilities outstanding	4,930,028
Noncurrent liabilities outstanding	<u>7,143,862</u>
Total liabilities	<u>12,073,890</u>
Net assets/(liabilities):	
Invested in capital assets, net of related debt	11,329,019
Restricted	2,107,870
Unrestricted	<u>(6,384,836)</u>
Total net assets	<u>\$ 7,052,053</u>

Changes in Net Assets

The Municipality's net assets increased by \$2.9 millions. Approximately 24 percent of the Municipality's total revenues came from taxes, while 71 percent resulted from restricted and unrestricted capital and operating grants, contributions and reimbursements, including federal financial assistance. The Municipality's expenses cover a range of services. The largest expenses were for general government (30 percent), public housing and welfare (23 percent) and health and sanitation (21 percent).

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

FINANCIAL ANALYSIS OF THE MUNICIPALITY'S GOVERNMENTAL FUNDS

As discussed earlier, the Municipality uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

Governmental Funds - The focus of the Municipality's *governmental funds* is to provide information on near-term inflows, outflows, and balance of *spendable 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 fiscal year. The following is a condensed presentation of the Municipality's balance sheet and results of operations of governmental funds:

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

The accompanying statement of net assets reported total gross capital assets, at cost, amounting to \$20,291,614, of which \$2,342,946 represents infrastructure assets at June 30, 2004. The related accumulated depreciation and amortization of capital assets amounted to \$7,048,235, of which \$996,573 is related to infrastructure assets at June 30, 2004. This investment in capital assets includes land, buildings, improvements, equipment, infrastructure and construction in progress. Infrastructure assets are items that are normally immovable and of value only to the municipal government, such as roads, bridges, streets and sidewalks, drainage systems, lighting systems, and similar items.

Actual costs incurred to purchase or construct capital assets were \$4,451,939 for the year ended June 30, 2004. Depreciation and amortization charges for the year totaled \$374,973.

The Municipality finances a significant portion of its construction activities through bond issuances and state and federal grants. The proceeds from bond issuances designated for construction activities are committed in its entirety for such purposes and cannot be used for any other purposes.

Debt Administration

The laws and regulations of the Commonwealth of Puerto Rico have established a limitation for the issuance of general obligation municipal bonds and notes for the payment of which the good faith, credit and taxing power of each municipality may be pledged.

The applicable laws and regulations also require that in order for a municipality to be able to issue additional general obligation bonds and notes, such municipality must have sufficient "payment capacity". Act No. 64 of July 3, 1996 as amended, provides that a municipality has sufficient "payment capacity" to incur additional general obligation debt if the deposits in such municipality's Redemption fund and the annual amounts collected with respect to such municipality's Special Additional Tax (as defined below), as projected by the Government Development Bank for Puerto Rico, will be sufficient to service to maturity the Municipality's outstanding general obligation debt and the additional proposed general obligation debt ("Payment Capacity").

The Municipality is required under applicable laws and regulations to levy the Special Additional Tax in such amounts as shall be required for the payment of its general obligation municipal bonds and notes. In addition, principal of and interest on all general obligation municipal bonds and notes and on all municipal notes issued in anticipation of the issuance of general obligation bonds issued by the Municipality constitute a first lien on the Municipality's Basic Tax revenues. Accordingly, the Municipality's Basic Tax revenues would be available to make debt service payments on general obligation municipal bonds and notes to the extent that the Special Additional Tax Levied by the Municipality, together with moneys on deposit in the Municipality's Redemption Fund, are not sufficient to cover such debt service. It has never been necessary to apply Basic Taxes to pay debt service on general obligation debt of the Municipality.

ECONOMIC FACTORS AND NEXT BUDGETS AND RATES

The Municipality relies primarily on property and municipal license taxes, as well as, federal and state grants to carry out the governmental activities. Historically, property and municipal license taxes have

been very predictable with increases not generally exceeding ten percent. Federal grant revenues may vary if new grants are available but the revenue is also very predictable.

Those factors were considered when preparing the Municipality's budget for the 2003-2004 fiscal year. There were no significant changes between the budget for fiscal year 2002-2003 and the one for fiscal year 2003-2004.

FINANCIAL CONTACT

The Municipality's financial statements are designed to present users (citizens, taxpayers, customers, investors and creditors) with a general overview of the Municipality's finances and demonstrate the Municipality's accountability. If you have any questions about the report or need additional financial information, contact the Municipality's Director of Finance, Mr. Luis A. Pacheco Santiago, at PO Box 785, Guánica, Puerto Rico, 00653.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Statement of Net Assets
June 30, 2004

Assets	<u>Governmental activities</u>
Current assets:	
Cash in commercial banks	\$ 485,709
Accounts receivable:	
Taxes:	
Property taxes (including \$46,804 related to amnesty), net of allowance for doubtful accounts of \$1,139,004	990,432
Municipal license taxes	57,962
Grants and contributions	1,231,582
Accrued interest	2,247
Other	375
Inventories	22,203
Prepaid expenses	14,246
Restricted assets:	
Cash in commercial banks	1,163,167
Cash in fiscal agents	991,658
Cash equivalents in commercial banks	603,920
Property taxes, net of allowance for doubtful accounts of \$339,070	292,922
Total current assets	<u>5,856,423</u>
Noncurrent assets:	
Capital assets, net of accumulated depreciation and amortization of \$7,048,235	13,243,379
Deferred charges, net of accumulated amortization of \$34,077	26,141
Total noncurrent assets	<u>13,269,520</u>
Total assets	<u>\$ 19,125,943</u>

The accompanying notes are an integral part of this statement.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Statement of Net Assets (continued)
June 30, 2004

Liabilities and net assets	Governmental activities
Current liabilities (due within one year):	
Accounts payable	\$ 1,260,634
Intergovernmental payables	322,767
Accrued employees' christmas bonus	129,835
Accrued interest payable on long-term debt	128,415
Unearned revenues	1,837,789
Current portion of long-term obligations (due within one year):	
Bonds payable	225,000
Notes payable	124,194
Obligation under capital leases	4,496
Compensated absences	721,450
Claims and judgments	175,448
Total current liabilities	4,930,028
Noncurrent liabilities (due in more than one year) :	
Bonds payable	3,369,000
Notes payable	3,556,079
Obligation under capital leases	15,796
Compensated absences	202,987
Total noncurrent liabilities	7,143,862
Total liabilities	12,073,890
Net assets:	
Invested in capital assets, net of related debt	11,329,019
Restricted for:	
Debt service	\$ 467,205
Capital projects	1,111,142
Other specified purposes	529,523
Total restricted net assets	2,107,870
Unrestricted deficit	(6,384,836)
Total net assets	\$ 7,052,053

The accompanying notes are an integral part of this statement.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Statement of Activities
Year Ended June 30, 2004

Functions/Programs	Expenses	Program Revenues		Net (expenses) and changes in net assets
		Charges for services	Program specific operating grants and contributions	
Governmental activities:				
General government	\$2,812,042	89,919	-	(2,722,123)
Urban and economic development	1,309,850	14,347	618,209	1,558,831
Public safety	957,240	-	222,660	(688,828)
Health and sanitation	1,983,559	-	-	(1,983,559)
Culture, recreation and education	40,356	4,239	171,920	135,803
Public housing and welfare	2,188,705	-	841,921	(773,443)
Interest on long-term obligations	361,717	-	-	(361,717)
Total governmental activities	<u>\$9,653,469</u>	<u>108,505</u>	<u>1,854,710</u>	<u>(4,835,036)</u>
General revenues:				
Taxes:				
Property taxes (including \$158,485 related to amnesty)				1,702,001
Municipal licenses				293,001
Construction excise taxes				667,446
Total taxes				<u>2,662,448</u>
Grants and contributions, not restricted to specific programs				4,566,060
Unrestricted interests on deposits				58,561
Gain on sale of capital assets				118,456
Miscellaneous				369,642
Total general revenues				<u>7,775,167</u>
Net change in net assets				2,940,131
Net assets at beginning of year as restated				<u>4,111,922</u>
Net assets at end of year				<u>\$7,052,053</u>

The accompanying notes are an integral part of this statement.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Balance Sheet – Governmental Funds
June 30, 2004

	<u>Major funds</u>				<u>Total governmental funds</u>
	<u>General Fund</u>	<u>State legislative joint resolutions fund</u>	<u>Debt service fund</u>	<u>Other governmental funds</u>	
Assets					
Cash in commercial banks	\$ 485,709	-	-	-	\$ 485,709
Prepaid expenses	14,246	-	-	-	14,246
Inventories	22,203	-	-	-	22,203
Accounts receivable, net of allowance for uncollectible accounts:					
Taxes:					
Property taxes (including amounts related to amnesty)	990,432	-	9,208	-	999,640
Municipal licenses	57,962	-	-	-	57,962
Due from other funds	708,392	325,583	114,321	-	1,148,296
Accrued interest	-	429	216	1,601	2,246
Grants and contributions	60,304	-	-	1,171,278	1,231,582
Other	377	-	-	-	377
Restricted assets:					
Cash in commercial banks	-	801,014	-	362,153	1,163,167
Cash in fiscal agents	114,925	-	358,359	518,374	991,658
Cash equivalents	-	603,920	-	-	603,920
Property taxes receivable, net of allowance for uncollectible accounts	-	-	283,714	-	283,714
Total assets	<u>\$ 2,454,550</u>	<u>1,730,946</u>	<u>765,818</u>	<u>2,053,406</u>	<u>\$ 7,004,720</u>
Liabilities					
Accounts payable and accrued liabilities	\$ 437,590	47,749	-	668,152	\$ 1,153,491
Intergovernmental	59,956	-	-	332	60,288
Due to other funds	114,321	-	-	708,392	822,713
Advances from other funds	325,583	-	-	-	325,583
Deferred revenues	1,255,971	-	279,523	362,599	1,898,093
Matured bonds due and payable	-	-	204,000	-	204,000
Matured interest due and payable	-	-	94,614	-	94,614
Total liabilities	<u>2,193,421</u>	<u>47,749</u>	<u>578,137</u>	<u>1,739,475</u>	<u>4,558,782</u>
Fund balances					
Reserved for:					
Encumbrances	36,150	-	-	-	36,150
Capital projects	-	1,180,655	-	286,950	1,467,605
Debt service	-	-	187,681	-	187,681
Advances	-	325,583	-	-	325,583
Inventories and other current assets	36,449	-	-	-	36,449
Other specified purposes	-	176,959	-	26,981	203,940
Unreserved	188,530	-	-	-	188,530
Total fund balances	<u>261,129</u>	<u>1,683,197</u>	<u>187,681</u>	<u>313,931</u>	<u>2,445,938</u>
Total liabilities and fund balances	<u>\$ 2,454,550</u>	<u>1,730,946</u>	<u>765,818</u>	<u>2,053,406</u>	<u>\$ 7,004,720</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Statement of Revenues, Expenditures and
Changes in Fund Balances – Governmental Funds
Year Ended June 30, 2004

	Major funds				Total governmental Funds
	General Fund	State legislative joint resolutions fund	Debt service fund	Other governmental funds	
Revenues:					
Taxes:					
Property taxes (including amounts related to amnesty)	\$ 1,322,513	-	325,345	-	1,647,858
Municipal license taxes	295,010	-	-	-	295,010
Construction excise taxes	667,446	-	-	-	667,446
Charges for services	89,919	-	-	18,586	108,505
Grants and contributions	4,567,465	1,546,013	-	3,163,915	9,277,393
Interests on deposits	214	23,300	1,947	33,100	58,561
Miscellaneous	369,642	-	-	-	369,642
Total revenues	7,312,209	1,569,313	327,292	3,215,601	12,424,415
Expenditures:					
Current:					
General government	3,095,578	-	-	-	3,095,578
Urban and economic development	673,806	-	-	618,208	1,292,014
Public safety	644,502	-	-	222,660	867,162
Health and sanitation	1,872,527	-	-	-	1,872,527
Culture, recreation and education	-	-	-	19,866	19,866
Public housing and welfare	377,204	577,066	-	1,052,509	2,006,779
Debt service:					
Principal	268,031	-	224,000	-	492,031
Interest	159,833	-	192,326	-	352,159
Capital outlays:	163,608	2,115,173	416,326	2,173,158	4,451,939
Total expenditures	7,255,089	2,692,239	416,326	4,086,401	14,450,055
Excess (deficiency) of revenues over (under) expenditures	57,120	(1,122,926)	(89,034)	(870,800)	(2,025,640)
Other financing sources (uses):					
Proceeds from issuance of notes payable:					
Puerto Rico Treasury Department	2,000,000	-	-	-	2,000,000
Puerto Rico Aqueduct and Sewer Authority	8,269	-	-	-	8,269
Puerto Rico Land Authority	250,000	-	-	-	250,000
Proceeds from sale of capital asset	150,000	-	-	-	150,000
Capital leases	14,722	-	-	-	14,722
Transfers-in from other funds	58,119	-	160,850	-	218,969
Transfers-out to other funds	(160,850)	(23,300)	(1,947)	(32,872)	(218,969)
Discount on notes payable to Puerto Rico Land Authority	(114,980)	-	-	-	(114,980)
Discount on notes payable to Puerto Rico Treasury Department	(364,823)	-	-	-	(364,823)
Total other financing sources, net	1,840,457	(23,300)	158,903	(32,872)	1,943,188
Excess (deficiency) of revenues and other financing sources over (under) expenditures and other financing uses	1,897,577	(1,146,226)	69,869	(903,672)	(82,452)
Special Items – gain/(losses):					
Proceeds on legal settlement award	458,420	-	-	-	458,420
Payment of legal case settlement	(1,635,177)	-	-	-	(1,635,177)
Total special items, net	(1,176,757)	-	-	-	(1,176,757)

Excess (deficiency) of revenues, other financing sources and special items over (under) expenditures, other financing uses and special items	720,820	(1,146,226)	69,869	(903,672)	(1,259,209)
Fund balance (deficit) at beginning of year, as restated	<u>(459,691)</u>	<u>2,829,423</u>	<u>117,812</u>	<u>1,217,603</u>	<u>3,705,147</u>
Fund balance at end of year	<u>\$ 261,129</u>	<u>1,683,197</u>	<u>187,681</u>	<u>313,931</u>	<u>\$ 2,445,938</u>

The accompanying notes are an integral part of this statement

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA
 Reconciliation of the Balance Sheet - Governmental Funds
 to the Statement of Net Assets
 June 30, 2004

Aggregate fund balance reported in the balance sheet - governmental funds	\$	2,445,938
Governmental activities' amounts reported in the statement of net assets and the balance sheet - governmental funds are different because:		
Capital assets used in governmental activities are not financial resources, therefore, are not reported in the governmental funds		13,243,379
Debt issued by the Municipality has associated costs that are paid from current available financial resources in the governmental funds. However, these costs are deferred in the statement of net assets		26,141
Deferred (unavailable) revenues in the governmental funds that are recorded as revenues in the statement of activities		60,304
The following liabilities are not due (mature) in the current period, therefore, are not reported in the governmental funds:		
Accounts payable		(107,143)
Intergovernmental payables		(262,479)
Accrued employees' christmas bonus		(129,835)
Claims and judgments		(175,448)
Compensated absences		(924,437)
Obligation under capital leases		(20,292)
Bonds payable		(3,594,000)
Notes payable		(3,680,273)
Accrued interest payable		(33,801)
Other reconciling items		<u>203,999</u>
Net change in net assets as reported in the accompanying statement of activities	\$	<u>7,052,053</u>

The accompanying notes are an integral part of this statement.

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**COMMONWEALTH OF PUERTO RICO
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Reconciliation of Statement of Revenues, Expenditures and Changes in Fund Balances -
Governmental Funds to the Statement of Activities
Year Ended June 30, 2004

Deficiency of revenues, other financing sources and special item under expenditures and other financing uses, as reported in the accompanying statement of revenues, expenditures and changes in fund balances - governmental funds	\$ (1,259,209)
Governmental funds report capital outlays as expenditures. However, in the accompanying statement of activities, the cost of those assets is allocated over their estimated useful lives as depreciation expense. This is the amount by which capital outlays exceeded depreciation in the current period.	4,076,965
Property tax revenues in the statement of activities that do not provide current financial resources are not reported as revenue in the fund financial statements.	54,143
Proceeds on issuance of notes, net of related discounts, are recorded as other financing sources in the fund financial statements, but the issuances increases long-term liabilities in the statement of net assets.	(1,778,466)
2002-2003 statement of net assets within legal claims and judgments, while such amounts were recorded as special item (loss) in the current year fund financial statements.	1,635,177
Legal case settlement award collected during fiscal year ended June 30, 2004 were accrued in the 2002-2003 statement of net assets within intergovernmental receivables, while such amounts were recorded as special item (gain) in the current year fund financial statements.	(458,420)
Additions to obligations under capital leases are recorded as other financing sources in the fund financial statements, but such additions increase long-term liabilities in the statement of net assets.	(14,722)
Governmental funds report proceeds on sale of capital assets as other financing sources. However, in the accompanying statement of activities, only the gain on sale of capital assets is recorded in the statement of activities. This is the amount by which the proceeds exceeded the gain on sale in the current period.	(31,544)
Repayment of bond and notes principal is recorded as expenditures in the governmental funds, but the repayment reduces long-term liabilities in the statement of net assets.	492,031
In the statement of activities, interest is accrued on outstanding bonds, whereas in governmental funds, interest expenditure is reported when due.	(9,558)
financial resources and therefore are not reported as expenditures in governmental funds.	<u>(137,826)</u>
Other reconciling items	<u>371,560</u>
Net change in net assets as reported in the accompanying statement of activities	<u>\$ 2,940,131</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Notes to Basic Financial Statements
June 30, 2004

1. Summary of Significant Accounting Policies

The Municipality of Guánica of the Commonwealth of Puerto Rico (the "Municipality") is a local government with full legislative, fiscal and administrative powers to operate as a government under Law No. 81 of August 30, 1991, as amended, known as the *Autonomous Municipalities Act of the Commonwealth of Puerto Rico (Law No. 81)*.

The Municipality's governmental system consists of executive and legislative branches. The Constitution of the Commonwealth of Puerto Rico (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 to its citizens related to public housing, welfare, public safety, health, sanitation, education, culture, recreation, urban and economic development, and many other general and administrative duties.

a) New Financial Reporting Model

The accompanying basic financial statements present the financial position and the results of operations of the Municipality as a whole, and its various governmental funds as of and for the year ended June 30, 2004, in conformity with accounting principles generally accepted in the United States of America, as prescribed by the Governmental Accounting Standards Board (GASB).

In June 1999, GASB issued Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments* (GASB No. 34). This statement established new financial reporting requirements for state and local governments. On July 1, 2002, the Municipality adopted the provisions of GASB No. 34 as well as other statements referred to below. These statements require the reporting of new financial information and restructured much of the information that governments have reported prior to July 1, 2002. Accordingly, comparability with financial statements issued for years ended June 30, 2002 or before, 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) governmental fund financial statements (GFFS), (3) notes to basic financial statements, and (4) required supplementary information (RSI).

The RSI, which consists of a management discussion and analysis (MD&A), is information presented along with, but separate from, the Municipality's basic financial statements. The MD&A is a narrative report that introduces the accompanying basic financial statements and

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Notes to Basic Financial Statements
June 30, 2004

provides an analytical overview of the Municipality's financial activities for the year ended June 30, 2004, 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, on July 1, 2002, other statements and interpretations were also adopted in conjunction and simultaneously with GASB No. 34. Those statements and interpretations are: (1) GASB Statement No. 33 – *Accounting and Financial Reporting for Nonexchange Transactions*, (2) GASB Statement No. 37 – *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments: Omnibus*, (3) GASB Statement No. 38 – *Certain Financial Statement Note Disclosures* and (4) GASB Interpretation No. 6 – *Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements*.

GASB No. 34 also required 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, in conjunction and 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.

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 and Budget, as prescribed by Law No. 81.

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 basic financial statements from those of the Municipality would cause the Municipality's basic financial statements to be misleading or incomplete.

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.

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On July 1, 2003, the Municipality adopted the provisions of GASB Statement No. 39 – *Determining Whether Certain Organizations are Component Units* (GASB No. 39). This statement provides additional guidance in determining whether certain organizations for which the primary government is not financially accountable should be reported as component units based on the nature and significance of their relationship with the primary government. Generally, GASB No. 39 requires reporting a component unit if an organization raises and holds economic resources for the direct benefit of a governmental unit.

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, 2004 nor for the year then ended.

c) *Government-wide Financial Statements*

The accompanying 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 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.

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). 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 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, reduced by the outstanding balances of bonds, notes and 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,

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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 unamortized 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 identifies 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 that are imposed by management, but can be removed or modified.

When both restricted and unrestricted resources are available for use, it is the Municipality's policy to 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, 2004, using a 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

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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 and budget
- Department of human resources
- Department of municipal secretary
- Department of internal audit

Urban and economic development:

- Department of public works
- Department of tourism

Public safety:

- Department of municipal police
- Department of emergency management

Health and sanitation

- Department of health
- Department of sanitation

Culture, recreation and education:

- Department of recreation and sports

Public housing and welfare:

- Department of elderly affairs
- Department of federal programs

The statement of activities demonstrates the degree to which program revenues offset direct expenses of a given function/program or segments. 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 citizens. In the statement of activities, program revenues reduce the costs (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:

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- **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 nontax revenues (including unrestricted investment earnings, grants and contributions not restricted for specific programs, and miscellaneous revenues) 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.

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 governmental 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.

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These governmental activities are also generally reported in the governmental fund financial statements.

The Municipality has no 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 operations or activities that are primarily 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.

d) Governmental Fund Financial Statements

The accompanying 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. Some of these financial statements 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 (one fiscal 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:

- **General fund** – The general fund is the Municipality's main 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. 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 governmental fund other than the general fund.
- **Special revenue funds** – The special revenue funds are nonmajor funds, as defined below, 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

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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 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. Principal and accrued interest due on July 1 of the following fiscal year related to long-term debt for which debt service payments are accounted for in the debt service fund, are recorded as debt service fund's liabilities at June 30, if resources are available at June 30 for its payment.

General long-term debts for which debt service payments do not involve the advance accumulation of resources (such as obligations under capital leases, compensated absences, claims and judgments, and notes payable, among others) are accounted for in the accompanying statement of net assets. The debt service payments of such debts are generally accounted for in the general fund.

- **Capital projects funds** – Capital projects funds are major and nonmajor 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 certain vehicles and other minor capital assets) have been reported in the fund from which financial resources were used for the purchase.

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 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 within the governmental fund financial statements. Major individual governmental funds are reported 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.

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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, and (3) the debt service fund.

The state legislative joint resolutions fund is a major fund used to account for financial resources derived from capital and 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.

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 interest income) 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), which the Municipality adopted on July 1, 2002. GASB No. 33 established accounting and reporting standards for nonexchange

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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, (c) government mandated nonexchange transactions, and (d) voluntary nonexchange transactions.

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 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 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 as follows:

- For reimbursement-type (commonly known as "expenditure-driven awards"), receivables and revenues are recorded when all eligibility requirements imposed by the provider have been met. The Municipality must expend resources on the specific purpose or project before the provider reimburses any amounts. Revenue is, therefore, generally recognized as qualifying reimbursable expenditures are incurred.
- For other types of grants (mainly grants and contributions with purpose restrictions but with no time requirements), receivables and revenues are recorded when all applicable eligibility requirements are met. When the provider is a government (including the government of the United States of America) the applicable recognition period for both, the provider and the recipient, is the provider's fiscal year and begins on the first day of that year.

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 types of transactions, receivables and revenues are generally

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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 reconciliations 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 generally 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, 2004, except for property taxes for which the availability period is 60 days. Revenue sources not meeting this availability criterion or collected in advance are recorded as deferred revenues at June 30, 2004. The principal revenue sources considered susceptible to accrual include property taxes, municipal license taxes, intergovernmental grants and contributions and interest income. These principal revenue sources meet both measurability and availability criteria in the accompanying GFFS, except for amounts recorded as deferred revenues.

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 in a similar manner to the GWFS, using the previously discussed criteria set forth by GASB No. 33 for nonexchange transactions, 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 reimbursement-type grants, contributions, donations and entitlements are also generally recorded as qualifying reimbursable expenditures are incurred ,

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while receivables and revenues from other types of grants are recorded when all eligibility requirements imposed by the provider have been met.

Interest income is recorded when earned only if collected within 90 days after year-end since these 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 consumed. The amount of the unpaid compensated absences has been reported only in the accompanying statements of net assets.
- 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 fund (generally June 30).
- Obligations under capital leases, amounts subject to claims and judgments under litigation and other long-term obligations are recorded only when they mature (when payment is due).
- Accounts payable and accrued liabilities not expected to be liquidated with available and expendable financial resources are recorded in the accompanying statement of net assets but not in the governmental funds.
- Executory purchase orders and contracts are recorded as a reservation of fund balance in the GFFS.

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.

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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 recorded in the accompanying statement of activities, but are not recorded 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 incorporated into the accompanying statement of net assets since July 1, 2002.

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 annual budgets each fiscal year for the Municipality's general fund and debt service fund. Such legally adopted budgets are based on expected expenditures by program and estimated resources by source for both funds. The annual budgets are developed using elements of performance-based program budgeting and zero-based budgeting, and include estimates 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.

The Municipal Legislature has 10 business days, up to June 13, to discuss and approve the Project with modifications. The Municipal Legislature may amend the budgets 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 approves 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 budgets. The Mayor may also veto the budgets in their entirety and return it to the Municipal Legislature with his objections. If the Mayor rejects the Project, 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 the budgets are not adopted prior to the end of the deadlines referred to above, the annual budgets for the preceding fiscal year, as approved by the Legislature and the Mayor, are automatically renewed for the ensuing fiscal year until the Municipal Legislature and the Mayor

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approve new budgets. This permits the Municipality to continue making payments for its operations and other purposes until the new budgets are approved.

The annual budgets 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 budgets, which are subject to the approval of the Municipal Legislature.

The Municipality's Department of Finance and Budget has the responsibility to ensure that budgetary spending control is maintained. 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. The Municipal Legislature may transfer amounts among programs within and among funds.

The legal level of budgetary control (i.e., the level at which expenditures may not legally exceed appropriation) is at the functions/program level (general government, urban and economic development, public safety, health and sanitation, culture, recreation and education, and public housing and welfare) within a fund.

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.

Budgetary Accounting

The Municipality's annual budgets are prepared under the budgetary (statutory) 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.

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.

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The accompanying budgetary comparison schedule 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, 2004. Further details of the Municipality's budgetary control at the legal level may be obtained from the Budgetary Liquidation Report for the fiscal year ended June 30, 2004, which is prepared by the Municipality's Department of Finance and Budget. Copies of that report may be obtained by writing to the Municipality's Director of Finance and Budget.

Accounting principles applied for purposes of developing data on a budgetary basis differ significantly from those used to present the governmental fund financial statements in conformity with GAAP. Accordingly, the accompanying budgetary comparison schedule is accompanied by a reconciliation of the differences between the budgetary basis and GAAP actual amounts.

The Municipality does not legally adopt budgets for the state legislative joint resolutions capital fund. The financial resources received by these funds are not subject to budgeting by the Municipality since the resources received each year from the respective grantors vary from year to year, and the respective amounts are granted at their discretion.

g) *Unrestricted and Restricted Deposits*

The Municipality's deposits are composed of cash on hand, demand deposits and cash equivalents in: (1) commercial banks, (2) 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, and (3) the Municipal Revenue Collection Center (CRIM, by its Spanish acronyms), a governmental entity responsible for the imposition and collection of property taxes on behalf of all municipalities of Puerto Rico.

The Municipality follows the practice of pooling cash. The balance in the pooled cash account is available to meet current operating requirements. 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 by agents designated by the Secretary of the Treasury of the Commonwealth, but not in the Municipality's name.

Restricted assets include cash and cash equivalents in commercial banks, GDB and CRIM. These cash balances are classified as restricted assets since its use is limited for the specified purposes discussed below, which are established by applicable agreements or required by law.

Restricted cash with fiscal agent in the general and debt service funds represent property tax collections which are retained and restricted for the payment of the Municipality's debt service, as established by law. Restricted cash in fiscal agent in other governmental funds consists of unspent proceeds of bonds and notes, and the balance of interest and noninterest bearing accounts which are restricted for: (1) the acquisition, construction or improvement of major capital assets and the operations of federal and state funded programs.

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Restricted cash includes cash equivalents amounting to \$603,920 at June 30, 2004, consisting of certificates of deposit with original maturities of three months or less. These cash equivalents are recorded in the state legislative joint resolutions fund, consequently, are restricted for use in specific activities accounted for in such fund.

h) Unrestricted and Restricted Accounts and Notes Receivable

In the accompanying GWFS, receivables consist of all revenues earned but not collected at June 30, 2004. 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. Restricted 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.

Intergovernmental receivables are composed of: (1) amounts owed to the Municipality for reimbursement of expenditures incurred pursuant to federal and state funded programs (recorded in the general fund, special revenue funds and capital project funds), and (2) contributions in lieu of taxes from the Puerto Rico Electric Power Authority, recorded in the general fund.

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.

Activities among 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.

i) Inventories and Other Current Assets

Inventories and other current assets consist of materials, supplies, food and medicine inventories held for consumption; and prepaid costs. Generally, inventories and other current assets are capitalized (consumption method). Inventories are stated at cost using the first-in, first-out method (FIFO).

j) 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

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in the current period as expenditures, whether or not withheld from the actual debt proceeds received.

k) 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 statement of net assets. Infrastructure assets are generally stationary in nature and include roads, bridges, streets and sidewalks, drainage systems and other similar assets.

The Municipality defines capital assets as assets with an individual cost of \$500 or more at the date of acquisition or construction, and with 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 accompanying statement of activities. In the governmental funds, all capital assets are recorded as expenditures.

In the 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 or after the year ended June 30, 2003.

Major outlays for capital assets and improvements are capitalized in the statement of net assets 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:

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	<u>Years</u>
Land improvements	20
Buildings, structures and building improvements	30 to 50
Infrastructure	20 to 50
Licensed 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.

l) 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 (60 days for property taxes) thereafter to pay obligations due at June 30, or;
- The Municipality receives resources before it has a legal claim to them. In subsequent periods, when the revenue recognition criterion is met, 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.

m) 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 accompanying statement of net assets is limited to leave that: (1) is attributable to services already rendered on or before June 30, 2004 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

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includes 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 and medicare taxes).

The vacation policy of the Municipality is established by law and provides for the accumulation of regular vacations at a rate of 2.5 days per month (30 days per year) per employee. Employees accumulate regular sick leave at a rate of 1.5 days per month (18 days per year). Employees accumulate compensatory time 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 is not paid to the employee, if not consumed. 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 employee 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.

n) Long-term Debt

The long-term liabilities reported in the accompanying statements of net assets include the Municipality's bonds, 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 accompanying statement of net assets. Principal and interest payments on bonds due in July 1 of the following fiscal year, are recorded as fund liabilities in the GFFS when resources are available in the debt service fund (generally at June 30). In the GFFS, the face amount of debt issued is reported as other financing sources when issued.

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 such costs are recognized as expenditures during the current period.

On July 1, 2002, the Municipality adopted the provisions of APB Opinion No. 21, *Interest on Receivables and Payables* (APB No. 21), to account for certain non-interest bearing notes payable to: (1) CRIM, (2) Puerto Rico Land Authority and Puerto Rico Aqueduct and Sewer Authority, two discretely presented component units of the Commonwealth, and (3) Puerto Rico Treasury Department and Puerto Rico Department of Labor and Human Resources, two agencies (governmental units) of the primary government of the Commonwealth.

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According to APB No. 21, the Municipality has recorded such 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, such notes payable are reported net of the applicable unamortized discount, which is the difference between the present value and the face amount of the notes. The notes discount is amortized over the life of the notes using the effective interest method. Amortization of the notes discount is recorded as part of interest expense in the statement of activities. In the GFFS, notes discount is recognized as other financing uses during the current period.

o) 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 agreement contains a bargain purchase option.
- The lease term is substantially equal (75% or more) 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 Municipality's lease agreements do not include contingent rental payments nor escalation clauses.

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. A portion of

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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 simultaneously as (1) expenditure and (2) other financing source. Minimum lease payments are recorded as expenditures in the GFFS.

p) *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 the majority of the participants in the aforementioned pension trust funds are part of the financial reporting entity of the Commonwealth. Accordingly, no portion of the net pension obligation (NPO) related to ERS has been allocated to the Municipality in the accompanying basic financial statements. The basic financial statements of the Commonwealth account for the total amount of the net pension obligation of ERS, including any amount that may be allocated to the Municipality.

According to GASB No. 27, 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.

q) *Risk Management*

The Municipality carries commercial insurance covering casualty, theft, tort claims and other losses. Insurance policies are negotiated by the Puerto Rico Treasury Department (the Treasury Department) on behalf of all municipalities of Puerto Rico. The Treasury Department 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 CRIM.

The Municipality carries insurance coverage for death and bodily injuries caused by automobile accidents. This insurance is obtained through the Automobile Accidents Compensation Administration ("ACAA", by its Spanish acronym), a discretely 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 ACAA.

The Municipality obtains workers' compensation insurance coverage through the State Insurance Fund Corporation ("FSE" by its Spanish acronym), a component unit of the Commonwealth. This insurance covers workers against injuries, disability or death because of work or

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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 obtains unemployment compensation, non-occupational disability, and drivers' insurance coverage for 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 obtains medical insurance coverage for its employees. The current insurance policies have not been canceled or terminated at June 30, 2004. In the past three years, the Municipality has not settled claims that exceeded insurance coverage.

r) 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.
- **Advances** – Represent the reservation of resources set aside for long-term accounts, notes and interfund receivables, which are not considered current available financial resources.
- **Inventories and other current assets** – Represent the reservation of resources set aside for inventories and prepaid costs, which are not considered current available financial resources.
- **Other Specified Purposes** – Represent resources set aside for use in federal and state grant programs accounted for in the special revenue funds.

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s) *Interfund Activities*

Permanent reallocations of resources among the Municipality's funds are classified as interfund transfers. The Municipality has the following types of activities recorded among funds in the accompanying 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 Activities*** – Represent transfers among funds that are reported as interfund transfers with receivables and payables presented as amounts due to and due from other funds.
- ***Advances*** – Represent amounts advanced among funds, which are not considered to be currently available financial resources.

In the GFFS, interfund activity has not been eliminated, as permitted by GAAP.

t) *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.

u) *Future Adoption of Accounting Pronouncements*

On March 27, 2003, the GASB issued its Statement No. 40 (GASB No. 40), *Deposit and Investment Risk Disclosure, an Amendment to GASB Statement No. 3*. This statement requires that state and local governments disclose essential risk information about deposits and investments. The disclosure requirements cover four main areas: (1) credit risk, (2) interest rate, (3) investment maturity, (4) interest rate sensitivity and (5) foreign exchange exposure. The provisions of GASB No. 40 are effective for the Municipality's fiscal year commencing on July 1, 2004.

On November 18, 2003, the GASB issued its Statement No. 42 (GASB No. 42), *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. This statement requires governments to report the effects of capital asset impairment in their financial statements. This statement also requires all governments to account for insurance recoveries in the same manner. The provisions of GASB No. 40 are effective for the Municipality's fiscal year commencing on July 1, 2005.

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The Municipality's management has concluded that the future adoption of GASB Statements No. 40 and 42, will not have a significant impact on the Municipality's basic financial statements.

2. DEPOSITS

The Municipality maintains its deposits of cash in various commercial banks located in Puerto Rico, GDB and CRIM. 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 agents of the Commonwealth's Secretary of the Treasury, in the Municipality's name.

The Municipality's bank balance of deposits with financial institutions is categorized to provide an indication of the level of collateral risk assumed by the Municipality at June 30, 2004. Risk categories are described as follows:

- Category 1:** Deposit is insured or collateralized with securities held by the Secretary of the Treasury' agents in the Municipality's name.
- Category 2:** Deposit is collateralized with securities held by pledging financial institution's trust department or agent in the Municipality's name.
- Category 3:** Deposit is uncollateralized; including 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 (book balance) of cash and cash equivalents at June 30, 2004 consist of the following:

	General fund	State legislative joint resolutions fund	Debt service fund	Nonmajor funds	Totals
Unrestricted (category 1):					
Cash in commercial banks	\$ 485,709	-	-	-	\$ 485,709
Restricted (category 1):					
Cash in commercial banks	-	801,014	-	362,153	1,163,167
Cash equivalents in commercial banks	-	603,920	-	-	603,920
Restricted (category 3):					
Cash in GDB or CRIM, as fiscal agents	114,925	-	358,359	518,374	991,658
Total deposits	\$ 600,634	1,404,934	358,359	880,527	\$ 3,244,454

The Municipality's bank balances in commercial banks amounting to \$2,543,488 at June 30, 2004 were fully collateralized (Category 1). The bank balance of deposits in GDB and CRIM, which is uninsured and uncollateralized (Category 3), amounted to \$633,298 at June 30, 2004.

3. MUNICIPAL LICENSE TAXES

The Municipality is authorized by Law No. 81 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 generally based on the business volume measured by gross sales. The Municipality establishes the applicable tax rates. At June 30, 2004, the municipal tax rates imposed by the Municipality were 1.50% for financing institutions and 0.50% for other types of 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 assess his/her corresponding municipal license tax by declaring his/her volume of business through a tax return to be filed 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 tax returns. The tax can be paid by the taxpayer in two

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equal installments due 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 total tax amount due.

Any municipal license taxes collected in advance (that is, pertaining to a future period) are recorded as deferred revenues. Deferred municipal license tax revenues recorded in the accompanying GWFS and GFFS amounted to \$256,905 at June 30, 2004, which represents municipal licenses collected in advance for the taxable year 2004-2005.

4. PROPERTY TAXES

The Municipality is authorized by Law No. 81 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 (assessment date) 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 at June 30, 2004 was 6.58% (of which taxpayers pay 6.38% and 0.20% is reimbursed by the Department of Treasury). 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 to 1957 market prices. The total real property tax rate in force at June 30, 2004 was 8.58% (of which 8.38% is paid by taxpayers and 0.20% is also reimbursed by the Department of Treasury).

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 each December 31. If CRIM remits to the Municipality property tax advances, which are less than the property 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.

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Law No. 81 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 and 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.

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.

As parts of its function of guarding for the collections of the municipalities property tax, the CRIM authorized by the Commonwealth's Legislature who approves Law No. 74 of March 1, 2004 (as amended by Law No. 131 of June 1, 2004), declare a amnesty. This Law granted to taxpayers an amnesty for payment of real and personal property tax debts from March 1, 2004 to June 30, 2004. During this period the CRIM distribute to the Municipality \$167,561 of property tax collections (related to the amnesty) of which \$126,877 were recorded in the general fund and \$31,608 recorded in the debt service fund. The CRIM also applied \$47,214 on additional collections for the payment of principal of the line of credit agreement, which was issued to finance delinquent property tax accounts sold to private investors under the provision of Law No. 146 of October 11, 2001.

Total property tax receivable, net of an allowance for uncollectible accounts of \$1,431,270, amounted to \$1,283,354 at June 30, 2004. The composition of the property tax receivable and the related allowance for doubtful accounts is as follows:

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	General fund	Debt service fund	Total
Property tax receivable	\$ 2,091,840	622,784	\$ 2,714,624
Allowance for doubtful accounts	(1,101,408)	(329,862)	(1,431,270)
Net property tax receivable	<u>\$ 990,432</u>	<u>292,922</u>	<u>\$ 1,283,354</u>
Deferred (unavailable) property tax revenues in GFFS	<u>\$ 938,762</u>	<u>279,523</u>	<u>\$ 1,218,285</u>

5. INTERFUND BALANCES

On July 1, 2001 the Municipality adopted the provisions of Statement No. 38, *Certain Financial Statement Note Disclosures*, issued by the Governmental Accounting Standards Board. This statement requires the disclosure of the flow of resources between funds and to assess the collectibility of interfund balances. Interfund balances at June 30, 2004 consisted of the following:

		<u>Operating transfers-in:</u>			
		<u>Major funds</u>			
		General fund	Debt service fund	Total	
<u>Operating transfers-out:</u>					
Major funds:					
General fund		\$ -	160,850	\$ 160,850	
State legislative joint resolutions fund		23,300	-	23,300	
Debt service fund		1,947	-	1,947	
Nonmajor governmental funds		<u>32,872</u>	<u>-</u>	<u>32,872</u>	
Total		<u>\$ 58,119</u>	<u>160,850</u>	<u>\$ 218,969</u>	
		<u>Due/advances from:</u>			
		<u>Major funds</u>			
		General fund	State legislative joint resolutions fund	Debt service fund	Total
<u>Due/advances to:</u>					
Major funds:					
General fund		\$ -	325,583	114,321	\$ 439,904
Debt service fund		-	-	-	-
Nonmajor governmental funds		<u>708,392</u>	<u>-</u>	<u>-</u>	<u>708,392</u>
Total		<u>\$ 708,392</u>	<u>325,583</u>	<u>114,321</u>	<u>\$ 1,148,296</u>

At June 30, 2004 all amounts due to among funds are considered collectible by the Municipality's management.

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6. CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2004, was as follows:

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

General government	\$ 115,711
Public safety	23,403
Public housing and welfare	144,696
Culture and education	4,652
Health and sanitation	39,351
Urban and economic development	<u>47,160</u>
Total depreciation and amortization expense	<u>\$ 374,973</u>

7. EMPLOYEES RETIREMENT SYSTEM

The Municipality's employees participate in the Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities (the "System"). The System is the administrator of a multi-employer cost-sharing (as related to the Municipality's reporting entity) defined pension plan established by the Commonwealth. The System was created under Act. No. 447, approved on May 15, 1951, as amended, and became effective on January 1, 1952. The System covers all regular employees of the Commonwealth and its instrumentalities, the Municipality and other municipalities of the Commonwealth.

The System is independent, thus assets may not be transferred to another system or used for any purpose other than to 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 percent 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 system ("System 2000"). System 2000

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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 joining the government on or after January 1, 2000, are the only required to become members of System 2000.

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 will be invested by the System, together with those of the current defined benefit plan. The Commonwealth nor the Municipality will not guarantee benefits at retirement age. The annuity will be based on a formula which assumes that each year the employees' contribution (with a minimum of 8.275 percent of the employees' salary up to a maximum of 10.00 percent) will be invested in an account which will either: (1) earn a fixed rate based on the two-year Constant Maturity U.S. Treasury Note; (2) earn a rate equal to 75 percent of the return of the System 2000'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 percent of the employees' salary which is applicable to the Municipality) 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 later January 1, 2000.

Funding Policy:

Contribution requirements are established by law and are as follows:

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

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, any actuarial deficiency that may exist or arise related to the Municipality's

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participating employees will be assumed by the Commonwealth 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 contributions for the current and the previous two fiscal years, which are equal to the statutory required contributions, were as follows:

<u>Fiscal year ended June 30,</u>	<u>Act No. 447</u>	<u>System 2000</u>
2004	<u>\$74,224</u>	<u>\$74,481</u>
2003	<u>\$80,633</u>	<u>\$20,775</u>
2002	<u>\$84,251</u>	<u>\$21,768</u>

8. LONG-TERM DEBT

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 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 percent of the total assessed value of the property located within the Municipality plus the balance of the ad valorem 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. At June 30, 2004, the Municipality is in compliance with the debt limitation requirements. The general long-term debt activity for the year ended June 30, 2004 was as follows:

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	Balance at June 30, 2003, as restated	Borrowings or Additions	Payments or Deductions	Balance at June 30, 2004	Due Within One Year
Bonds payables	\$ 3,793,000	-	(199,000)	\$ 3,594,000	\$ 225,000
Notes payable to:					
Puerto Rico Treasury Department:					
Loan for payment of legal settlement	-	1,635,177	(475)	1,634,702	972
Financing agreement for the excess of property tax advances over collections through fiscal year 1993	509,648	-	(10,452)	499,196	11,216
Puerto Rico Department of Labor and Human Resources	175,386	-	(112,646)	62,740	62,740
Puerto Rico Land Authority	-	135,020	(10,000)	125,020	4,205
Puerto Rico Aqueduct and Sewer Authority	51,976	8,269	(40,887)	19,358	19,358
CRIM:					
Act No. 42 - Financing agreement for the excess of property tax advances over collections through fiscal year 2000	1,054,250	-	(27,235)	1,027,015	13,975
Other - LDMS	118,779	-	(11,047)	107,732	11,728
Financing of delinquent property tax accounts sold	251,724	-	(47,214)	204,510	-
Compensated absences	740,801	183,636	-	924,437	721,450
Claims and judgments	1,740,708	175,448	(1,740,708)	175,448	175,448
Obligation under capital leases	13,644	14,722	(8,074)	20,292	4,496
Total	\$ 8,449,916	2,152,272	(2,207,738)	\$ 8,394,450	\$ 1,250,588

a) Bonds Payable

The Municipality issues general and special (public improvements) obligations bonds and notes to provide for the acquisition and construction of major capital facilities and equipment, as well as, to cover certain operating needs. Bonds and notes payable at June 30, 2004 is composed of the following debts:

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These bonds are payable from the ad valorem property tax of 1.67% which is restricted for debt service and retained by the Government Development Bank for Puerto Rico for such purposes.

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 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 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.

Interest rates on serial bonds subject to variable rates are reviewed periodically by GDB and are based on the fluctuation of GDB's weighted average rate for its commercial paper program, not to exceed 8%. Under this program, GDB issues commercial paper in the U.S. taxable and tax-exempt markets, in the Eurodollar market and to corporations that have tax exemption under the Commonwealth's

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Industrial Incentives Act and qualify for benefits provided by the U.S. Internal Revenue Code Section 936.

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

<u>Year ended June 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2005	\$ 225,000	186,105	\$ 411,105
2006	190,000	194,815	384,815
2007	179,000	183,707	362,707
2008	170,000	173,618	343,618
2009	180,000	163,416	343,416
2010-2014	785,000	672,017	1,457,017
2015-2019	770,000	423,774	1,193,774
2020-2024	620,000	236,005	856,005
2025-2029	475,000	43,270	518,270
Totals	\$ 3,594,000	2,276,727	\$ 5,870,727

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b) Notes Payable to Puerto Rico Treasury Department

Financing of the excess of property tax advances over collections - On November 4, 1999 the Municipality entered into a financing agreement with the Puerto Rico Treasury Department to pay a debt related to the excess of property tax advances over collections made by the Puerto Rico Treasury Department prior to the creation of CRIM in 1993. The outstanding principal and accrued interest balances of the note payable to CRIM amounted to \$499,196 and \$2,945, respectively, at June 30, 2004. 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>
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	14,876	31,324	46,200
2010-2014	92,381	138,619	231,000
2015-2019	131,484	99,516	231,000
2020-2025	210,424	44,329	254,753
Total	<u>\$ 499,196</u>	<u>448,557</u>	<u>\$ 947,753</u>

Loan for payment of legal settlement - On December 1, 2003 the Municipality obtained a loan from the Puerto Rico Treasury Department to pay a legal settlement related to the Federal Civil Case No. 01-2692 (JP). The face amount of the loan was \$2,000,000 at no interest. This note has an imputed interest rate of 3.00% and was originally recorded at its present value of \$1,635,177, net of an unamortized discount of \$364,823, at inception. At June 30, 2004, the balance of this note, net of the unamortized discount of \$340,298, amounted to \$1,634,702. The principal and discount amortization (recorded as interest expense) maturities are as follows.

<u>Year ending June 30,</u>	<u>Principal amortization</u>	<u>Discount amortization</u>	<u>Total</u>
2005	\$ 972	\$ 49,028	\$ 50,000
2006	1,002	48,998	50,000
2007	102,419	47,581	150,000
2008	105,534	44,466	150,000
2009	159,437	40,563	200,000
2010-2013	1,265,338	109,662	1,375,000
Total	<u>\$ 1,634,702</u>	<u>\$ 340,298</u>	<u>\$ 1,975,000</u>

c) Notes Payable to Puerto Rico Department of Labor and Human Resources

On February 12, 2002, the Municipality entered into a financing agreement with the Puerto Rico Department of Labor and Human Resources for the payment of past due unemployment insurance premiums amounting to \$389,118. The note bears interest at 7.95% and is payable in monthly installments of \$10,247, including interests, through November 18, 2004. At June 30, 2004, the outstanding principal and accrued interest balance on this note amounted to \$62,739 and \$1,423 respectively.

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d) Notes Payable to Puerto Rico Land Authority

On October 22, 2003, the Municipality acquired a parcel of land from the Puerto Rico Land Authority in the amount of \$250,000 for which the Municipality issue a note payable. The note bears no interest and has an imputed interest rate of 6.00%. The note was originally recorded at its present value of \$135,020, net of an unamortized discount of \$114,980, at inception. At June 30, 2004, the balance of this note, net of the unamortized discount of \$114,980, amounted to \$125,020. The principal and discount amortization (recorded as interest expense) maturities are as follows.

<u>Year ending June 30,</u>	<u>Principal amortization</u>	<u>Discount amortization</u>	<u>Total</u>
2005	\$ 4,205	\$ 5,795	\$ 10,000
2006	2,751	7,249	10,000
2007	2,916	7,084	10,000
2008	3,091	6,909	10,000
2009	3,277	6,723	10,000
2010-2014	19,579	30,421	50,000
2015-2019	15,601	24,399	40,000
2020-2024	31,477	18,523	50,000
2025-2029	42,123	7,877	50,000
Total	<u>\$ 125,020</u>	<u>\$ 114,980</u>	<u>\$ 240,000</u>

e) Notes Payable to Puerto Rico Aqueduct and Sewer Authority

On December 23, 2003, the Municipality entered into a financing agreement with the Puerto Rico Aqueduct and Sewer Authority for the payment of past due water utilities services amounting to \$61,397. The note is payable in monthly installments of \$4,900 through October 1, 2004. The note bears no interest and has an imputed interest rate of 6.00%. It was originally recorded at its present value of \$60,244, net of an unamortized discount of \$1,153, at inception. At June 30, 2004, the balance of this note, net of the unamortized discount of \$243, amounted to \$19,358.

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f) Notes Payable to CRIM

Act No. 42 – Act No. 42 of January 26, 2000 was enacted to authorize CRIM to enter into a financing agreement of up to \$200 million, for a term not exceeding 30 years. The financing agreement allows 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 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 increases in this subsidy was the result of the Public Law No. 238 of August 15, 1999.

In addition, on December 16, 2002 the Municipality entered into a repayment agreement with GDB and CRIM to pay off the remaining \$1,061,453 of excess of property tax advances from fiscal year 2000 and 2001. CRIM retains the principal and interest from the property tax advances of the Municipality. The amounts retained by CRIM are remitted to CDB on July 1 of each year through July 1, 2032. The repayment agreement bears interest at variable rates determined by GDB (6.48% at June 30, 2004) but not exceeding 8.00%. The outstanding principal and accrued interest balances of the note payable to CRIM amounted \$1,027,015 and \$5,317 respectively, at June 30, 2004. The principal and interest maturities are as follows:

<u>Year ending June 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2005	\$ 13,974	\$ 63,405	\$ 77,379
2006	14,868	62,511	77,379
2007	15,818	61,561	77,379
2008	16,829	60,550	77,379
2009	17,905	59,474	77,379
2010-2014	108,227	278,670	386,897
2015-2019	147,530	239,367	386,897
2020-2024	201,105	185,791	386,896
2025-2033	490,758	134,725	625,483
Total	<u>\$ 1,027,014</u>	<u>\$ 1,146,054</u>	<u>\$ 2,173,068</u>

Other – LIMS – On June 28, 2001, the Municipality entered into a financing agreement with CRIM for the payment of the Municipality's share of the cost of an information management system, acquired by CRIM on behalf of all municipalities, for the management of a digital database of taxpayers properties located in Puerto Rico. The face amount of the loan was \$178,730 and bears no interest. The note is payable in monthly installments of \$1,490 through December 1, 2011. This note has an imputed interest rate of 6.00% and was originally recorded at its present value of \$130,789, net of an unamortized discount of \$47,942, at inception. At June 30, 2004, the balance of this note, net of the unamortized discount of \$26,316, amounted to \$107,732. The principal and discount amortization (recorded as interest expense) maturities are as follows:

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Year ending June 30,	Principal	Interest	Total
2005	\$ 11,728	\$ 6,145	\$ 17,873
2006	12,452	5,421	17,873
2007	13,220	4,653	17,873
2008	14,035	3,838	17,873
2009	14,901	2,972	17,873
2010-2012	41,396	3,285	44,681
Total	\$ 107,732	\$ 26,314	\$ 134,046

Financing of delinquent property tax accounts sold – On April 22, 2002, the Municipality entered into a financing agreement with CRIM in the amount of \$251,724 for the payment of delinquent property tax account sold to private investors. The financing agreement in the form of a line of credit bearing interests at 6.50% during the first 5 years, and variable interests 125 points over LIBOR rate during the next 25 years. During this fiscal year CRIM has record credits for the amount of \$47,215 to the principal on this agreement. At June 30, 2004, the outstanding principal and accrued interest balances amounted to \$204,510 and \$16,293, respectively. The principal and interest maturities are as follows.

Year ending June 30,	Principal	Interest	Total
2005	\$ -	\$ 13,293	\$ 13,293
2006	-	13,293	13,293
2007	-	13,293	13,293
2008	-	13,293	13,293
2009	3,714	13,184	16,898
2010-2014	22,651	61,838	84,488
2015-2019	31,322	53,166	84,488
2020-2032	146,823	70,020	216,843
Total	\$ 204,510	\$ 251,381	\$ 455,890

g) Compensated Absences

At June 30, 2004, the liability for compensated absences is composed as follows:

	Due within one year	Due after one year	Total
Vacations	\$ 407,678	69,262	\$476,940

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Sick leave	244,607	133,725	378,332
Compensatory time	69,165	-	69,165
Total	\$721,450	202,987	\$924,437

9. LEASE OBLIGATIONS

The Municipality is obligated under capital leases with third parties that expire through 2009 for the acquisition of office equipment. At June 30, 2004, the capitalized costs and the related accumulated amortization of the leased equipment amounted to \$43,572 and \$18,898, respectively, which are accounted for as capital assets in the accompanying government-wide statement of net assets. Amortization charges applicable to capital leases and included within depreciation expense amounted to \$2,579. The present value of the future minimum capital lease payments at June 30, 2004 reported in the accompanying government-wide statement of net assets is as follows:

Year ending	Amount
<u>June 30,</u>	
2005	\$ 5,884
2006	5,364
2007	5,364
2008	4,919
2009	2,388
Total future minimum lease payments	23,919
Less: amount representing future interest cost at 8.00%	(3,627)
Present value of minimum lease payments	20,292
Less:	
Current portion of obligation under capital leases	4,496
Obligation under capital leases, excluding current portion	\$ 15,796

10. COMMITMENTS AND CONTINGENCIES

The Municipality is defendant in various legal proceedings pertaining to matters incidental to the performance of routine governmental operations. Under Act No. 104 of June 25, 1955, 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 of any judgment that may be entered against them. There is no limitation on the payment of such judgment.

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With respects to pending or threatened litigation, the Municipality has reported liabilities of \$175,448 for awarded or anticipated unfavorable judgments as of June 30, 2004. Management believes that any unfavorable outcome in relation to pending or threatened litigation would not be significantly in excess of recorded amounts.

The Municipality has reported, outstanding encumbrances amounting to \$36,150 in the general fund at June 30, 2004. The Municipality intends to honor these encumbrances, which will continue to be liquidated under the current year's budget during a lapse period that extends into the subsequent fiscal year.

In May 2003 the Environmental Protection Board (EPB) present a complaint against the Municipality by deficiencies found in the Municipal Public Works Factory. These deficiencies are related to inefficiencies in the used oil handling, inadequate accumulation of wastes, and the use of spray painting in the facility. The board has ordered to stop those practices and it wishes that a correction plan is implemented. The Municipality has decided to move the Public Works operations to other facilities during this year as part of this correction plan.

11. RESTATEMENTS

The following schedule reconciles the June 30, 2003 fund balances as previously reported by the Municipality to the beginning fund balances, as restated:

	June 30, 2003, fund balance, as previously reported	Correction of accounting errors	June 30, 2003, fund balance, as restated
Major funds:			
General fund	\$(445,681)	(14,010)	(459,691)
Debt service fund	110,865	6,947	117,812
State legislative joint resolutions fund	2,812,363	17,060	2,829,423
Nonmajor funds:			
Capital project funds	1,332,948	(115,345)	1,217,603
Totals	<u>\$3,810,495</u>	<u>(105,348)</u>	<u>3,705,147</u>

The following schedule reconciles the June 30, 2003 net assets previously reported by the Municipality to the beginning net assets, as restated in the accompanying statement of activities:

June 30, 2003, net assets, as previously reported	Correction of accounting errors	June 30, 2003, net assets, as restated
<u>\$3,150,830</u>	<u>961,092</u>	<u>4,111,922</u>

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12. SUBSEQUENT EVENTS

1. The Municipality was awarded \$900,000 by the Economic Development Administration (EDA) on September 25, 2001. The project consists of the construction of a building known as the Coastal Enterprise Center for small tourism related businesses and the construction of an outdoor produce market.

The Municipality signed a deed of unilateral mortgage for the amount of \$900,000 on October 8, 2004. This mortgage was signed in be half of EDA over an immovable property in which the project will be located. The agreement and mortgage shall terminate and be of no further force twenty (20) years from the date here of, in which period of years has been established as the useful life of the improvements of the property. The aforesaid grant from EDA provides the purposes for which the award amount may be used and provides, interalia, where the Municipality will not sell, lease, mortgage or other wise use the project, unless prior approval of the Assistance Secretary of Commerce for Economic Development or their designees, successors or assignees.

2. On October 27, 2004 the Governmental Development Bank of Puerto Rico (GDB) approved the issuance of a \$145,000 operational loan to the Municipality to finance the payment of a legal claim. Payments are due in monthly installments through year 2014, bearing interest at a variable rate (LIBOR + 1.25%). Principal and interest payments will be financed through the Municipality's general fund.

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 Budgetary Comparison Schedule – General Fund
 Year Ended June 30, 2004

	Budgeted Amounts		Actual Amounts (Budgetary Basis) (See Note 1)	Variance With Final Final Budget - Positive (Negative)
	Original	Final		
Revenues:				
Property taxes	\$ 906,203	1,141,333	1,249,510	\$ 108,177
Municipal license taxes	266,500	266,500	288,545	22,045
Construction excise taxes	850,000	850,000	667,446	(182,554)
Charges for services and rents	96,500	96,500	89,544	(6,956)
Intergovernmental grants and contributions	4,886,735	4,886,735	4,567,465	(319,270)
Interest on deposits	60,000	60,000	80,449	20,449
Miscellaneous	45,000	178,203	812,601	634,398
	<u>\$ 7,110,938</u>	<u>\$ 7,479,271</u>	<u>7,755,561</u>	<u>276,289</u>
Expenditures:				
General government	3,542,968	3,952,062	3,129,580	822,483
Urban and economic development	708,464	701,656	688,395	13,261
Public safety	977,001	936,071	644,898	291,173
Public housing and welfare	432,609	397,074	387,947	9,127
Health and sanitation	1,449,896	1,492,408	1,761,452	(269,044)
	<u>\$ 7,110,938</u>	<u>\$ 7,479,271</u>	<u>\$ 7,156,529</u>	<u>\$ 867,000</u>
Explanation of Differences:				
Sources/inflows of financial resources:				
Actual amounts (budgetary basis) "available for appropriations" from budgetary comparison schedule				\$ 7,755,561
Differences - budget basis to GAAP:				
Differences in assets and liabilities resulting from modified accrual basis of accounting in comparison with budgetary basis				(385,233)
Transfers from other funds are inflows of budgetary resources but are not revenues for financial reporting				(58,119)
Total revenues as reported on the statement of revenues, expenditures and changes in fund balances - general fund				<u>\$ 7,312,209</u>
Uses/outflows of financial resources:				
Actual amounts (budgetary basis) "total charges to appropriations"				
From the budgetary comparison schedule				\$ 7,156,529
Differences - budget basis to GAAP:				
Transfers to other funds are outflows of budgetary resources				(160,850)
Differences in assets and liabilities resulting from modified accrual basis of accounting in comparison with budgetary basis				208,065
Prior-year encumbrances recorded as current year expenditures for GAAP basis				517,647
Current-year encumbrances recorded as expenditures for budgetary purposes				(466,302)
Total expenditures as reported on the statement of revenues, expenditures and changes in fund balances - governmental funds				<u>\$ 7,255,089</u>

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