

OFICINA DEL COMISIONADO DE ASUNTOS MUNICIPALES

AREA DE ASESORAMIENTO, REGLAMENTACION E INTERVENCION FISCAL

AREA DE ARCHIVO DIGITAL

MUNICIPIO DE GUANICA

AUDITORIA 2004-2005

30 DE JUNIO DE 2005

OFFICE OF THE COMPTROLLER
OF THE COMMONWEALTH OF PUERTO RICO
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UNIDAD DE CORREO

Café 1375

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA**

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

FISCAL YEAR ENDED JUNE 30, 2005

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA**

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FINANCIAL SECTION

Independent Auditor's Report

*Mayor and Municipal Legislature
Municipality of Guanica
Guanica, 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 Guanica, Puerto Rico, as of and for the year ended June 30, 2005, which collectively comprise the Municipality's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Municipality's management. Our responsibility is to express opinions on these financial statements based on our audit.

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

We were unable to obtain sufficient and competent evidence to support the allocation of pool cash transactions recorded in the General Fund because of the inadequacy of accounting records and reports, which do not permit the application of adequate alternative procedures.

In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to obtain sufficient and competent evidence to support the allocation of pool cash transactions recorded in the General Fund, the financial statements referred to in the first paragraph present fairly, in all material respects, the respective financial position of the General Fund of the Municipality of Guanica, Puerto Rico as of June 30, 2005, 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.

In addition, in our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the respective financial position of the governmental activities, the State Legislative Joint Resolutions Fund, the Debt Service Fund, the FEMA-Hazard Mitigation Grant Program Fund and the aggregate remaining fund information of the Municipality of Guanica, Puerto Rico as of June 30, 2005, 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.

In accordance with *Government Auditing Standards*, we have also issued a report dated December 22, 2005 on our consideration of the Municipality's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis on pages 3 through 15 and the Budgetary Comparison Schedule – General Fund on page 59 are not a required part of the basic financial statements, but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

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



Rodriguez, Rivera & Toro L.P.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Management Discussion and Analysis
June 30, 2005

Our discussion and analysis of the Municipality of Guánica financial performance provides an overview of the Municipality's financial activities for the fiscal year ended June 30, 2005. Because this MD&A is designed to focus on the current year activities, resulting changes and currently known facts, we encourage reader to consider the information presented in this MD&A in conjunction with the additional information furnished in the accompanying basic financial statements.

FINANCIAL HIGHLIGHTS

- The Municipality has reported assets amounting to \$18.31 millions in the accompanying statement of net assets, of which most significant are Capital assets, cash and cash in fiscal agent amounting to \$ 14.27million, \$1.93 million and \$1.23 million respectively.
- The Municipality's capital assets increase as a result of this year's operations. Capital assets as of June 30, 2005 are \$14.27 million, as compared to \$ 13.24 million for the year ended June 30, 2004, for a 7.2% of increase.
- The assets of the Municipality exceeded its liabilities by \$6.85 millions at June 30, 2005, represented as "net assets" in the accompanying statements of net assets. Restricted and unrestricted (deficit) net assets amounted to \$2.35 million and \$(6.92) millions, respectively. Net assets invested in capital assets amounted \$11.42 millions.
- During the year, the Municipality reported revenues of \$ 7.57 million in the General Fund of total revenues restricted and unrestricted of \$12.68 million.
- Loans principal payments were \$.20 million. During the year ended June 30, 2005, the Municipality issued \$.145 millions on bonds payable.
- The Municipality has reported total expenses amounting to \$13.50 millions in the accompanying statement of activities.

USING THIS ANNUAL REPORT

This annual report consists of a series of financial statements. The Statement of Net Assets and the Statement of Activities provide information about the activities of the Municipality as a whole and present a long-term view of the Municipality's finances. For governmental activities, these statements tell how these services were financed in the short term as well as what remains for future spending. Fund financial statements also report the Municipalities' operations in more detail than the government-wide statements by providing information about the Municipality's most significant funds. Both perspectives 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.

COMMONWEALTH OF PUERTO RICO
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June 30, 2005

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
3. notes of the financial statements

These components are described below:

Government-wide financial statement: Are designed to provide reader with a broad of the Municipality's operations and finance as 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. The governmental-wide financial statements include; the statement of net assets and the statement of activities.

The Statement of Net Assets and the Statement of Activities

The Statement of Net Assets and the Statement of Activities report information about the Municipality as a whole and about its activities. These statements include *all* assets and liabilities using the *accrual basis of accounting*, which is similar to the accounting used by most private-sector companies. All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

These two statements report the Municipality's *net assets* and changes in them. You can think of the Municipality's net assets, the difference between assets and liabilities, as one way to measure the Municipality's financial health, or *financial position*. Over time, *increases or decreases* in the Municipality's net assets are one indicator of whether its *financial health* is improving or deteriorating. You will need to consider other non-financial factors, however, such as changes in the Municipality's property tax base and the condition of the roads, to assess the *overall health* of the Municipality of Guánica.

In the Statement of Net Assets and the Statement of Activities, we divide the Municipality into:

- Governmental activities – Most of the Municipality's basic services are reported here, including the municipal police, public works, garbage disposal, public energy and health services, and general administration. Property taxes, municipal license tax, state and federal grants finance most of these activities.

Reporting the Municipality's Most Significant Funds

Fund Financial Statement: Report the financial position and results of operations of the Municipality's governmental funds. The Fund Financial statement components are the Balance Sheet-government

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funds and the statements of revenues, expenditures and changes in fund balance. The Fund financial statements provide detailed information about the most significant funds, not the Municipality as a whole. Some funds are required to be established by bond covenants.

The Municipality's basic services are reported in the governmental funds, that uses an accounting approach which focus on how money flows into and out of those funds and the balances left at year-end that are available for spending. These funds are reported using an accounting method called *modified accrual* accounting, which measures cash and all other *financial* assets that can readily be converted to cash. The governmental fund statements provide a detailed *short-term view* of the Municipality's general government operations and the basic services it provides. Governmental fund information helps you determine whether there are more or fewer financial resources that can be spent in the near future to finance the Municipality's programs. We describe the relationship (or differences) between governmental *activities* (reported in the Statement of Net Assets and the Statement of Activities) and governmental *funds* in a reconciliation on this report.

Notes to the Basic Financial Statement: The notes provide additional information that is essential to a full understanding of the data provided in government-wide and the fund financial statements.

THE MUNICIPALITY AS A WHOLE

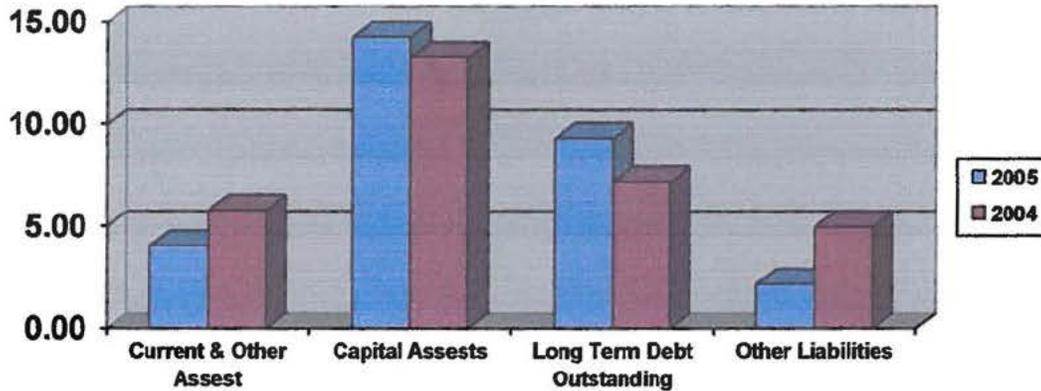
The Municipality's *combined* net assets decreases from a year ago, from \$6.91 million to \$6.85 million. Our analysis below focuses on the net assets (Table 1) and changes in net assets (Table 3) of the Municipality's governmental activities.

Table 1
NET ASSETS
(in Millions)

	Governmental Activities	
	2005	2004
Current and other assets	\$4.04	\$5.78
Capital assets	14.27	13.27
Total assets	18.31	19.05
Long-term debt outstanding	(9.30)	(7.18)
other liabilities	(2.16)	(4.96)
Total liabilities	(11.46)	(12.14)
Net assets:		
Invested in capital assets, net of related debt	11.42	11.33
Restricted for:		
Debt services	.45	.47
Capital project	1.65	1.11
Other specified purpose	.24	.53
Unrestricted	(6.92)	(6.38)
Net Assets	\$ 6.85	\$ 6.91

COMMONWEALTH OF PUERTO RICO
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Components of Net Assests (in millions)



Net assets of the Municipality's governmental activities decreased by \$0.06 million ((\$6.91 million Compared to \$6.85 million). *Unrestricted* net assets, the part of net assets that can be used to finance day-to-day operations without constraints established by debt covenants, enabling legislation or other legal requirements, changed from approximately \$(6.38) million at June 30, 2004 to a \$(6.92) million at June 30, 2005. The following is a condensed presentation of the Municipality's results of operations, as reported in the government-wide financial statements:

Comparative Condensed Statement of Activities:

	2005	2004
Revenues:		
Program revenues:		
Operating grants and contributions	\$ 2,797,555	\$ 1,854,710
Capital grants and contributions	2,218,357	2,855,218
Charges for services	1,046,815	108,505
General revenues:		
Property taxes	1,430,068	1,650,331
Municipal license taxes	281,401	289,796
Construction excise taxes		667,446
Unrestricted intergovernmental contributions and reimbursements	4,774,038	4,566,060
Unrestricted interest on deposit	20,685	58,561
Other	404,522	369,642
Special items-		
Gain on Sale of capital assets	483,140	118,456
Total revenues	<u>13,456,581</u>	<u>12,538,725</u>
Expenses:		
General government	6,020,246	2,914,565
Urban and economic development		1,309,850
Public Safety	1,173,292	957,240
Public work and sanitation	2,028,433	1,983,559
Culture and recreation	646,020	40,356
Health and welfare	3,451,785	2,188,705
Interest and bonds, notes and capital lease obligations	183,983	361,717
Total expenses	<u>13,503,759</u>	<u>9,755,992</u>
Net increase in net assets	(47,178)	2,782,731
Net assets-at the beginning of the year, as restated	<u>6,894,655</u>	<u>4,111,922</u>
Net assets- at end of the year	<u><u>6,847,477</u></u>	<u><u>6,894,655</u></u>

COMMONWEALTH OF PUERTO RICO
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Financial analysis of the Municipality's Governmental Funds

The Municipality uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. The focus of the Municipality's governmental fund is to provide information on near-term inflow, outflow, and balance of spend able resources. Such information is useful in assessing the Municipality's financial 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 government fund:

	2005	2004
Comparative Condensed Balance Sheet-Governmental funds:		
Total assets-major funds	3,760,778	4,859,990
Total assets-nonmajor funds	<u>1,948,092</u>	<u>1,992,327</u>
Total assets	<u>5,708,870</u>	<u>6,852,317</u>
Total liabilities-major funds	2,380,777	3,243,940
Total liabilities-nonmajor funds	<u>1,998,387</u>	<u>1,739,475</u>
Total liabilities	<u>4,379,164</u>	<u>4,983,415</u>
Fund Balances:		
Reserved-major funds	2,439,881	1,870,878
Reserved-nonmajor funds	(50,295)	252,852
Unreserved-major funds	<u>(1,059,970)</u>	<u>(254,828)</u>
Total fund balances	<u>1,329,616</u>	<u>1,868,902</u>
Comparative Condensed Statement of Operations-Governmental funds:		
Total revenues-major funds	9,552,230	9,153,939
Total revenues-nonmajor funds	<u>3,128,703</u>	<u>3,154,522</u>
Total revenues	<u>12,680,933</u>	<u>12,308,461</u>
Total expenditures-major funds	10,054,675	10,824,736
Total expenditures-nonmajor funds	<u>3,910,544</u>	<u>4,086,401</u>
Total expenditures	<u>13,965,219</u>	<u>14,911,137</u>
Other Financial Sources-major funds(excluding operating transfers among funds)	<u>145,000</u>	<u>1,943,188</u>
Special items, net	<u>600,000</u>	<u>(1,176,757)</u>
Net changes in fund balances	<u>(539,286)</u>	<u>(1,836,245)</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
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Governmental Activities

Revenues of Municipality's governmental activities increased by 8.0% (\$.91 million) while total expenses increased by 39.0% (3.75 millions). The Municipality of Guánica took the following major actions this year to improve the financial position:

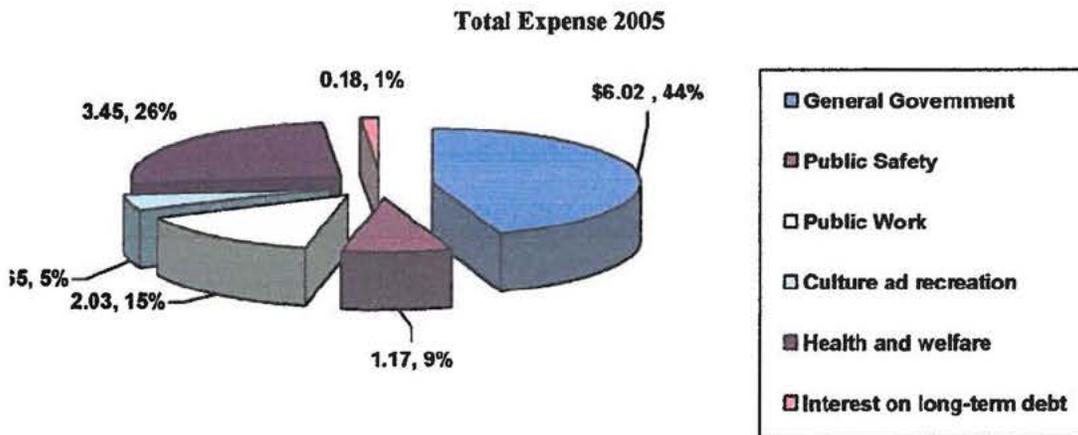
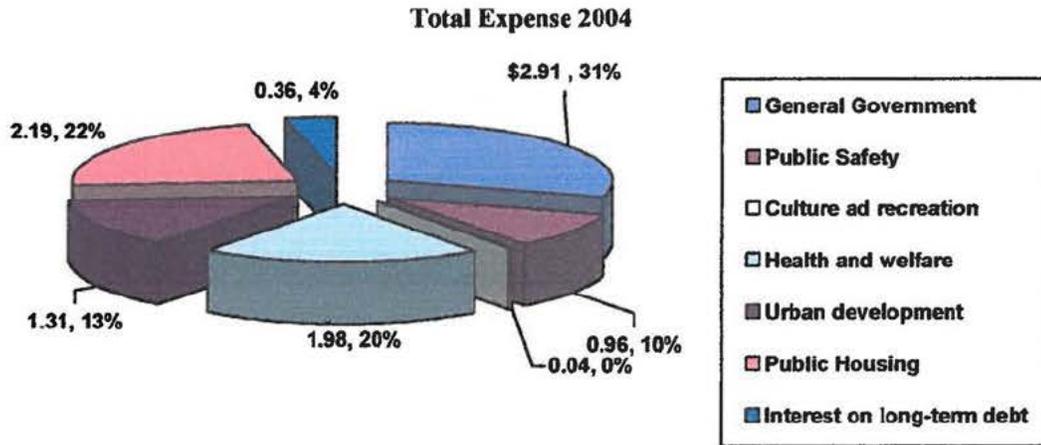
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- The Mayor of the Municipality of Guánica hire a Finance Auxiliar Director to improve the collections of Municipal licensed tax and property tax revenues, supervise the operations of the official and auxiliary collector of the Municipality.
- In the budget respect the administration of the Municipality received the estimated of expenses by each department, and the Budget Director and the Mayor performed the evaluation to those expenses and determine the needed of each one, looking for the reduction of those unnecessary expenses without affecting the daily operations.

Expenses during the fiscal year ended June 30, 2005 was substantially related to the following:

Table 2
Governmental Activities
(in Millions)

	Total expenses	
	2005	2004
General Government	\$6.02	\$2.91
Public Safety	1.17	.96
Public Work	2.03	
Culture, recreation and education	.65	.04
Health and welfare	3.45	1.98
Urban Development		1.31
Legal Service		
Public Housing		2.19
Interest on long term debt	.18	.36
Depreciation		
Totals	\$13.50	\$9.75

COMMONWEALTH OF PUERTO RICO
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 Management Discussion and Analysis
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The cost of all governmental activities this year was \$13.50 million compared to \$9.75 million last year. Table 2 presents the cost of each of the Municipality of Guanica's largest programs.

The major governmental revenue sources are property taxes, other, grant and contributions not restricted, which in total represent \$6.62 (90%) and \$7.38 (96%) of all revenues in 2005 and 2004, respectively. Changes within these sources of revenues were a decrease \$.76 million.

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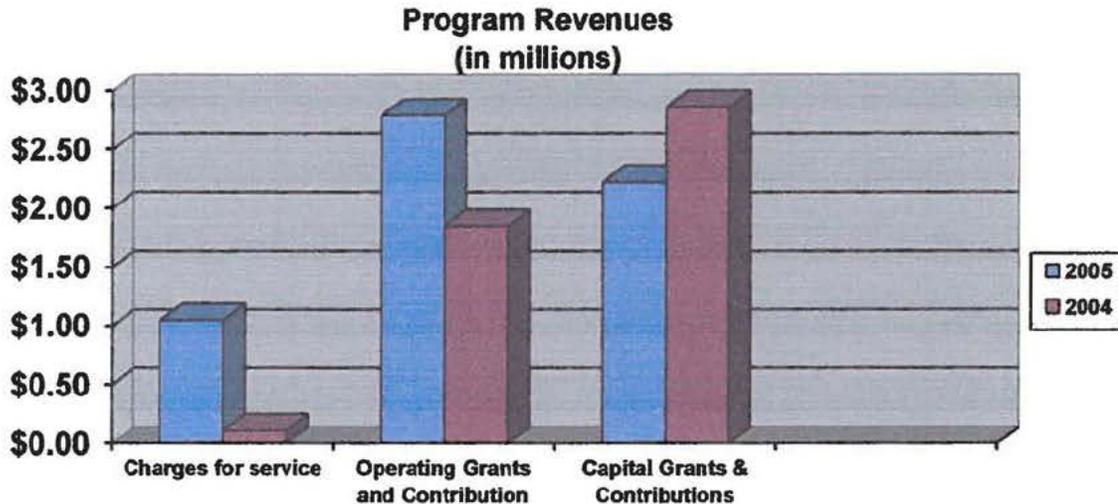
Table 3
Governmental Activities
(in Millions)

	General Revenues by major sources	
	2005	2004
Property taxes	\$1.43	\$1.65
Other	.42	1.16
Grants and contributions	4.77	4.57
Totals	\$6.62	\$7.38

Table 4
Governmental Activities
(in Millions)

	Program Revenues by major sources	
	2005	2004
Charges for service	\$1.05	\$1.11
Operating Grants and Contribution	2.79	1.85
Capital Grants and Contributions	2.22	2.86
Totals	\$6.06	\$4.82

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Management Discussion and Analysis
June 30, 2005



THE MUNICIPALITY'S FUND

As the Municipality completed the year, its governmental funds reported a combined fund balance of \$1.33 million, which is lower than last year total of \$2.45 million.

In addition, these other changes in fund balance should be noted:

- The Municipality experienced an increase in the collection of Licenses and Permits due to the developments of construction project which began during the year. The taxes paid to the Municipality related to those constructions permits increases as result of the developments of the city organization plan.
- This year the Municipality decreases the property tax.

General Fund Budgetary Highlights

Over the course of the year, the Municipal Assembly revised the Municipality of Guanica budget several times. These budget amendments fall into various categories. The first category includes amendments and supplemental appropriations that were approved shortly after the beginning of the year and reflect the actual beginning balances (versus the amounts we estimated in May 2004).

COMMONWEALTH OF PUERTO RICO
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CAPITAL ASSET AND DEBT ADMINISTRATION

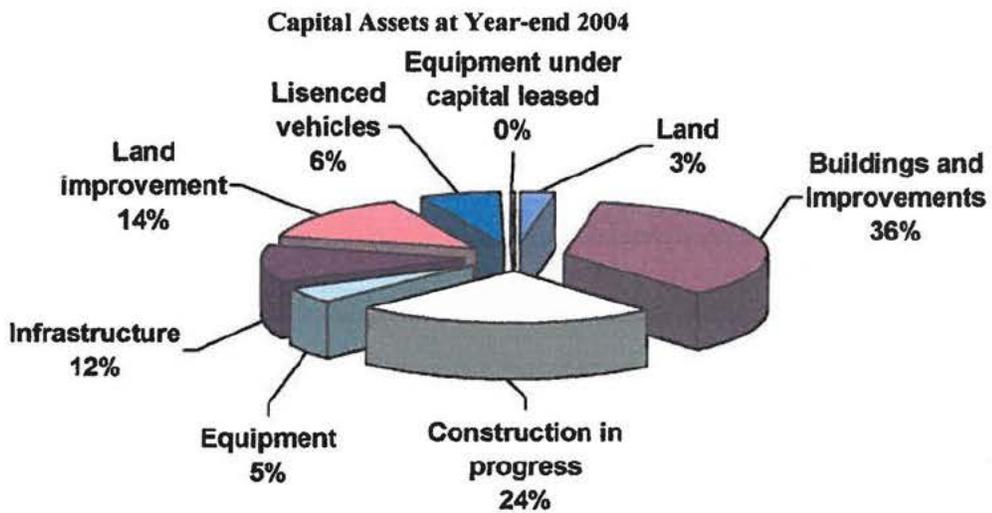
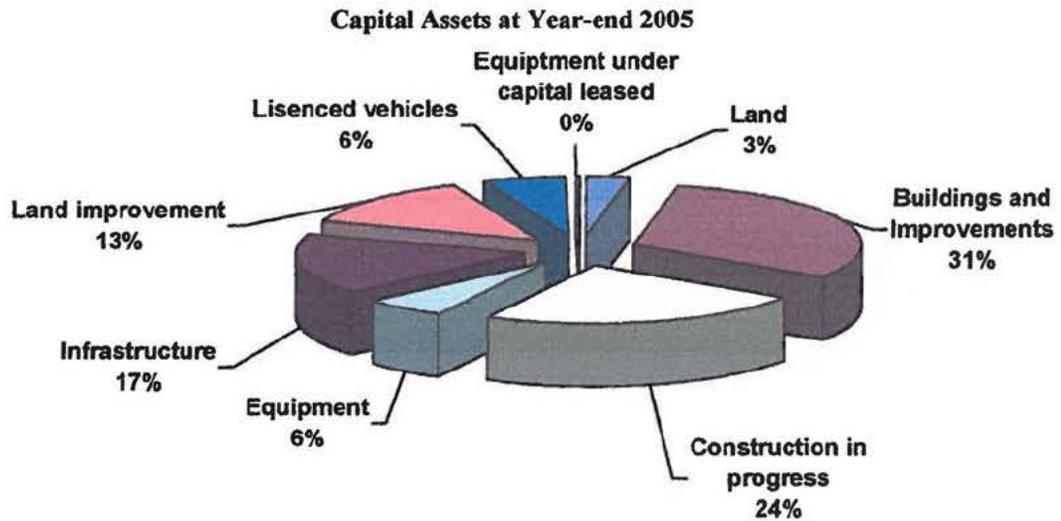
Capital Assets

As of June 30, 2005, the Municipality of Guánica had \$ 21.44 million invested in a broad range of capital assets, including buildings, parks, roads, bridges, and equipment. (See Table 5). This amount represents a net increase (including additions and deductions) of just over under \$20.28 million, or 5.7 percent, over last year. In this table you see few changes in amount compared to last year due to reclassifications of real property to proper division.

Table 5
Capital Assets at Year-end
(At cost, in Thousands)

	<i>Governmental Activities</i>	
	2005	2004
Land	\$.67	\$.57
Land improvement	2.88	2.88
Buildings and Improvements	6.69	7.25
Construction in progress	5.04	4.92
Licensed vehicles	1.29	1.29
Equipment	1.21	.99
Equipment under capital leases	.04	.04
Infrastructure	3.62	2.34
Totals	\$ 21.44	\$ 20.28

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Management Discussion and Analysis
June 30, 2005



More detailed information about the Municipality's capital assets is presented in Note 5 to the financial statements.

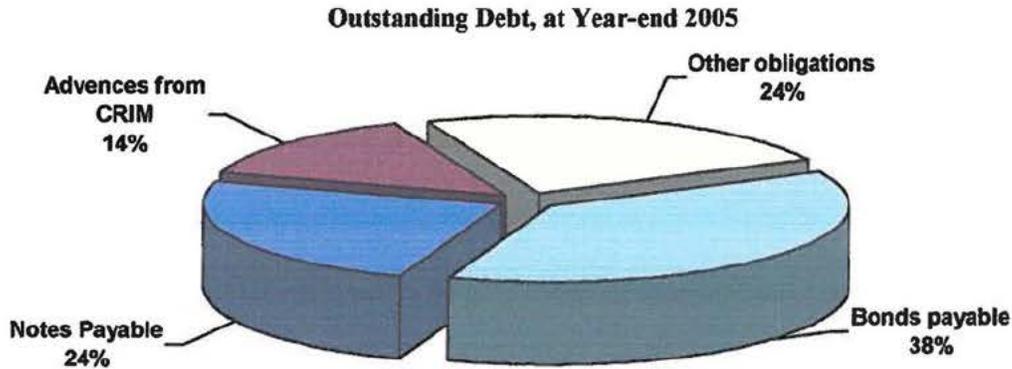
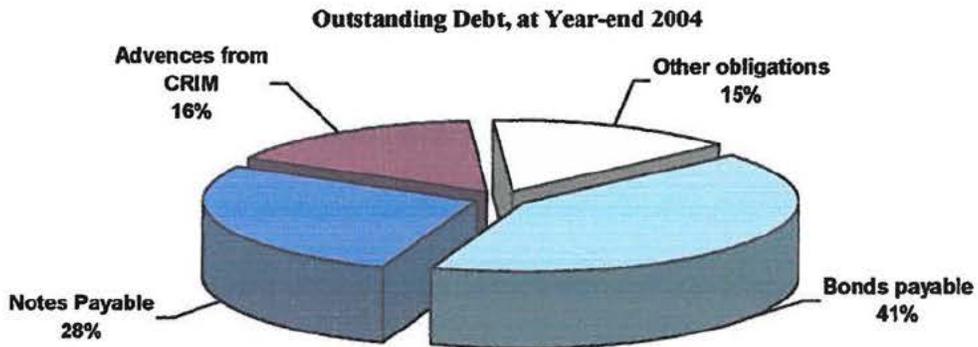
COMMONWEALTH OF PUERTO RICO
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 Management Discussion and Analysis
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Debt

At year-end, the Municipality had \$ 9.31 million in bonds and notes outstanding versus \$ 8.56 million last year, an increase of 8.6 percent, as shown in Table 6.

Table 6
Outstanding Debt, at Year-End
(in Thousands)

	Governmental Activities	
	<u>2005</u>	<u>2004</u>
Bonds payable	\$3.51	\$3.59
Notes Payable	2.25	2.36
Advances from CRIM	1.33	1.35
Other obligations	2.22	1.36
Totals	<u><u>\$9.31</u></u>	<u><u>\$8.56</u></u>



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New bonds in the amount of \$.145 million were issued. The Municipality is required to limit the amount of general obligation debt to 10% of the total assessment of property located within the Municipality, for bonds to be repaid with the proceeds of property taxes restricted for debt services. Other obligations include accrued vacation and sick leave, claims and judgments, and landfill obligation. More detailed information about the Municipality's long-term liabilities is presented in Note 7 to the financial statements.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

The Municipality's elected and appointed officials considered many factors when setting the fiscal-year 2005 budget. Unemployment in the Municipality now stands at 25.6 percent.

Amounts available for appropriations in the General Fund for the fiscal year 2006 are \$.82 million, a decrease of 66 percent under the final 2005 budget of \$7.65 million.

Budgeted expenditures are expected to rise accordingly to the increase in budgeted revenues.

If these estimates are realized, the Municipality's budgetary General Fund balance is expected to increase modestly by the close of 2006.

CONTACTING THE MUNICIPALITY'S FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, taxpayers, and creditors with a general overview of the Municipality's finances and to show the accountability for the money it receives. If you have questions about this report or need additional financial information, contact us at Municipality of Guánica, PO Box 785, Guánica, Puerto Rico 00653.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA
STATEMENT OF NET ASSETS
JUNE 30, 2005**

ASSETS	<u>Governmental Activities</u>
Cash and cash equivalents	\$ 1,930,939
Receivables, net of allowance for uncollectible accounts:	
Due from governmental agencies	848,376
Restricted Assets:	
Cash in fiscal agents	1,231,002
Deferred bond issuance costs	26,105
Capital assets (note 5):	
Nondepreciable assets:	
Land and construction in progress	5,606,557
Depreciable assets:	
Other capital assets, net	8,666,670
	<u>14,273,227</u>
Total assets	<u><u>\$ 18,309,649</u></u>
LIABILITIES	
Accounts payable and accrued liabilities	\$ 736,014
Due to governmental agencies	445,456
Deferred revenues	836,369
Interest payable	141,379
Long term liabilities (note 7) :	
Due within one year	605,260
Due in more than one year	8,697,694
Total liabilities	<u>11,462,172</u>
NET ASSETS	
Invested in capital assets, net of related debt	11,423,741
Restricted for:	
Debt service	452,162
Capital Projects	1,650,488
Other specified purposes	242,915
Unrestricted (deficit)	(6,921,829)
Total net assets	<u><u>\$ 6,847,477</u></u>

The accompanying notes are an integral part of this statement.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA
STATEMENT OF ACTIVITIES
YEAR ENDED JUNE 30, 2005**

<u>Functions</u>	<u>Program Revenues</u>			<u>Net (expense) revenue and changes in net assets</u>	
	<u>Expenses</u>	<u>Fees, Fines and Charges for Services</u>	<u>Operating Grants and Contributions</u>		<u>Capital Grants and Contributions</u>
Governmental Activities:					
General government	\$ 6,020,246	\$ 1,046,815	\$ 549,292	\$ 95,911	\$ (4,328,228)
Public safety	1,173,292	-	212,341	-	(960,951)
Public works and sanitation	2,028,433	-	53,395	1,348,921	(626,117)
Culture and recreation	646,020	-	-	8,750	(637,270)
Health and welfare	3,451,785	-	1,982,527	764,775	(704,483)
Interest on long term debt	183,983	-	-	-	(183,983)
Total	<u>\$ 13,503,759</u>	<u>\$ 1,046,815</u>	<u>\$ 2,797,555</u>	<u>\$ 2,218,357</u>	<u>(7,441,032)</u>
 General revenues :					
Taxes					
Property taxes				1,430,068	
Municipal licenses taxes				281,401	
Grants contributions not restricted to specific programs				4,774,038	
Interest				20,685	
Other				404,522	
Special item:					
Gain on sale of capital asset				483,140	
Total general revenues and special item:				<u>7,393,854</u>	
Change in net assets				(47,178)	
Net assets-beginning, as restated (note 11)				6,894,655	
Net assets-ending				<u>\$ 6,847,477</u>	

The accompanying notes are an integral part of this statement.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA
BALANCE SHEET
JUNE 30, 2005**

	General	State Legislative Joint Resolutions	Debt Service	FEMA- Hazard Mitigation Grant Program	Other Governmental Funds	Total Governmental Funds
ASSETS AND OTHER DEBITS						
Cash and cash equivalents	\$ -	\$ 1,072,531	\$ -	\$ -	\$ 858,408	\$ 1,930,939
Receivables, net of allowance for uncollectable accounts:						
Due from governmental agencies	95,589	-	47,876	81,632	623,279	848,376
Due from other funds	721,245	874,214	-	-	103,004	1,698,463
Restricted Assets:						
Cash in fiscal agents	-	-	499,781	367,820	363,401	1,231,002
TOTAL ASSETS	\$ 816,834	\$ 1,946,745	\$ 547,657	\$ 449,452	\$ 1,948,092	\$ 5,708,780
LIABILITIES						
Accounts payable and accrued liabilities	\$ 349,007	\$ -	\$ -	\$ -	\$ 387,007	\$ 736,014
Due to governmental agencies	445,251	-	-	-	205	445,456
Due to other funds	527,767	76,811	-	449,452	644,433	1,698,463
Deferred revenues	258,519	-	-	-	966,742	1,225,261
Matured bonds due and payable	-	-	179,000	-	-	179,000
Matured interest due and payable	-	-	94,970	-	-	94,970
TOTAL LIABILITIES	1,580,544	76,811	273,970	449,452	1,998,387	4,379,164
FUND BALANCES						
Reserved for:						
Encumbrances	296,260	-	-	-	-	296,260
Capital projects	-	1,869,934	-	-	(111,226)	1,758,708
Debt service	-	-	273,687	-	-	273,687
Other specified purposes	-	-	-	-	60,907	60,907
Unreserved	(1,059,970)	-	-	-	24	(1,059,946)
TOTAL FUND BALANCES	(763,710)	1,869,934	273,687	-	(50,295)	1,329,616
TOTAL LIABILITIES AND FUND BALANCES	\$ 816,834	\$ 1,946,745	\$ 547,657	\$ 449,452	\$ 1,948,092	\$ 5,708,780

The accompanying notes are an integral part of this statement.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA
RECONCILIATION OF TOTAL GOVERNMENTAL FUND BALANCE
TO NET ASSETS OF GOVERNMENTAL ACTIVITIES
JUNE 30, 2005**

Total fund balances- governmental funds	\$	1,329,616									
<p>Amounts reported for governmental activities in the Statement of Net Assets are different because:</p>											
<p>Capital assets used in governmental activities are not current financial resources and therefore are not reported in the governmental funds balance sheet:</p>		14,273,227									
<p>Other assets used in governmental activities are not current financial resources and therefore are not reported in the funds:</p> <p style="padding-left: 20px;">Deferred Charges</p>		26,105									
<p>Other assets are not available to pay current-period expenditures and therefore are deferred in the funds:</p> <table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 60%;">Receivable - christmas bonus reimbursement</td> <td style="width: 10%; text-align: right;">\$ 95,590</td> <td style="width: 30%;"></td> </tr> <tr> <td>Receivable - EDA</td> <td style="text-align: right;">111,294</td> <td></td> </tr> <tr> <td>Receivable - Public Order Code</td> <td style="text-align: right;"><u>182,008</u></td> <td style="text-align: right;">388,892</td> </tr> </table>	Receivable - christmas bonus reimbursement	\$ 95,590		Receivable - EDA	111,294		Receivable - Public Order Code	<u>182,008</u>	388,892		
Receivable - christmas bonus reimbursement	\$ 95,590										
Receivable - EDA	111,294										
Receivable - Public Order Code	<u>182,008</u>	388,892									
<p>Interest liabilities are not due and payable in the current period and therefore, are not reported in the funds:</p>		(46,409)									
<p>Long term liabilities, including bonds payable, are not due and payable in the current period and therefore are not reported in the funds:</p>		(9,123,954)									
Net assets of governmental activities:	\$	<u>6,847,477</u>									

The accompanying notes are an integral part of this statement.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCE (DEFICIT)
YEAR ENDED JUNE 30, 2005

	General	State Legislative Joint Resolutions	Debt Service	FEMA- Hazard Mitigation Grant Program	Other Governmental Funds	Total Governmental Funds
REVENUES						
Property taxes	\$ 1,135,579	\$ -	\$ 294,489	\$ -	\$ -	\$ 1,430,068
Municipal license tax	281,401	-	-	-	-	281,401
Licenses, permits and other local taxes	904,313	-	-	-	-	904,313
Charges for services	-	-	-	-	14,046	14,046
Fines and forfeitures	16,620	-	-	-	-	16,620
Interest	6,836	-	4,552	-	9,297	20,685
Intergovernmental:						
Federal operating grants	-	-	-	449,452	401,610	851,062
Federal capital grants	-	-	-	-	1,898,200	1,898,200
State operating grants	-	1,222,878	-	-	602,687	1,825,565
State capital grants	-	6,000	-	-	202,863	208,863
Other operating grants and contributions	4,738,752	-	-	-	-	4,738,752
Rent	111,836	-	-	-	-	111,836
Other	379,522	-	-	-	-	379,522
Total revenues	7,574,859	1,228,878	299,041	449,452	3,128,703	12,680,933
EXPENDITURES:						
Current:						
General government	4,236,801	-	-	-	817,584	5,054,385
Public safety	792,468	-	-	-	300,825	1,093,293
Public works and sanitation	1,741,393	-	-	-	164,818	1,906,211
Culture and recreation	414,361	56,368	-	-	22,548	493,277
Health and welfare	987,451	915,172	-	449,452	1,071,912	3,423,987
Capital Outlays	6,100	70,601	-	-	1,530,014	1,606,715
Debt service:						
Principal	-	-	200,000	-	-	200,000
Interest	-	-	184,508	-	-	184,508
Bond issuance costs	-	-	-	-	2,843	2,843
Total expenditures	8,178,574	1,042,141	384,508	449,452	3,910,544	13,965,219
Excess (deficiency) of revenues over (under) expenditures	(603,715)	186,737	(85,467)	-	(781,841)	(1,284,286)
OTHER FINANCING SOURCES (USES):						
Proceeds from issuance of long-term debt	-	-	-	-	145,000	145,000
Transfers in	13,849	-	176,025	-	342,991	532,865
Transfers out	519,016	-	4,552	-	9,297	532,865
Total other financing sources	(505,167)	-	171,473	-	478,694	145,000
SPECIAL ITEM:						
Proceeds from sale of capital asset	600,000	-	-	-	-	600,000
EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES AND OTHER SOURCES (USES)	(508,882)	186,737	86,006	-	(303,147)	(539,286)
FUND BALANCE (DEFICIENCY) AS RESTATED, JULY 1, 2004	(254,828)	1,683,197	187,681	-	252,852	1,868,902
FUND BALANCE (DEFICIENCY), JUNE 30, 2005	(763,710)	\$ 1,869,934	\$ 273,687	\$ -	\$ (50,295)	\$ 1,329,616

The accompanying notes are an integral part of this statement.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA
RECONCILIATION OF STATEMENT OF REVENUES, EXPENDITURES AND CHANGES
IN FUND BALANCES OF GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES
YEAR ENDED JUNE 30, 2005

Net change in fund balances - total governmental funds: **\$ (539,286)**

Amounts reported for governmental activities in the Statement of Activities are different because:

Governmental funds reports capital assets outlays as expenditures. However, in the Statement of Activities the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense:

Expenditures for capital assets	\$ 1,606,715	
Less: current year depreciation	<u>(485,007)</u>	1,121,708

Governmental funds report the effect of bond issuance costs as expenditure when debt is first issued, whereas these amounts are deferred and amortized in the Statement of Activities. This is the net effect of these differences:

Bond issuance costs	2,843	
Amortization of deferred charges	<u>(2,879)</u>	(36)

Governmental funds only report the proceeds received in the disposal of assets. In the Statement of Activities, a gain or loss is reported for each disposal. Thus, the change in net assets differs from the change in fund balance by the cost of the disposed asset:

(541,860)

Revenues in the Statement of Activities that do not provide current financial resources are not reported as revenues in the funds:

Christmas bonus reimbursement	95,590	
EDA	111,294	
Public Order Code	120,928	
Capital asset received in a non monetary exchange	425,000	
Donated Capital Assets	<u>25,000</u>	777,812

Revenues reported in funds which are not reported as revenues in the Statement of Activities:

Christmas bonus reimbursement-prior year		(60,304)
--	--	----------

Proceeds from general obligation bonds are other financing sources in funds but as liabilities in the Statement of Net Assets:

(145,000)

Expenditures reported in funds which are not reported as expenses in the Statement of Activities:

Matured bonds principal payments (net change)	(25,000)	
Prior year accounts payable (net change)	<u>(64,322)</u>	(89,322)

Repayment of long term debt is an expenditure in the governmental funds, but reduces long-term liabilities in the Statement of Net Assets:

General obligation bonds and notes	225,000	
Other long term liabilities	<u>483,281</u>	708,281

Some expenses reported in the Statement of Activities do not require the use of current financial resources and therefore are not reported as expenditures in the governmental funds:

Compensated absences	(197,477)	
Current Year Property Taxes	(56,138)	
Judgment and Claims	(123,543)	
Disallowed costs-FEMA	(750,467)	
Accrued interest (net change)	17,468	
Christmas bonus	<u>(169,014)</u>	(1,279,171)

Change in net assets of governmental activities:

\$ (47,178)

The accompanying notes are an integral part of this statement.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Notes to Basic Financial Statements
June 30, 2005

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) 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), as amended by GASB Statement No. 39 - *Determining Whether Certain Organizations are Component Units* (GASB No. 39) 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. GASB Statement No. 39 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 raise 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, 2005 nor for the year then ended.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Notes to Basic Financial Statements
June 30, 2005

b) 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, 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.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Notes to Basic Financial Statements
June 30, 2005

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, 2005, 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) public safety, (3) public works and sanitation, (4) culture and recreation, (5) health and welfare (6) capital outlays. The governmental operations of the Municipality's departments and operational units are classified within the following functions/programs in the accompanying basic financial statements:

General government:

- Municipal legislature
- Mayor's office
- Department of finance and budget
- Department of human resources
- Department of municipal secretary
- Department of federal programs
- Department of internal audit

Public safety:

- Department of municipal police
- Department of emergency management

Public works and sanitation:

- Department of public works
- Department of sanitation

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Notes to Basic Financial Statements
June 30, 2005

Culture and recreation:

Department of recreation and sports
Department of tourism

Health and welfare

Department of health
Department of elderly affairs

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:

- **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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Notes to Basic Financial Statements
June 30, 2005

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. 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:

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Notes to Basic Financial Statements
June 30, 2005

- **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 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.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Notes to Basic Financial Statements
June 30, 2005

Under current standards 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.

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 or based on the Municipality's official's criteria, if the fund is particularly important to financial statement users. 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 mean 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:

General Fund: The General Fund is the general operations fund of the Municipality. It is used to account for all financial resources except those required to be accounted in another fund.

State Legislative Joint Resolutions Fund: State Legislative Joint Resolutions fund is used to account for revenue sources to be used for the construction and improvement of capital facilities and for welfare purposes.

Debt Service Fund: Debt Service Fund is used to account for the accumulation of resources for, and the payment of, general long-term debt principal and interest.

Hazard Mitigation Grant Program Fund (HMGP): HMGP fund is used to account for revenues sources for the acquisition of property ("buyouts") severely damaged or destroyed in a natural disaster.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Notes to Basic Financial Statements
June 30, 2005

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).

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 current standards, 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 types 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.

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- 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 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, 2005, 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, 2005. 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.

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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, 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.

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).

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

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

Under current standards all general capital assets and the unmatured long-term liabilities (determined using the modified accrual basis of accounting) are incorporated into the accompanying statement of net assets.

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f) 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 the Secretary of the Treasury of the Commonwealth, in the Municipality's name.

Restricted assets include cash and cash equivalents in 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.

g) Unrestricted and Restricted Accounts Receivable

In the accompanying GWFS, receivables consist of all revenues earned but not collected at June 30, 2005. Major receivable balances for the governmental activities include property taxes and intergovernmental receivables.

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 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).

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.

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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.

h) Inventories

The Municipality purchases gasoline, oil and other expendable supplies held for consumption. The cost of those purchases is recorded as expenditure when incurred in the appropriate fund but the year-end inventory is not recorded in the Statement of Net Assets, as management believes is not significant.

i) Deferred Charges

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

j) 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.

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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:

	<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.

k) 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.

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l) Compensated Absences

The Municipality's employees accumulate vacation, sick leave and compensatory time based on continuous service. Compensated absences are recorded as a liability if (1) are earned on the basis of services already performed by employees, (2) it is probable that will be paid (in the form of paid time off, cash payments at termination or retirement, or some other means) and (3) are not contingent on a specific event (such as illness).

The compensated absences are accumulated on the basis of 2½ days per month of vacation and 1½ days per month of sick pay and compensatory time up to a maximum of 60 days of vacations and 90 days of sick leave. Upon separation from employment the accumulated vacations are liquidated up to the maximum number of days. Accumulated sick leave, which is accrued based on all vesting amounts for which payment is probable, is liquidated to employees with 10 years or more service up to the maximum number of days.

The accrual of compensated absences includes estimated payments that are related to payroll. The entire compensated absence liability is reported on the government-wide financial statements. For governmental fund financial statements, the current portion of unpaid compensated absences is the amount that is normally expected to be paid using expendable available financial resources. The non-current portion of the liability is not reported.

m) 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.

n) 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:

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- 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 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.

o) Accounting for Pension Costs

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.

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.

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p) 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 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, 2005. In the past three years, the Municipality has not settled claims that exceeded insurance coverage.

q) 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:

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

r) 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.

s) 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.

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t) Future Adoption of Accounting Pronouncements

The GASB has issued the following statements, which the Municipality has not yet adopted:

Statement	To be Adopted in Fiscal year ended,
42 Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries	June 30, 2006
43 Financial Reporting for Post employment Benefits Plans Other Than Pension Plans	June 30, 2008
44 Economic Condition Reporting: The Statistical Section – an amendment of NCGA Statement No. 1	June 30, 2006
45 Accounting and Financial Reporting by Employers for Post employment Benefits Other Than Pensions	June 30, 2009
46 Net Assets Restricted by Enabling Legislation, an amendment of GASB Statement No. 34	June 30, 2006
47 Accounting for Termination Benefits	June 30, 2006; for termination benefits provided through an existing defined benefit OPEB plan, the provisions of this Statement should be implemented simultaneously with the requirements of Statement 45.

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

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2. CUSTODIAL CREDIT RISK - DEPOSITS

Custodial credit risk is the risk that in the event of a bank failure, the government's deposits may not be returned to it. The Municipality maintains cash deposits in commercial and governmental banks located in Puerto Rico.

Under Commonwealth of Puerto Rico statutes, public funds deposited in commercial banks must be fully collateralized for the amount deposited in excess of federal deposit insurance. All securities pledged as collateral by the Municipality are held by the Secretary of Treasury of Puerto Rico in the Municipality's name. At year end the Municipality's bank balance in commercial banks amounts to \$2,211,860.

Deposits in governmental banks are uninsured and uncollateralized. At year end the Municipality's bank balance in governmental banks amounts to \$1,231,002.

3. DUE FROM (TO) GOVERNMENTAL ENTITIES

a. Amounts due from governmental entities as of June 30, 2005 follows:

	Commonwealth Government	Federal Government
Municipal Revenue Collection Center (CRIM) – property taxes (debt service fund)	\$ 47,876	\$ -
Puerto Rico Department of Family – Child Care	-	71,231
US Department of Justice-COPS	-	999
US Federal Emergency Management Agency – HMGP	-	81,632
Office of Commissioner of Municipal Affairs – CDBG	-	43,968
US Department of Housing and Urban Development – Section 8	-	99
US Department of Commerce – EDA	-	111,294
Puerto Rico Department of Labor – Law 52	206,764	-
Puerto Rico Police Department – Public Order Code	182,008	-
Puerto Rico Rural Development Corporation – Other governmental funds	6,916	-
Puerto Rico Department of Treasury – Christmas bonus reimbursement	95,589	-
	\$ 539,153	\$ 309,223

The amounts due from Puerto Rico Department of Treasury – Christmas bonus (\$95,589), US Department of Commerce – EDA (111,294) and Puerto Rico Police Department – Public Order Code (182,008) are recorded as deferred revenue in the governmental funds statements since are not available as required by current standards.

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b. Amounts due to governmental entities as of June 30, 2005 follows:

	Commonwealth Entities
Puerto Rico Aqueduct and Sewer Authority (PRASA)	\$ 15,517
Puerto Rico General Services Administration	30,236
Puerto Rico Employee Retirement System Administration	42,292
Puerto Rico Industrial Development Corporation (PRIDCO)	16,366
Puerto Rico Department of Labor - unemployment	340,840
Other entities	205
	\$ 445,456

4. INTERFUND TRANSACTIONS

a. Due from/to other funds:

Amounts due from/to other funds represent temporary advances to other funds for payroll and payroll taxes expenditures and to record the overdrawn of pool cash by the general fund to other special funds as follows:

Receivable Fund	Payable Fund	Amount
General Fund	Major fund – State Legislative Joint Resolutions	\$ 76,811
General Fund	Other governmental funds -Public Order Code	192,040
General Fund	Other governmental funds-Law 52	208,672
General Fund	Other governmental funds -CDBG	94,151
General Fund	Other governmental funds-Child Care	110,000
General Fund	Other governmental funds-others	39,571
Major Fund – State Legislative Joint Resolutions	General Fund	424,763
Major Fund – State Legislative Joint Resolutions	Major fund – FEMA HMGP	449,451
Other governmental funds –Citizens Participation	General Fund	99,713
Other governmental funds -others	General Fund	3,291
Total:		\$ 1,698,463

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b. Operating transfers:

Transfers between individual funds were made for operational purposes. Transfers includes: interest earned on restricted cash with fiscal agents in the debt service fund and operating and capital improvement loans in other governmental funds which is transferred to the general fund; principal and interest payments of general long term debt transferred from the general fund to the debt service fund; and transfers of funds from general fund to other special funds for matching purposes or to finance unreimbursable funds from governmental agencies.

5. CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2005, was as follows:

	Balance July 1, 2004	Increases	Decreases	Balance June 30, 2005
<u>Governmental activities:</u>				
Capital assets, not being depreciated:				
Land	\$ 565,795	99,213	-	\$ 665,008
Construction in progress	4,923,631	1,392,175	1,275,044	5,040,762
Total capital assets not being depreciated:	5,489,426	1,491,388	1,275,044	5,705,770
Capital assets, being depreciated:				
Buildings, structures and building improvements	7,252,712	350,987	912,606	6,691,093
Infrastructure	2,342,946	1,275,044	-	3,617,990
Land improvements	2,884,899	-	-	2,884,899
Licensed vehicles	1,286,328	-	-	1,286,328
Machinery and equipment	991,731	214,340	-	1,206,071
Equipment under capital leases	43,572	-	-	43,572
Total capital assets being depreciated	14,802,188	1,840,371	912,606	15,729,953
Less accumulated depreciation for:				
Buildings, structures and building improvements	2,768,368	145,054	370,746	2,542,676
Infrastructure	996,574	117,147	-	1,113,721
Land improvements	1,823,769	85,323	-	1,909,092
Licensed vehicles	773,871	88,410	-	862,281
Machinery and equipment	666,755	49,073	-	715,828
Equipment under capital leases	18,898	-	-	18,898
Total accumulated depreciation	7,048,235	485,007	370,746	7,162,496
Total capital assets being depreciated, net	7,753,953	1,355,364	541,860	8,567,457
Governmental activities capital assets, net	<u>\$ 13,243,379</u>	<u>\$ 2,846,752</u>	<u>\$ 1,816,904</u>	<u>\$ 14,273,227</u>

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

Governmental activities:

General government	\$	102,245
Public safety		80,000
Health and welfare		27,797
Culture and recreation		152,743
Public works and sanitation		<u>122,222</u>
 Total depreciation expense, governmental activities	 \$	 <u>485,007</u>

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.

6. DEFERRED REVENUES

The Municipality reports deferred revenue on its GFFS and GWFS as follows:

	Resources not available	Resources received before legal claim
EDA Fund	\$ 111,294	\$ -
Unearned volume of municipal license taxes	-	162,930
Christmas bonus	95,589	-
Citizens Participation Fund	-	366,234
Federal Emergency Management Agency	-	65,002
Public Order Code Fund	182,008	-
Section 8 Fund	-	132,045
Solid Waste Authority Fund	-	96,603
Others	-	13,555
	<u>\$ 388,892</u>	<u>\$ 836,369</u>

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7. 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, 2005, the Municipality is in compliance with the debt limitation requirements.

The general long-term debt activity for the year ended June 30, 2005 was as follows:

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	Balance at July 1, 2004, as restated	Increases	Decreases	Balance at June 30, 2005	Due within one year
Bonds payable	\$ 3,594,000	\$ 145,000	\$ 225,000	\$ 3,514,000	\$ 200,000
Notes payable to:					
PR Treasury					
Department:					
Loan for payment of legal settlement	1,634,702	-	972	1,633,730	1,002
Financing agreement for the excess of property tax over advances thorough fiscal year 2003	499,196	-	11,216	487,980	12,037
PR Department of Labor and Human Resources	79,457	-	79,457	-	-
PR Land Authority	125,020	-	4,205	120,815	2,751
PR Aqueduct and Sewer Authority	19,358	-	19,358	-	-
CRIM:					
Act No. 42 – Financing agreement for the excess of property tax advances over tax collections through fiscal year 2000	1,041,998	-	13,994	1,028,004	14,868
LIMS	107,732	-	12,539	95,193	12,391
Financing of delinquent property tax accounts sold	204,510	-	65,668	138,842	12,242
Payable to CRIM - Excess of property tax advances over actual collections	-	56,138	-	56,138	-
Payable to FEMA	-	750,467	-	750,467	-
Compensated absences	924,437	197,477	-	1,121,914	50,087
Claims and judgments	175,448	129,700	140,488	164,660	124,146
Obligation under capital leases	27,746	-	5,549	22,197	6,722
Christmas bonus	129,835	169,014	129,835	169,014	169,014
	<u>\$ 8,563,439</u>	<u>\$ 1,447,796</u>	<u>\$ 708,281</u>	<u>\$ 9,302,954</u>	<u>\$ 605,260</u>

a) Bonds Payable and operational loans

The Municipality issues general and special (public improvements) obligations bonds and operational loans 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, 2005 is composed of the following debts:

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	Outstanding Amount
<u>General Obligation Bonds:</u>	
1992 serial bonds, original amount of \$375,000, due in annual principal installments ranging from \$25,000 to \$50,000; plus interest due in semiannual installments at variable rates from 5.00% to 7.81% (5.00% at June 30, 2005) through July 1, 2009	\$ 220,000
2002 serial bonds, original amount of \$530,000, due in annual principal installments ranging from \$10,000 to \$40,000; plus interest due in semiannual installments at variable rates from 2.70% to 5.60% (2.89% at June 30, 2005) through July 1, 2026	500,000
<u>Public Improvement Bonds:</u>	
1981 serial bonds, original amount of \$217,000, due in annual principal installments ranging from \$5,000 to 13,000; plus interest due in annual installments at rates of 5.00% through January, 1, 2006	13,000
1983 serial bonds, original amount of \$127,000, due in annual principal installments ranging from \$3,000 to \$8,000; plus interest due in annual installments at rates of 5.00% through January 1, 2006	8,000
1995 serial bonds, original amount of \$1,125,000, due in annual principal installments ranging from \$20,000 to \$110,000; plus interest due in semiannual installments at variable rates from 4.70% to 6.63% (5.925% at June 30, 2005) through July 1, 2016	860,000
<u>Operational loans:</u>	
1986 original issue amount of \$280,000, due in annual principal installments of \$14,000, plus interest due in semiannual installments at variable rates from 5.00% to 8.50% (5.00% at June 30, 2005) through July 1, 2006	28,000
2000 original issue amount of \$135,000, due in annual principal installments ranging from \$10,000 to \$20,000; plus interest due in semiannual installments at variable rates from 5.00% to 7.81% (5.00% at June 30, 2005) through July 1, 2009	80,000
2002 original amount of \$1,740,000, due in annual installments ranging from \$10,000 to \$130,000; plus interest due in semiannual installments at variable rates from 5.00% to 6.00% (5.00% at June 30, 2005) through July 1, 2026	1,660,000
2005 original amount of \$145,000, due in annual principal installments ranging from \$10,000 to \$20,000; plus interest due in annual installments at rates of 5.00% through July 1, 2014	145,000
	\$ 3,514,000

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

June 30	Principal	Interest
2006	\$ 200,000	\$ 181,985
2007	189,000	190,448
2008	185,000	179,759
2009	195,000	168,832
2010	210,000	157,057
2011-2015	845,000	638,002
2016-2020	705,000	382,089
2021-2025	660,000	202,508
2026-2029	325,000	21,740
Totals	<u>\$ 3,514,000</u>	<u>\$ 2,122,420</u>

b) Notes Payable to Puerto Rico Treasury Department

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, 2005, the balance of this note, net of the unamortized discount of \$287,186, amounted to \$1,633,730, with an accrued interest of \$4,084. This amount will be repaid with unrestricted funds. The principal and discount amortization (recorded as interest expense) maturities are as follows:

June 30	Principal	Interest
2006	\$ 1,002	\$ 48,996
2007	102,419	47,325
2008	105,534	44,202
2009	159,437	40,164
2010	164,287	35,303
2011-2014	1,101,051	71,196
Totals	<u>\$ 1,633,730</u>	<u>\$ 287,186</u>

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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 \$487,980 and \$2,879, respectively, at June 30, 2005. This amount will be repaid with unrestricted funds. The principal and interest maturities are as follows:

June 30	Principal	Interest
2006	\$ 12,037	\$ 34,092
2007	12,917	33,207
2008	13,862	32,256
2009	14,876	31,236
2010	15,964	30,142
2011-2015	99,137	131,277
2016-2020	141,101	89,067
2021-2025	178,086	29,417
Totals	<u>\$ 487,980</u>	<u>\$ 410,694</u>

c) 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, 2005, the balance of this note, net of the unamortized discount of \$102,540, amounted to \$120,815, with an accrued interest of \$6,645. This amount will be repaid with unrestricted funds. The principal and discount amortization (recorded as interest expense) maturities are as follows:

June 30	Principal	Interest
2006	\$ 2,751	\$ 7,098
2007	2,916	6,924
2008	3,091	6,739
2009	3,277	6,543
2010	3,473	6,335
2011-2015	20,753	28,106
2016-2020	16,537	22,554
2021-2025	33,366	14,798
2026-2029	34,651	3,443
Totals	<u>\$ 120,815</u>	<u>\$ 102,540</u>

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d) 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 were 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 a rate of 6.2%. The outstanding principal and accrued interest balances of the note payable to CRIM amounted \$1,028,004 and \$31,804 respectively, at June 30, 2005. This amount will be repaid with unrestricted funds. The principal and interest maturities are as follows:

June 30	Principal	Interest
2006	\$ 14,873	\$ 63,021
2007	15,807	61,958
2008	16,801	60,994
2009	17,876	59,845
2010	19,028	58,689
2011-2015	114,354	273,585
2016-2020	155,496	231,312
2021-2025	210,317	174,436
2026-2030	284,641	91,153
2031-2033	178,811	10,995
Totals	\$ 1,028,004	\$ 1,085,988

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, 2005, the balance of this note, net of the unamortized discount of \$20,511, amounted to \$95,193. This amount will be repaid with unrestricted funds. The principal and discount amortization (recorded as interest expense) maturities are as follows:

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June 30	Principal	Interest
2006	\$ 12,391	\$ 5,421
2007	13,139	4,669
2008	13,932	3,871
2009	14,774	3,026
2010	15,666	2,129
2011-2012	25,291	1,395
Totals	<u>\$ 95,193</u>	<u>\$ 20,511</u>

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 is 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 \$65,668 to the principal on this agreement. At June 30, 2005, the outstanding principal amounted to \$138,842. The principal and interest maturities are as follows:

June 30	Principal	Interest
2006	\$ 12,242	\$ 9,025
2007	-	7,566
2008	-	8,229
2009	2,177	8,165
2010	2,323	8,019
2011-2015	14,165	37,543
2016-2020	19,588	32,121
2021-2025	27,086	24,622
2026-2030	37,456	14,253
2031-2033	23,805	2,049
Totals	<u>\$ 138,842</u>	<u>\$ 151,592</u>

- e) **Other payable to CRIM - Excess of property tax advances over actual collections** – The \$56,138 represents the balance owed as of June 30, 2005 to CRIM for excess of advances of property tax and other subsidies over final amount of property tax collections for the fiscal year ended June 30, 2005 (see note 8). This amount will be repaid with unrestricted funds.
- f) **Note Payable to FEMA** – This amount represents final disallowed costs as determined by an audit performed by the Governor's Authorized Representative (GAR) of FEMA funds related to Hurricane Georges. As of June 30, 2005, the outstanding balance amounts to \$750,467. The Municipality intends to pay the amount through a payment plan with FEMA which will be financed with unrestricted funds.

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- g) **Compensated absences*** - Includes accrued vacations, sick leave benefits and other benefits with similar characteristics such as compensatory time, represents the Municipality's commitment to fund such costs from future operations. As of June 30, 2005 the outstanding balance amounts to \$1,121,914. This amount will be repaid with unrestricted funds.
- h) **Other claims and judgments*** - Represent the final costs of legal cases paid subsequent to June 30, 2005 and other claims outstanding as of that date. The awarded amounts will be paid with unrestricted funds. As of June 30, 2005 the outstanding balance amounts to \$164,660.
- i) **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, 2005, 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. The present value of the future minimum capital lease payments at June 30, 2005 reported in the accompanying government-wide statement of net assets is as follows:

<u>Year ending June 30,</u>	<u>Amount</u>
2006	\$ 8,542
2007	7,152
2008	6,756
2009	<u>3,184</u>
Total future minimum lease payments	25,634
Less: amount representing future interest cost at 8.00%	<u>(3,437)</u>
Present value of minimum lease payments	22,197
Less:	
Current portion of obligation under capital leases	<u>6,722</u>
Obligation under capital leases, excluding current portion	<u>\$ 15,475</u>

- j) **Christmas bonus*** - Represent the accrued portion corresponding to fiscal year 2004-2005 of the Christmas bonus to be paid in December 2005.

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8. PROPERTY TAXES

The Municipal Revenue Collection Center (CRIM) of the Commonwealth of Puerto Rico is responsible for the assessment, collection and distribution of real and personal property taxes. The tax on personal property is self-assessed by the taxpayer. The assessment is made on a return, which must be filed with the CRIM by May 15 of each year and is based on the current value at the date of the assessment. Real property is assessed by the CRIM. The tax is general assessed on January 1 on all taxable property located within the Municipality and is based on the current value existing in the year 1957. For personal property the tax is due with the return filed on or before May 15. Taxes on real property may be paid on two equal installments, July 1st and January 1st.

The tax rates in force as of June 30, 2005 are 8.78% for real property (of which 8.58% is paid by the taxpayer and .20% is reimbursed by the Puerto Rico Treasury Department) and 6.58% for personal property (of which 6.38% is paid by the taxpayer and .20% is reimbursed by the Puerto Rico Treasury Department). For both tax rates 1.03% belongs to the Commonwealth and 7.75% and 5.75%, respectively, belongs to the Municipality. Of the portion belonging to the Municipality, 6% on real property and 4% on personal property represents the Municipality's portion which is appropriated for general purposes and accounted in the general fund. The remaining portion of 1.75% on both tax rates belonging to the Municipality is restricted for debt service and accounted in the debt service fund.

Residential real property occupied by its owner is exempt by law from property taxes on the first \$15,000 of the assessed value. For such exempted amounts, the Puerto Rico Department of Treasury assumes payment of the basic tax to the Municipality, except for residential units assessed at less than \$3,500 on which a complete exemption is granted. Revenue related to exempt property is recorded in the General Fund. The Municipality grants a complete exemption from personal property taxes up to an assessment value of \$50,000 to retailers with annual net sales of less than \$150,000.

The CRIM advances funds to the Municipality based on an estimate of special governmental subsidies and the property taxes to be levied and which are collected in subsequent periods. This distribution includes advances of property tax and amounts of municipal equalization fund from the Commonwealth government. The CRIM is required by law to prepare a settlement statement on a fiscal year basis, whereby a comparison is made between the amounts advanced to the Municipality and amounts actually collected from taxpayers. The CRIM prepares a preliminary settlement not later than three months after fiscal year-end and a final settlement not later than six months after fiscal year-end. If actual collections exceed the advances a receivable from CRIM is recorded. However, if advances exceed actual collections, a payable to CRIM is recorded. The Municipality has a net payable to the CRIM of \$ 56,138 resulting from the final settlement for fiscal year 2004-2005. The total amount is recorded as a long term debt in the government-wide statement since will not be paid with expendable available resources.

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9. 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, 2005, 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 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 \$162,930 at June 30, 2005, which represents municipal licenses collected in advance for the taxable year 2005-2006.

10. INTERGOVERNMENTAL REVENUES

Intergovernmental revenues in the General Fund are comprised of the following:

	Amount
Amount of municipal equalization fund and subsidy send by CRIM	\$ 3,684,757
Compensation in lieu of tax from the Puerto Rico Electric Power Authority (PREPA)	917,793
Reimbursement from Commonwealth Government - Christmas Bonus expenditures	131,920
Other intergovernmental revenues	4,282
	\$ 4,738,752

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11. FUND BALANCE RESTATEMENTS

a. Fund balances

The beginning fund balances of the General Fund and Public Order Code fund included in other governmental funds have been restated to recognize corrections of accounting errors. In the general fund corrections include: overstatement of assets for \$91,324 and understatement of liabilities for \$424,633. The following schedule reconciles the fund balance at July 1, 2004 as previously reported to the beginning fund balance, as restated:

Fund	Prior period adjustments		
	Balance at beginning of year, as previously reported	Correction of errors	Balance at beginning of year, as Restated
General fund	\$ 261,129	\$ (515,957)	\$ (254,828)
Other governmental funds	313,931	(61,079)	252,852

b. Net assets

Net assets at beginning of year have been adjusted to reflect the following restatements:

Net assets at beginning of year as previously reported:	\$ 7,052,053
Restatements:	
Overstatement of assets	(91,324)
Understatement of other long-term debt	(39,154)
Understatement of accrued interest payable	(26,920)
Net assets at beginning of year as restated:	\$ 6,894,655

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12. 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 issues 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 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 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.

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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 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</u> <u>ended June 30,</u>	<u>Act No. 447</u>	<u>System 2000</u>
2005	<u>\$68,503</u>	<u>\$130,816</u>
2004	<u>\$74,224</u>	<u>\$74,481</u>
2003	<u>\$80,633</u>	<u>\$20,775</u>

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13. COMMITMENTS AND CONTINGENCIES

a. Encumbrances and construction commitments

The Municipality has reported, outstanding encumbrances amounting to \$296,260 in the general fund at June 30, 2005. 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.

The Municipality has commitments at June 30, 2005 of approximately \$572,224 for design, construction, improvements or renovation of certain municipal facilities.

b. Operating leases

The Municipality leases office equipment under operating lease agreements, which generally have terms of one year or less and are automatically renewed for the same terms. Rental expenses amounted approximately \$ 8,641. Management believes that the summary of the future minimum rental commitments under noncancelable operating leases with terms exceeding one year is not significant

c. Federal and State Grants

Projects financed by the Federal and State Grants are subject to audits by grantors and other governmental agencies in order to determine its expenditures to comply with the conditions of such grants. During fiscal period and as disclosed in Note 7(f) the Municipality accrued in the GWFS \$750,467 representing disallowed costs as determined by an audit performed by the Governor's Authorized Representative (GAR) of FEMA funds related to Hurricane Georges. As of June 30, 2005 the GAR informed the Municipality that additional funds in the amount of 296,635 may be disallowed since certain projects have not been completed. The final outcome of this matter is undeterminable.

It is the Municipality's opinion that no additional material unrecorded liabilities will arise from audits previously performed or to perform.

d. Litigations

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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Notes to Basic Financial Statements
June 30, 2005

With respects to pending or threatened litigation, the Municipality has reported liabilities of \$164,660 for awarded or anticipated unfavorable judgments as of June 30, 2005. Management believes that any unfavorable outcome in relation to pending or threatened litigation would not be significantly in excess of recorded amounts.

14. FUND BALANCE DEFICITS

Certain special funds included as other governmental funds in the fund statements disclosed fund balance deficits as follows:

	Amount
Economic Development Administration-EDA	\$ 111,226
Public Order Code	\$ 181,999

The deficits results from the accrual of expenditures without accruing intergovernmental revenues for reimbursement of expenditures. As required by current standards, the Municipality recorded intergovernmental revenues for reimbursement-based (expenditure-driven) grants on fund statements when all applicable eligibility requirements have been met and the resources are available.

15. SPECIAL ITEM

During fiscal year the Municipality sold a building and corresponding land with a book value of \$541,860 for \$600,000 in cash and a building and corresponding land valued at \$425,000. The transaction falls under the definition of special item set forth by GASB 34, as it is a transaction of unusual or infrequent nature within the control of Municipality's management.

16. SUBSEQUENT EVENTS

- a. On July 26, 2005 the Municipality agreed to sell a parcel of land for a total amount of \$612,265. The Municipality received \$50,000 as an advance on June 20, 2005 and \$562,265 on August 1, 2005. The amount received as an advance was recorded as deposit payable in the financial statements.

- b. On September 9, 2005, the Governmental Development Bank of Puerto Rico (GDB) approved the issuance of a \$1,310,000 public improvement bond to the Municipality to finance various capital projects, including roads improvements and construction of ceilings for various basketball courts. Payments are due in annual installments through year 2025, bearing interest at a variable rate (LIBOR + 1.25%). Principal and interest payments will be financed through the Municipality's debt service fund.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA
BUDGETARY COMPARISON SCHEDULE - GENERAL FUND
YEAR ENDED JUNE 30, 2005**

	<u>Budgeted Amounts</u>		<u>Actual Amounts (Budgetary Basis)</u>	<u>Variance with Final Budget Positive (Negative)</u>
	<u>Original</u>	<u>Final</u>		
REVENUES:				
Property taxes	\$ 1,034,707	\$ 1,034,707	\$ 1,135,579	\$ 100,872
Municipal license tax	285,000	285,000	281,401	(3,599)
Licenses, permits and other local taxes	861,500	861,500	904,313	42,813
Fines and forfeitures	1,000	1,000	16,620	15,620
Interest	50,000	50,000	20,685	(29,315)
Intergovernmental:				
Other operating grants and contributions	5,441,864	5,441,864	4,668,802	(773,062)
Rent	95,000	95,000	111,836	16,836
Other	65,000	65,000	768,260	703,260
Total revenues	<u>7,834,071</u>	<u>7,834,071</u>	<u>7,907,496</u>	<u>73,425</u>
EXPENDITURES:				
Current:				
General government	3,839,109	3,986,278	4,084,830	(98,552)
Public safety	960,366	825,796	799,375	26,421
Public works and sanitation	1,764,817	1,764,177	1,743,638	20,539
Culture and recreation	415,686	436,701	427,624	9,077
Health and welfare	674,013	641,039	603,369	37,670
Total expenditures	<u>7,653,991</u>	<u>7,653,991</u>	<u>7,658,836</u>	<u>(4,845)</u>
Excess (deficiency) of revenues over (under) expenditures	180,080	180,080	248,660	68,580
Other financing sources (uses)				
Transfers out	180,080	180,080	176,025	4,055
Total other financing sources (uses)	<u>(180,080)</u>	<u>(180,080)</u>	<u>(176,025)</u>	<u>4,055</u>
Excess (deficiency) of revenues and other financing sources over expenditures and other financing uses	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 72,635</u>	<u>\$ 72,635</u>

The accompanying notes are an integral part of this required supplementary information.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Notes to Required Supplementary Information-
Budgetary Comparison Schedule-General Fund
June 30, 2005

1. 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 preliminary 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 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, public safety, public works and sanitation, culture and recreation and health 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.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Notes to Required Supplementary Information-
Budgetary Comparison Schedule-General Fund
June 30, 2005

2. 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.

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, 2005. 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, 2005, 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.

3. Budget to GAAP Reconciliation

The accompanying budgetary comparison schedule presents comparisons of the original and final legally adopted budget with actual data on a budgetary basis. Since accounting principles applied for the purposes of developing data on a budgetary basis differ significantly from those used to present accounting principles generally accepted in the United States, the following budget to GAAP reconciliation is presented:

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA
Notes to Required Supplementary Information -
Budgetary Comparison Schedule-General Fund
June 30,2005

Excess of revenues and other financing sources over expenditures and other financing uses (budgetary basis):	\$	72,635
Budget to GAAP differences:		
Entity differences:		
Non budgeted funds recorded as revenues for financial reporting purposes:		265,545
Non budgeted funds recorded as expenditures for financial reporting:		(438,374)
Non budgeted transfers out:		(342,991)
Basis of accounting differences:		
Revenues recorded in budgetary basis purposes but not in financial reporting:		(50,000)
Expenditures recorded for financial reporting purposes but not in budgetary basis:		(249,032)
Timing differences:		
Current year encumbrances recorded as expenditures for budgetary reporting purposes:		233,336
Net change in fund balance (GAAP basis):	\$	<u>(508,882)</u>

SINGLE AUDIT SECTION

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
YEAR ENDED JUNE 30, 2005**

<u>Federal Grantor/Pass-Through Grantor/Program Title</u>	<u>Federal CFDA Number (note B)</u>	<u>Pass-Through Entity Identifying Number (note C)</u>	<u>Federal Expenditures (note A)</u>
<u>U.S. Department of Agriculture</u>			
Passed through the P.R. Department of Education: Child and Adult Care Food Program	10.558	N/A	\$ 9,835
<u>U.S. Department of Commerce</u>			
Direct program: Grant for Public Works and Economic Development	11.300	N/A	856,842
<u>U.S. Department of Housing and Urban Development</u>			
Passed through the Office of Commissioner of Municipal Affairs: Community Development Block Grant - State's Program	14.228	AF - 25 AB - 25 FD - 25	1,238,559
Direct program: Section 8 Housing Choice Vouchers Program	14.871	N/A	187,510
			<u>1,426,069</u>
<u>U.S. Department of Justice</u>			
Passed through the P.R. Department of Justice: Local Law Enforcement Block Grant	16.592	2003-LB-BX-1619	50,000
Public Safety Partnership and Community Policy Grants (COPS)	16.710	2000SHWX0527	41,411
			<u>91,411</u>
<u>U.S. Department of Health and Human Services</u>			
Passed through the P.R. Department of Family - Families and Children Administration: Child Care and Development Block Grant	93.575	2003-030	142,806
<u>Federal Emergency Management Agency</u>			
Passed through the Puerto Rico Governor Office - (Governor's Authorized Representative-GAR): Hazard Mitigation Grant Program	97.039	DR-1501-PR-0001	449,452
Total Expenditures of Federal Awards			<u>\$ 2,976,415</u>

The accompanying notes are an integral part of this schedule.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Notes to Schedule of Expenditures of Federal Awards
June 30, 2005

NOTE A – BASIS OF PRESENTATION

The accompanying schedule of expenditures of federal awards includes the federal grant activity of the Municipality and is presented on the modified accrual basis of accounting. Expenditures are recognized when the related liability is incurred. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, "Audits of States, Local Governments and Nonprofit Organizations". Therefore, some amounts presented in this schedule may differ from the amounts presented in, or used in the preparation of, the basic financial statements.

NOTE B – FEDERAL CFDA NUMBER

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

NOTE C – PASS-THROUGH ENTITY IDENTIFYING NUMBER

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

NOTE D – RECONCILIATION OF EXPENDITURES PRESENTED IN THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS TO THE EXPENDITURES PRESENTED IN THE BASIC FINANCIAL STATEMENTS

Description	FEMA-Hazard Mitigation Grant Program	Other Governmental Funds
10.558	\$ -	\$ 9,835
11.300	-	856,842
14.228	-	1,238,559
14.871	-	187,510
16.592	-	50,000
16.710	-	41,411
93.575	-	142,806
97.039	449,452	-
Total federal awards expenditures:	449,452	2,526,963
Total non-federal awards expenditures:	-	1,383,581
Total expenditures, fund statements:	\$ 449,452	\$ 3,910,544

Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With Government Auditing Standards

*Mayor and Municipal Legislature
Municipality of Guanica
Guanica, Puerto Rico*

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the Municipality of Guanica, Puerto Rico (the Municipality) as of and for the year ended June 30, 2005, and have issued our report thereon dated December 22, 2005 which is qualified since we were unable to obtain sufficient and competent evidence to support the allocation of pool cash transactions recorded in the General Fund because of the inadequacy of accounting records and reports. Except as discussed in the first sentence, we conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the Municipality's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Municipality's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying schedule of findings and questioned costs as items **2005 II-1** and **2005 II-3**.

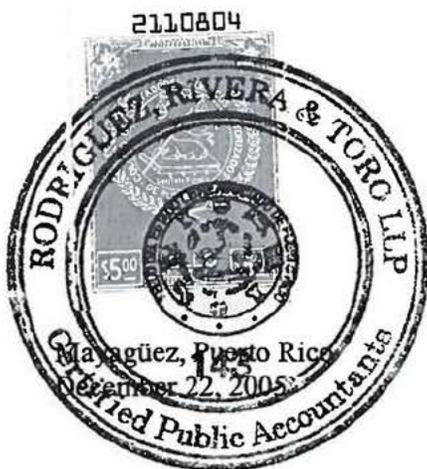
A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider items **2005 II-1** and **2005 II-3** in the accompanying schedule of findings and questioned costs to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Municipality's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule of findings and questioned costs as items 2005 II-2 and 2005 II-4.

We also noted certain additional matters that we reported to management of the Municipality in a separate letter dated December 22, 2005.

This report is intended for the information of the management and the Municipal Legislature of the Municipality, Commonwealth and Federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than the specified parties.



Rodriguez, Rivera & Toro LLP

Report on Compliance With Requirements Applicable to Each Major Program and on Internal Control Over Compliance in Accordance With OMB Circular A-133

*Mayor and Municipal Legislature
Municipality of Guanica
Guanica, Puerto Rico*

Compliance

We have audited the compliance of Municipality of Guanica, Puerto Rico (the Municipality) with the types of compliance requirements described in the U. S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2005. The Municipality's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to its major federal programs is the responsibility of the Municipality's management. Our responsibility is to express an opinion on the Municipality's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Municipality's compliance with those requirements and performing such other procedures, as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the Municipality's compliance with those requirements.

As described in items 2005 III-4, 2005 III-5, and 2005 III-7 in the accompanying schedule of findings and questioned costs, the Municipality did not comply with requirements regarding *Cash Management, and Davis Bacon* that are applicable to its *Community Development Block Grant – State's Program* and with requirements regarding *Reporting* that are applicable to its *Hazard Mitigation Grant Program*. Compliance with such requirements is necessary, in our opinion, for the Municipality to comply with the requirements applicable to these programs.

In our opinion, except for the non-compliance described in the preceding paragraph, the Municipality of Guanica complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2005.

Internal Control over Compliance

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

We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect the Municipality's ability to administer a major federal program in accordance with the applicable requirements of laws, regulations, contracts, and grants. Reportable conditions are described in the accompanying schedule of findings and questioned costs as items 2005 III-1 to 2005 III-7.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider items 2005 III-4, 2005 III-5, and 2005 III-7 to be material weaknesses.

This report is intended for the information of the management and the Municipal Legislature of the Municipality, Commonwealth and Federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than the specified parties.



Rodriguez, Rivera & Toro LLP

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

For the year ended June 30, 2005

Section I - Summary of Auditor's Results:

Part I - Financial Statements

- Type of auditor's report issued: Unqualified opinion Qualified opinion
 Adverse opinion Disclaimer of opinion
- Internal control over financial reporting:
- Material weaknesses identified? Yes No
 - Reportable conditions identified that are not considered to be material weaknesses? Yes None reported
- Noncompliance material to financial statements noted? Yes No

Part II - Federal Awards

- Internal control over major programs:
- Material weaknesses identified? Yes No
 - Reportable conditions identified that are not considered to be material weaknesses? Yes None reported
- Type of auditor's report on compliance for major programs: Unqualified opinion Qualified opinion
 Adverse opinion Disclaimer of opinion
- Audit findings disclosed that are required to be reported under Section 510(a) of OMB Circular A-133: Yes No

Identification of major programs:	CFDA Number	Name of Federal Program or Cluster
	11.300	Grants for Public works and Economic Development
	14.228	Community Development Block Grant - State's Program
	97.039	Hazard Mitigation Grant Program

- Dollar threshold used to distinguish between type A and type B programs: \$300,000
- Auditee qualified as low-risk auditee: Yes No

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS- Continued

For the year ended June 30, 2005

Section II – Financial Statement Findings Reported in Accordance with *Government Auditing Standards*:

Reference Number: 2005 II-1
Area: Accounting records and reports
Type: Material weakness

Criteria: The Municipality should establish internal control policies and procedures to maintain adequate, complete and reconciled accounting records and reports. Accounting principles generally accepted in the United States of America require financial transactions to be recorded in accounting records properly reconciled with subsidiaries or supporting records and reports.

Condition: Our tests to the Municipality's accounting records disclosed the following:

- (1) There are no adequate controls over transactions recording and balances analysis related to Form 4(a) Monthly Cash Report. The pooled cash account balance in the General Fund at June 30, 2005, as disclosed in the bank reconciliation of the general bank account, did not agreed by a significant amount with the pooled cash balance disclosed in the Form 4(a) Monthly Cash Report maintained by the Finance Department.
- (2) The Municipality has not established a complete set of accounting records properly balanced and has no proper procedures for reconciliation with the computerized accounting system. Certain records, such as the disbursement register, are not being properly maintained since not all the disbursement transactions of the year were posted. The financial statements have been prepared from other alternative sources, including manual subsidiary records and reports.

Cause: The Municipality has no proper procedures to maintain a complete and reconciled set of accounting records and reports. Personnel in the Finance Department lacks of adequate supervision and monitoring of financial reporting process. Deficiencies related to Form 4(a) Monthly Cash Report are caused by accounting errors and interfund loans or advance payments not adjusted or reimbursed.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS- Continued

For the year ended June 30, 2005

Section II – Financial Statement Findings Reported in Accordance with *Government Auditing Standards*:

Reference Number: 2005 II-2
Area: Accounting records and reports
Type: Material instance of noncompliance

Criteria:	As required by the Autonomous Municipal Law of 1981, as amended, the Municipality should provide adequate resources to amortize the general fund deficit.
Condition:	The June 30, 2005 financial statements disclosed that the General Fund ended with a cumulative fund balance deficit of \$763,710.
Cause:	This matter was caused primarily to inadequate revenue projections, inadequate controls over appropriations and interfund advances not collected in current and previous years.
Effect:	The Municipality must include in subsequent years budgets amounts sufficient to amortize such deficit.
Recommendation:	Procedures should be established to assure compliance with requirements of the Municipal Law. The Municipality should establish a deficit reduction plan assigning the necessary budgetary credits in the annual budget as required by law and controlling and collecting interfund advances. In addition, appropriate steps should be implemented in order to avoid future deficits.
Views of responsible officials and planned corrective actions:	See accompanying corrective action plan submitted by management and included as part of this audit report.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS- Continued

For the year ended June 30, 2005

Section II – Financial Statement Findings Reported in Accordance with *Government Auditing Standards*:

Reference Number: 2005 II-3
Area: Interfund transactions – due from\to other funds
Type: Material weakness

Criteria:	Funds are temporarily advanced from general current bank account to other funds for salaries, fringe benefits and other costs incurred by several special accounts. Those advances should be subsequently reimbursed by the applicable Commonwealth and Federal agencies based on billings prepared by the Municipality.
Condition:	The Municipality has no adequate billing and collection procedures established to assure proper and timely repayment of advances.
Cause:	The Municipality has not established controls and procedures for billing and collection of advances.
Effect:	Several amounts are not being reimbursed or not timely reimbursed by the applicable agencies. The Municipality has suffered significant losses for uncollectible amounts which severely affected its cash flow and general fund's operational results.
Recommendation:	The Municipality should establish the referred controls and procedures including responsible personnel of processes. A complete review of uncollected balances since previous years should be performed to identify, bill and collect unclaimed funds from Commonwealth and Federal agencies.
Views of responsible officials and planned corrective actions:	See accompanying corrective action plan submitted by management and included as part of this audit report.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS- Continued

For the year ended June 30, 2005

Section II – Financial Statement Findings Reported in Accordance with *Government Auditing Standards*:

Reference Number: 2005 II-4
Area: Interfund transactions – use of restricted funds
Type: Material instance of noncompliance

Criteria: Article 8.004 (c) of the Municipal Law No. 81, as revised, establish that grant funds and similar funds received specifically for predetermined use can be used only for the purpose for which they were received. Circular letter No. 93-34 issued by the Office of Commissioner of Municipal Affairs (OCAM) on November 17, 1993 establish that the use of the special funds granted by the Legislative Body of the Commonwealth of Puerto Rico are restricted only for the specific purposes established through resolutions and can not be used for any other purpose unless subsequently disposed by this body. Law No. 72 of August 11, 1997, an amendment of the Municipal Law No. 81 of August 30, 1991, establish that special funds granted by the Legislative Body must be deposited in a separate bank account to avoid their use as part of the cash reserve maintained by the Municipalities.

Condition: During our audit we became aware that a significant amount of Commonwealth's Legislature Resolution funds deposited in a separate bank account were used to finance, through temporary interfund loans, the operations of a federal program. We also noted that this practice continued through the next fiscal year.

Cause: This practice arises because of deficiencies of General Fund's cash flow.

Effect: This situation could cause a limitation over the special funds resources available for projects and caused non compliance with the applicable laws and regulations.

Recommendation: The Finance Department must immediately discontinue this practice in order to be in compliance with the established local law and regulation.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS- Continued

For the year ended June 30, 2005

Section II – Financial Statement Findings Reported in Accordance with *Government Auditing Standards*:

Area: Interfund Transactions – use of restricted funds (continued):

Reference number 2005 II-4 - continued

**Views of responsible
officials and planned
corrective actions:**

See accompanying corrective action plan submitted by
management and included as part of this audit report.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS- Continued

For the year ended June 30, 2005

III. Federal Award Findings and Questioned Costs Reported in Accordance with *OMB Circular A-133*:

Reference Number: 2005 III-1
Agency: U. S. Department of Commerce
Program: Grants for Public Works and Economic Development
CFDA Number: 11.300
Project: Construction of Coastal Enterprise Center - Award number 01-01-07597
Regulation/Requirement: Cash management, 24 CFR 85.20(b)
Type: Reportable condition
Questioned Costs: \$ -0-

Criteria: Program funds are requested to grantor agency based on incurred costs. The Municipality should minimize the time elapsing between the transfer of funds from the U.S. Treasury and the corresponding disbursements.

Condition: In 2 instances during the year the Municipality has excess cash in bank for unreasonable periods of time after transfer of funds by the grantor agency.

Context: We verified the activity of all the 4 requisitions made to the grantor during the year and the disbursements issued to use deposited funds and found one case on which a balance of \$20,720 was outstanding for a period of 52 consecutive days. We also found that in another case on which a balance of \$66,656 was outstanding for a period of 75 consecutive days which ended after June 30, 2005.

Cause: Program did not made adequate calculations of fund needs in the process of requesting funds to grantor agency when they still have some cash available in the bank account.

Effect: The program has excess cash in bank account which not permit compliance with this requirement to reduce time elapsing between the transfer of funds from the U.S. Treasury and the corresponding disbursements.

Recommendation: The program should establish specific cash flow planning procedures to assure that disbursements are issued soon after the related deposits are made and to avoid the request of excess funds when matching funds are also received.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS- Continued

For the year ended June 30, 2005

III. Federal Award Findings and Questioned Costs Reported in Accordance with *OMB Circular A-133*:

Reference Number: 2005 III-1 - continued

**Views of responsible officials
and planned corrective
actions:**

See accompanying corrective action plan submitted by
management and included as part of this audit report.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS- Continued

For the year ended June 30, 2005

III. Federal Award Findings and Questioned Costs Reported in Accordance with OMB Circular A-133:

Reference Number:	<u>2005 III-2</u>
Agency:	U. S. Department of Commerce
Program:	Grants for Public Works and Economic Development
CFDA Number:	11.300
Project:	Construction of Coastal Enterprise Center - Award number 01-01-07597
Regulation/Requirement:	Davis-Bacon Act
Type:	Reportable condition
Questioned Costs:	\$ -0-

Criteria:

The Davis Bacon Act requires that all laborers and mechanics employed on the site of a project financed with federal funds be paid not less than the wages and fringe benefits determined by the Department of Labor to be prevailing in the area. As part of the requirements of the Davis-Bacon Act, the Municipality should conduct regular compliance checks, such as payroll review and site visits, as often as necessary to ensure compliance with contract labor standards. The contractor and subcontractors must provide certified payrolls weekly for the life of the project in accordance with the Copeland Anti-Kickback Act. The Municipality should ensure that the payrolls are submitted on time, no later than a week after the wages have been paid. On-site inspections should be made regularly after reviewing the payrolls to crosscheck the information.

Condition:

Our tests over procedures related to the construction activity financed with EDA funds disclosed that:

- 1) There is no evidence supporting the data; the payrolls were submitted by the contractor. The Federal Programs Director stated that generally the payrolls are received monthly.
- 2) There is no evidence supporting that the Municipality is performing on-site visits and employee's interviews.

Cause:

The Municipality has not followed established procedures for compliance with applicable requirements on this EDA grant. No specific explanation was provided for this noncompliance.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS- Continued

For the year ended June 30, 2005

III. Federal Award Findings and Questioned Costs Reported in Accordance with *OMB Circular A-133*:

Reference Number: 2005 III-2 - continued

Effect:	As compliance with the Davis-Bacon requirements were not adequately monitored, it is unclear whether the minimum wage requirements of Davis-Bacon were met.
Recommendation:	The Municipality should enforce the weekly submission of the payrolls and assign to a specific department or employee duties related to site visits and employees interviews to determine contractor's compliance with Davis-Bacon Act requirements for EDA grant.
Views of responsible officials and planned corrective actions:	See accompanying corrective action plan submitted by management and included as part of this audit report.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS- Continued

For the year ended June 30, 2005

III. Federal Award Findings and Questioned Costs Reported in Accordance with *OMB Circular A-133*:

Reference Number: 2005 III-3
Agency: U. S. Department of Commerce
Program: Grants for Public Works and Economic Development
CFDA Number: 11.300
Project: Construction of Coastal Enterprise Center - Award number 01-01-07597
Regulation/Requirement: Special tests and provisions - tests to accounting records for compliance with 13 CFR 143.20 (b)
Type: Reportable condition
Questioned Costs: \$ -0-

Criteria: Accounting records - Grantees and sub-grantees must maintain records which adequately identify the source and application of funds provided for financially-assisted activities. These records must contain information pertaining to grant or sub-grant awards and authorizations, obligations, un-obligated balances, assets, liabilities, outlays or expenditures, and income.

Condition: A complete general ledger has not been maintained by the Municipality. Grant receivables and payables are not recognized.

Cause: General ledger is maintained on cash basis and not on modified accrual basis.

Effect: General ledger is not balanced and complete; do not include significant transactions at year end.
Program amounts included in the basic financial statements and the accompanying schedule of expenditures of federal awards were obtained from other alternative sources, including manual subsidiary records and reports.

Recommendation: A complete general ledger should be maintained and program transactions should be recorded on a modified accrual basis of accounting. Responsible personnel should be properly trained in accounting matters.

Views of responsible officials and planned corrective actions: See accompanying corrective action plan submitted by management and included as part of this audit report.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS- Continued

For the year ended June 30, 2005

III. Federal Award Findings and Questioned Costs Reported in Accordance with *OMB Circular A-133*:

Reference Number:	<u>2005 III-4</u>
Agency:	U. S. Department of Housing and Urban Development
Pass-through Entity:	Office of Commissioner of Municipal Affairs (OCAM)
Program:	Community Development Block Grant – State’s Program
CFDA Number:	14.228
Regulation/Requirement:	Cash management, 24 CFR 85.20(b)
Type:	Material weakness\material instance of noncompliance
Questioned Costs:	\$ -0-

Criteria: Program funds are requested to the pass-through entity based on incurred costs. The Municipality should minimize the time elapsing between the transfer of funds from the U.S. Treasury and the corresponding disbursements.

Condition: The Municipality has excess cash in bank for an unreasonable period on time after transfer of funds by the pass-through entity. In several cases checks were issued before the corresponding requisitions were made and send to the pass-through agency.

Context: Our tests to a sample of 7 bank deposits related to grant funds requested to the pass-through agency (from a total population of 20 deposits) disclosed the following:

- a. In 3 cases the corresponding fund disbursements were issued on a period between 19 days to 10 months after funds were deposited.
- b. In 5 cases the corresponding fund disbursements were issued before the applicable requisitions were made and send to the pass-through agency. These disbursements were financed with excess funds from previous requisitions.

Cause: Program accounting controls were not adequate and there were no proper procedures established to determine excess cash available. In addition, several disbursements were paid before funds were requested since disbursements were financed with excess funds from previous requisitions.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS- *Continued*

For the year ended June 30, 2005

III. Federal Award Findings and Questioned Costs Reported in Accordance with *OMB Circular A-133*:

Reference Number: 2005 III-4 - continued

Cause-continued:	In previous years the Municipality had significant deficiencies related to controls over requests and requested funds in excess. As a consequence the Municipality has currently excess funds in bank.
Effect:	The Municipality has excess cash in bank account which not permit compliance with requirement to reduce times elapsing between the transfer of funds from the U.S. Treasury and the corresponding disbursements.
Recommendation:	The Municipality should establish specific procedures to assure that disbursements are issued soon after the related deposits are made. Also, the Federal Programs Office should obtain from the pass-through entity specific instructions for the final outcome on excess cash in bank as a result of deficiencies on controls over requests in previous years.
Views of responsible officials and planned corrective actions:	See accompanying corrective action plan submitted by management and included as part of this audit report.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS- Continued

For the year ended June 30, 2005

III. Federal Award Findings and Questioned Costs Reported in Accordance with *OMB Circular A-133*:

Reference Number:	2005 III-5
Agency:	U. S. Department of Housing and Urban Development
Pass-through Entity:	Office of Commissioner of Municipal Affairs (OCAM)
Program:	Community Development Block Grant – State’s Program
CFDA Number:	14.228
Regulation/Requirement:	Davis-Bacon Act
Type:	Material weakness\material instance of noncompliance
Questioned Costs:	\$ -0-

Criteria:

The Davis Bacon Act requires that all laborers and mechanics employed on the site of a project financed with federal funds be paid not less than the wages and fringe benefits determined by the Department of Labor to be prevailing in the area. As part of the requirements of the Davis-Bacon Act, the Municipality should conduct regular compliance checks, such as payroll review and site visits, as often as necessary to ensure compliance with contract labor standards. The contractor and subcontractors must provide certified payrolls weekly for the life of the project in accordance with the Copeland Anti-Kickback Act. The Municipality should ensure that the payrolls are submitted on time, no later than a week after the wages have been paid. On-site inspections should be made regularly after reviewing the payrolls to crosscheck the information.

Condition:

Our tests over monitoring made by the Municipality over two construction activities financed with CDBG funds disclosed the following:

- (1) In one of the activities we did not found evidence of payrolls reviews. In addition, from a total of 11 payrolls submitted by contractor in 5 cases we did not found evidence documenting submission date. Only one case has evidence indicating that it was received within a week after the wages have been paid.
- (2) In the other construction activity, we did not found evidence of payrolls reviews. Only 2 payrolls were found and none of them had evidence of the date they were received.

COMMONWEALTH OF PUERTO RICO
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SCHEDULE OF FINDINGS AND QUESTIONED COSTS- Continued

For the year ended June 30, 2005

III. Federal Award Findings and Questioned Costs Reported in Accordance with *OMB Circular A-133*:

Reference Number: 2005 III-5 - continued

Cause:	The Municipality has not followed adequate procedures to assure compliance with Davis Bacon requirements applicable to CDBG grant. Program employees are not aware of some specific requirements regarding Davis Bacon.
Effect:	As compliance with the Davis-Bacon requirements were not adequately monitored, it is unclear whether the minimum wage requirements of Davis-Bacon were met.
Recommendation:	The Program should enforce the weekly submission of the payrolls and establish a procedure to document the reviews made to payrolls submitted by contractors paid with this federal fund to fully document its monitoring procedures made to determine contractor's compliance with Davis-Bacon Act requirements.
Views of responsible officials and planned corrective actions:	See accompanying corrective action plan submitted by management and included as part of this audit report.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS- Continued

For the year ended June 30, 2005

III. Federal Award Findings and Questioned Costs Reported in Accordance with *OMB Circular A-133*:

Reference Number: 2005 III-6
Agency: U. S. Department of Housing and Urban Development
Pass-through Entity: Office of Commissioner of Municipal Affairs (OCAM)
Program: Community Development Block Grant – State's Program
CFDA Number: 14.228
Regulation/Requirement: Special tests and provisions - tests to accounting records for compliance with 24 CFR 85.20(b)
Type: Reportable condition
Questioned Costs: \$ -0-

Criteria: Accounting records - Grantees and sub-grantees must maintain records which adequately identify the source and application of funds provided for financially-assisted activities. These records must contain information pertaining to grant or sub-grant awards and authorizations, obligations, un-obligated balances, assets, liabilities, outlays or expenditures, and income.

Condition: A complete general ledger has not been maintained by the Municipality. Grant receivables and payables are not recognized.

Context: We examined the general ledger of all open Program Years. Record does not include significant receivables and payables accounts.

Cause: General ledger is maintained on cash basis and not on modified accrual basis.

Effect: General ledger is not complete and do not include significant transactions at year end.
Program amounts included in the basic financial statements and the accompanying schedule of expenditures of federal awards were obtained from other alternative sources, including manual subsidiary records and reports.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS- Continued

For the year ended June 30, 2005

III. Federal Award Findings and Questioned Costs Reported in Accordance with *OMB Circular A-133*:

Reference Number: 2005 III-6 - continued

Recommendation:	Complete program general ledgers should be maintained and program transactions should be recorded on a modified accrual basis of accounting. Responsible personnel should be properly trained in accounting matters.
Views of responsible officials and planned corrective actions:	See accompanying corrective action plan submitted by management and included as part of this audit report.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS- Continued

For the year ended June 30, 2005

III. Federal Award Findings and Questioned Costs Reported in Accordance with OMB Circular A-133:

Reference Number:	<u>2005 III-7</u>
Agency:	U. S. Department of Homeland Security: Federal Emergency Management Agency
Program:	Hazard Mitigation Grant (HMGP)
CFDA Number:	97.039
Project:	Acquisition and Demolition of 19 Housing Units – Award Number FEMA-1501 DR-PR
Regulation/Requirement:	Reporting
Type:	Material weakness\material instance of noncompliance
Questioned Costs:	\$ -0-

Criteria:	As specified in the Grant Agreement conditions, the program must submit to the Governor's Authorized Representative (GAR) a quarterly progress report by the 10 th day of the next month after the end of the quarter. They also state that the program must submit to the GAR a monthly progress report by the 10 th day of the next month after end of the month to be reported. In addition the Grant Agreement conditions states that the program must submit to the GAR a quarterly financial report (Standard form 269) with the submission of the quarterly progress report.
Condition:	The Municipality did not comply with requirements applicable to progress and financial reports.
Context:	<ol style="list-style-type: none">(1) The quarterly progress reports were submitted after the prescribed period of time – 3 of 4 reports.(2) The monthly progress reports were submitted after the prescribed period of time – 11 of 12 reports.(3) There is documentation supporting the preparation of only 1 of the quarterly financial reports but no evidence of its submission. There is no evidence supporting the preparation and submission of the other 3 quarterly financial reports – 4 of 4 reports.
Cause:	The program has not established adequate procedures to produce and document submission of the various reports required by grantor agency.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS- *Continued*

For the year ended June 30, 2005

III. Federal Award Findings and Questioned Costs Reported in Accordance with *OMB Circular A-133*:

Reference Number: 2005 III-7 - continued

Effect: The program is not in compliance with the reporting requirements established in the grant agreement.

Recommendation: The program must establish and follow adequate procedures to assure full compliance with the reporting requirements of the grant agreement.

Views of responsible officials and planned corrective actions: See accompanying corrective action plan submitted by management and included as part of this audit report.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA**

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

For the year ended June 30, 2005

Financial Statement Findings Reported in Accordance with *Government Auditing Standards*:

Fiscal year ended June 30,	Finding No.	Condition	Status
2004	2004 II-1	Funds are temporarily advanced from general current bank account to other funds for salaries, fringe benefits and other costs incurred by several special accounts. Those advances should be subsequently reimbursed by the applicable Commonwealth and Federal agencies based on billings prepared by the Municipality. The Municipality has no adequate billing and collection procedures established to assure proper and timely repayment of advances.	Audit report and related findings have not been cleared by the pass-through entity, the Office of Commissioner of Municipal Affairs (OCAM). See related finding No. 2005 II-3 in the accompanying schedule of findings and questioned costs.
2003	2003 II-1	As required by the Autonomous Municipal Law of 1981, as amended, the Municipality should provide adequate resources to amortize the general fund deficit. The June 30, 2003 financial statements disclosed that the general fund ended with a cumulative fund balance deficit of \$445,683.	Audit report and related findings were cleared by the pass-through entity, the Office of Commissioner of Municipal Affairs (OCAM) on letter dated December 14, 2004.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA**

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS - Continued

For the year ended June 30, 2005

Financial Statement Findings Reported in Accordance with *Government Auditing Standards*:

Fiscal year ended June 30,	Finding No.	Condition	Status
2003	2003 II-2	<p>a. The general ledger is not reconciled with other accounting records or supporting reports on a monthly basis, including federal programs records.</p> <p>b. The Municipality does not prepare the Form 4(a) Cash report properly reconciled on a monthly basis with the general ledger and corresponding bank conciliations.</p>	Audit report and related findings were cleared by the pass-through entity, the Office of Commissioner of Municipal Affairs (OCAM) on a letter dated December 14, 2004. See related finding No. 2005 II-1 in the accompanying schedule of findings and questioned costs.
2003	2003 II-3	Our tests disclosed that the Municipality has not adequate controls and procedures over recording of advances and reimbursements. Also, there are no adequate follow up over amounts to be reimbursed to assure proper and timely repayment of advances.	Audit report and related findings were cleared by the pass-through entity, the Office of Commissioner of Municipal Affairs (OCAM) on a letter dated December 14, 2004. See related finding No. 2005 II-3 in the accompanying schedule of findings and questioned costs.
2003	2003 II-4	The Municipality performed a review of capital assets inventory records in order to comply with requirements of GASB Statement Number 34. Our tests disclosed several deficiencies in this area.	Audit report and related findings were cleared by the pass-through entity, the Office of Commissioner of Municipal Affairs (OCAM) on letter dated December 14, 2004.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA**

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS - Continued

For the year ended June 30, 2005

Financial Statement Findings Reported in Accordance with *Government Auditing Standards*:

Fiscal year ended June 30,	Finding No.	Condition	Status
2002	2002 II-1	The Municipality has not properly implemented and established internal controls and procedures to maintain adequate, complete and reconciled set of accounting records and reports.	Audit report and related findings were cleared by the pass-through entity, the Office of Commissioner of Municipal Affairs (OCAM) on a letter dated December 14, 2004. See related finding No. <u>2005 II-1</u> in the accompanying schedule of findings and questioned costs.
2002	2002 II-2	Our tests disclosed that the Municipality has not established adequate controls and procedures over the recording of advances and reimbursements. Also, there is no adequate follow up over amounts to be reimbursed to assure proper and timely repayment of advances.	Audit report and related findings were cleared by the pass-through entity, the Office of Commissioner of Municipal Affairs (OCAM) on a letter dated December 14, 2004. See related finding No. <u>2005 II-3</u> in the accompanying schedule of findings and questioned costs.
2002	2002 II-3	Our tests over the budget and costs control procedures disclosed that the general fund ended with an operational deficit of \$295,214 and a cumulative fund balance deficit of \$1,830,433.	Audit report and related findings were cleared by the pass-through entity, the Office of Commissioner of Municipal Affairs (OCAM) on letter dated December 14, 2004.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA**

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS - Continued

For the year ended June 30, 2005

Financial Statement Findings Reported in Accordance with *Government Auditing Standards*:

Fiscal year ended June 30,	Finding No.	Condition	Status
2002	2002 II-4	The Municipality has not established adequate controls and procedures to assure the completeness, existence and valuation of fixed assets inventories.	Audit report and related findings were cleared by the pass-through entity, the Office of Commissioner of Municipal Affairs (OCAM) on letter dated December 14, 2004.
2002	2002 II-5	Our examination of internal controls and procedures over a sample of 23 cash disbursements revealed several internal controls and/or compliance deficiencies.	Audit report and related findings were cleared by the pass-through entity, the Office of Commissioner of Municipal Affairs (OCAM) on letter dated December 14, 2004.
2002	2002 II-6	Our examination of internal controls and procedures over a sample of 12 employee's files revealed several deficiencies.	Audit report and related findings were cleared by the pass-through entity, the Office of Commissioner of Municipal Affairs (OCAM) on letter dated December 14, 2004.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA**

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS - Continued

For the year ended June 30, 2005

Federal Award Findings and Questioned Costs Reported in Accordance with OMB Circular A-133:

Fiscal year ended June 30,	Program	No.	Condition	Status
2004	US Department of Commerce: Grants for Public Works and Economic Development - CFDA No. 11.300	2004 III-1	Our tests disclosed that there is no evidence that the Municipality is performing on-site visits and employee's interviews. The Municipality has not assigned to a specific department or responsible employee duties related to contractor's payrolls review for compliance with Davis-Bacon Act requirements of this EDA grant.	Finding remains not cleared by grantor agency. See related finding No. 2005 III-2 in the accompanying schedule of findings and questioned costs.
2004	US Department of Commerce: Grants for Public Works and Economic Development - CFDA No. 11.300	2004 III-2	A complete general ledger has not been maintained by the Municipality. Grant receivables and payables are not recognized. General ledger is maintained on cash basis and not on modified accrual basis.	Finding remains not cleared by grantor agency. See related finding No. 2005 III-3 in the accompanying schedule of findings and questioned costs.
2004	US Department of HUD: Community Development Block Grant State's Program - CFDA No. 14.228	2004 III-3	The Municipality has excess cash in bank for an unreasonable period of time after transfer of funds by the pass-through entity. In several cases checks were issued before corresponding requisitions were made and send to the pass-through agency.	Audit report and related findings have not been cleared by the pass-through entity, the Office of Commissioner of Municipal Affairs (OCAM). See related finding No. 2005 III-4 in the accompanying schedule of findings and questioned costs.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA**

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS - Continued

For the year ended June 30, 2005

Federal Award Findings and Questioned Costs Reported in Accordance with OMB Circular A-133:

Fiscal year ended June 30,	Program	No.	Condition	Status
2004	US Department of HUD: Community Development Block Grant State's Program - CFDA No. 14.228	2004 III-4	A complete general ledger has not been maintained by the Municipality. Grant receivables and payables are not recognized. General ledger is maintained on cash basis and not on modified accrual basis.	Audit report and related findings have not been cleared by the pass-through entity, the Office of Commissioner of Municipal Affairs (OCAM). See related finding No. 2005 III-6 in the accompanying schedule of findings and questioned costs.
2004	US Department of HUD: Community Development Block Grant State's Program - CFDA No. 14.228	2004 III-5	Certain participant files lacks of adequate eligibility documentation or evidence of follow up visits to monitor use of donated construction materials. In 1 case the application was not signed by the participant. In 3 cases there is no evidence of receipt of materials and in 1 case evidence is incomplete. In 2 cases there was no follow up visit and in 1 case the final visit was made 4 months after the work was ended.	Audit report and related findings have not been cleared by the pass-through entity, the Office of Commissioner of Municipal Affairs (OCAM).

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA**

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS - Continued

For the year ended June 30, 2005

Federal Award Findings and Questioned Costs Reported in Accordance with OMB Circular A-133:

Fiscal year ended June 30,	Program	No.	Condition	Status
2003	US Department of HUD: Community Development Block Grant State's Program - CFDA No. 14.228	2003 III-1	Our tests to a sample of 8 bank deposits related to grant funds requested to the pass-through agency (from a total population size of 17 deposits) disclosed certain deficiencies related to cash management requirements.	Audit report and related findings were cleared by the pass-through entity, the Office of Commissioner of Municipal Affairs (OCAM) on a letter dated December 14, 2004. See related finding No. <u>2005 III-4</u> in the accompanying schedule of findings and questioned costs.
2003	US Department of HUD: Community Development Block Grant State's Program - CFDA No. 14.228	2003 III-2	Our evaluation of a sample of 8 quarterly reports, (from a population of 15 reports corresponding to program years reporting disbursements) submitted to the pass-through entity during the fiscal period disclosed certain deficiencies related to reporting requirements.	Audit report and related findings were cleared by the pass-through entity, the Office of Commissioner of Municipal Affairs (OCAM) on letter dated December 14, 2004.

**COMMONWEALTH OF PUERTO RICO
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SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS - Continued

For the year ended June 30, 2005

Federal Award Findings and Questioned Costs Reported in Accordance with OMB Circular A-133:

Fiscal year ended June 30,	Program	No.	Condition	Status
2003	US Department of HUD: Community Development Block Grant State's Program - CFDA No. 14.228	2003 III-3	Program accounting records maintained by the Federal Programs Office of the Municipality are not balanced and complete. Several transactions, related to assets, liabilities, revenues and expenditures, has not been recorded in the general ledger, the cash receipts and cash disbursement journals. In addition, amounts do no reconcile with centralized accounting records. Program accounting records reported \$404,344 in expenditures versus \$544,923 as reported by the centralized accounting records in the financial statements.	Audit report and related findings were cleared by the pass-through entity, the Office of Commissioner of Municipal Affairs (OCAM) on a letter dated December 14, 2004. See related finding No. <u>2005 III-6</u> in the accompanying schedule of findings and questioned costs.
2003	US Department of HUD: Community Development Block Grant State's Program - CFDA No. 14.228	2003 III-4	Our tests to a sample of 6 participant's files (from a population of 26 files) of the materials donation program disclosed that certain documents were missing from files.	Audit report and related findings were cleared by the pass-through entity, the Office of Commissioner of Municipal Affairs (OCAM) on letter dated December 14, 2004.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA**

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS - Continued

For the year ended June 30, 2005

Federal Award Findings and Questioned Costs Reported in Accordance with OMB Circular A-133:

Fiscal year ended June 30,	Program	No.	Condition	Status
2002	US Department of HUD: Community Development Block Grant State's Program CFDA No. 14.228	2002 III-1	Municipalities are required to request from contractors a certification stating that Entity's Principals are not suspended or debarred from doing business with State or Federal Government or this requirement may be included as a contract clause. Our examination of the only construction contract financed with federal funds disclosed that such clause was not included in contract nor a certification was obtained from contractor.	Audit report and related findings were cleared by the pass-through entity, the Office of Commissioner of Municipal Affairs (OCAM) on letter dated December 14, 2004.
2002	US Department of HUD: Community Development Block Grant State's Program CFDA No. 14.228	2002 III-2	Our tests to a sample of 6 participant's files of housing rehabilitation program financed with SBGP funds disclosed documents missing from the files.	Audit report and related findings were cleared by the pass-through entity, the Office of Commissioner of Municipal Affairs (OCAM) on letter dated December 14, 2004.
2002	US Department of HUD: Community Development Block Grant State's Program CFDA No. 14.228	2002 III-3	Condition and criteria: In our examination of controls and procedures used in the administration of federal funds, we noted that for a sample of six (6) receipts and deposits tested, in five (5) cases disbursements were made between seven (7) and twenty-seven (27) days after related funds were deposited by OCAM.	Audit report and related findings were cleared by the pass-through entity, the Office of Commissioner of Municipal Affairs (OCAM) on a letter dated December 14, 2004. See related finding No. <u>2005 III-4</u> in the accompanying schedule of findings and questioned costs.

**COMMONWEALTH OF PUERTO RICO
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SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS - Continued

For the year ended June 30, 2005

Federal Award Findings and Questioned Costs Reported in Accordance with OMB Circular A-133:

Fiscal year ended June 30,	Program	No.	Condition	Status
2002	US Department of HUD: Community Development Block Grant State's Program CFDA No. 14.228	2002 III-4	Our examination disclosed that the Municipality has not performed adequate procedures to close Program Years 1994 and 1997.	Audit report and related findings were cleared by the pass-through entity, the Office of Commissioner of Municipal Affairs (OCAM) on letter dated December 14, 2004.
2002	US Department of HUD: Community Development Block Grant State's Program CFDA No. 14.228	2002 III-5	SBGP program general ledgers are not balanced and complete. Salaries and fringe benefits expenditures amounts are recorded as reimbursed to the general fund instead as when incurred. Also, transactions related to assets and liabilities arising from interfund transactions are not recorded.	Audit report and related findings were cleared by the pass-through entity, the Office of Commissioner of Municipal Affairs (OCAM) on a letter dated December 14, 2004. See related finding No. <u>2005 III-6</u> in the accompanying schedule of findings and questioned costs.



COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA

COMMENTS TO SCHEDULE OF FINDINGS AND QUESTIONED COSTS

For the year ended June 30, 2005

FINDING 2005 II-1

The Municipality is in process to evaluate the accounting personnel to establish the needs associated with the individual knowledge on accounting principles related to governmental financial reporting. Also we are in process to review and actualize reports Form 4(a), bank reconciliation and general ledger to reconcile the records to provide complete, accurate and reliable set of accounting records and reports.

FINDING 2005 II-2

The Municipality has established a deficit reduction plan assigning the budgetary credits in the annual budget that permits our economic situation, without affecting the necessary services to our citizen.

FINDING 2005 II-3

The Municipality created the Sub-Director of the Finance Department position which one of his objectives is to review uncollected balances, bill and collect them from the Commonwealth and Federal agencies.

FINDING 2005 II-4

The Finance Department has been instructed to discontinue this inappropriate practice.

FINDING 2005 III-1

The Municipality would be more precautionous in his cash flow procedures to avoid this situation to occur again.

FINDING 2005 III-2

The Federal Program personnel have been instructed that the payroll should be submitted weekly by the contractors and to enforce the site visits and employees interviews fully documented.

FINDING 2005 III-3

The OCAM accounting system is recorded in accrual basis but the manual General ledger is record in cash basis due to habitual procedure, the Municipality is looking for a way to resolve this situation.

FINDING 2005-4

The Finance Department and the Federal Programs Office would establish the necessary procedures and control to avoid this situation in the future.

FINDING 2005-5

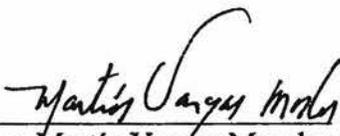
The Federal Program personnel have been instructed that the payroll should be submitted weekly by the contractors and to establish a procedure of reviewing the submitted payroll.

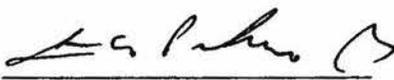
FINDING 2005-6

The OCAM accounting system is recorded in accrual basis but the manual General ledger is record in cash basis due to habitual procedure, the Municipality is looking for a way to resolve this situation.

FINDING 2005-7

The Federal Program personnel have been instructed to document all submission of the reports required by the grantor agency.


Hon. Martín Vargas Morales
Mayor


Luis A. Pacheco Santiago
Finance Director



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA**

*FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT*

FISCAL YEAR ENDED JUNE 30, 2005

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA**

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FINANCIAL SECTION

Independent Auditor's Report

*Mayor and Municipal Legislature
Municipality of Guanica
Guanica, 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 Guanica, Puerto Rico, as of and for the year ended June 30, 2005, which collectively comprise the Municipality's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Municipality's management. Our responsibility is to express opinions on these financial statements based on our audit.

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

We were unable to obtain sufficient and competent evidence to support the allocation of pool cash transactions recorded in the General Fund because of the inadequacy of accounting records and reports, which do not permit the application of adequate alternative procedures.

In addition, in our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to obtain sufficient and competent evidence to support the allocation of pool cash transactions recorded in the General Fund, the financial statements referred to in the first paragraph present fairly, in all material respects, the respective financial position of the General Fund of the Municipality of Guanica, Puerto Rico as of June 30, 2005, 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.

In addition, in our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the respective financial position of the governmental activities, the State Legislative Joint Resolutions Fund, the Debt Service Fund, the FEMA-Hazard Mitigation Grant Program Fund and the aggregate remaining fund information of the Municipality of Guanica, Puerto Rico as of June 30, 2005, 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 on pages 4 through 16 and the Budgetary Comparison Schedule – General Fund on page 60 are not a required part of the basic financial statements, but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.



Rodriguez, Rivera & Toro LLP

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Management Discussion and Analysis
June 30, 2005

Our discussion and analysis of the Municipality of Guánica financial performance provides an overview of the Municipality's financial activities for the fiscal year ended June 30, 2005. Because this MD&A is designed to focus on the current year activities, resulting changes and currently known facts, we encourage reader to consider the information presented in this MD&A in conjunction with the additional information furnished in the accompanying basic financial statements.

FINANCIAL HIGHLIGHTS

- The Municipality has reported assets amounting to \$18.31 millions in the accompanying statement of net assets, of which most significant are Capital assets, cash and cash in fiscal agent amounting to \$ 14.27million, \$1.93 million and \$1.23 million respectively.
- The Municipality's capital assets increase as a result of this year's operations. Capital assets as of June 30, 2005 are \$14.27 million, as compared to \$ 13.24 million for the year ended June 30, 2004, for a 7.2% of increase.
- The assets of the Municipality exceeded its liabilities by \$6.85 millions at June 30, 2005, represented as "net assets" in the accompanying statements of net assets. Restricted and unrestricted (deficit) net assets amounted to \$2.35 million and \$(6.92) millions, respectively. Net assets invested in capital assets amounted \$11.42 millions.
- During the year, the Municipality reported revenues of \$ 7.57 million in the General Fund of total revenues restricted and unrestricted of \$12.68 million.
- Loans principal payments were \$.20 million. During the year ended June 30, 2005, the Municipality issued \$.145 millions on bonds payable.
- The Municipality has reported total expenses amounting to \$13.50 millions in the accompanying statement of activities.

USING THIS ANNUAL REPORT

This annual report consists of a series of financial statements. The Statement of Net Assets and the Statement of Activities provide information about the activities of the Municipality as a whole and present a long-term view of the Municipality's finances. For governmental activities, these statements tell how these services were financed in the short term as well as what remains for future spending. Fund financial statements also report the Municipalities' operations in more detail than the government-wide statements by providing information about the Municipality's most significant funds. Both perspectives 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.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Management Discussion and Analysis
June 30, 2005

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
3. notes of the financial statements

These components are described below:

Government-wide financial statement: Are designed to provide reader with a broad of the Municipality's operations and finance as 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. The governmental-wide financial statements include; the statement of net assets and the statement of activities.

The Statement of Net Assets and the Statement of Activities

The Statement of Net Assets and the Statement of Activities report information about the Municipality as a whole and about its activities. These statements include *all* assets and liabilities using the *accrual basis of accounting*, which is similar to the accounting used by most private-sector companies. All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

These two statements report the Municipality's *net assets* and changes in them. You can think of the Municipality's net assets, the difference between assets and liabilities, as one way to measure the Municipality's financial health, or *financial position*. Over time, *increases or decreases* in the Municipality's net assets are one indicator of whether its *financial health* is improving or deteriorating. You will need to consider other non-financial factors, however, such as changes in the Municipality's property tax base and the condition of the roads, to assess the *overall health* of the Municipality of Guánica.

In the Statement of Net Assets and the Statement of Activities, we divide the Municipality into:

- Governmental activities – Most of the Municipality's basic services are reported here, including the municipal police, public works, garbage disposal, public energy and health services, and general administration. Property taxes, municipal license tax, state and federal grants finance most of these activities.

Reporting the Municipality's Most Significant Funds

Fund Financial Statement: Report the financial position and results of operations of the Municipality's governmental funds. The Fund Financial statement components are the Balance Sheet-government

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Management Discussion and Analysis
June 30, 2005

funds and the statements of revenues, expenditures and changes in fund balance. The Fund financial statements provide detailed information about the most significant funds, not the Municipality as a whole. Some funds are required to be established by bond covenants.

The Municipality's basic services are reported in the governmental funds, that uses an accounting approach which focus on how money flows into and out of those funds and the balances left at year-end that are available for spending. These funds are reported using an accounting method called *modified accrual* accounting, which measures cash and all other *financial* assets that can readily be converted to cash. The governmental fund statements provide a detailed *short-term view* of the Municipality's general government operations and the basic services it provides. Governmental fund information helps you determine whether there are more or fewer financial resources that can be spent in the near future to finance the Municipality's programs. We describe the relationship (or differences) between governmental *activities* (reported in the Statement of Net Assets and the Statement of Activities) and governmental *funds* in a reconciliation on this report.

Notes to the Basic Financial Statement: The notes provide additional information that is essential to a full understanding of the data provided in government-wide and the fund financial statements.

THE MUNICIPALITY AS A WHOLE

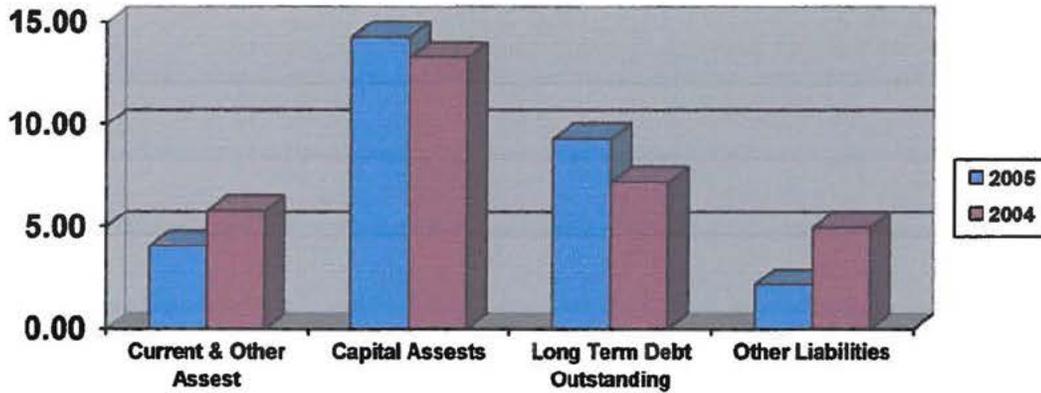
The Municipality's *combined* net assets decreases from a year ago, from \$6.91 million to \$6.85 million. Our analysis below focuses on the net assets (Table 1) and changes in net assets (Table 3) of the Municipality's governmental activities.

Table 1
NET ASSETS
(in Millions)

	Governmental Activities	
	2005	2004
Current and other assets	\$4.04	\$5.78
Capital assets	14.27	13.27
Total assets	18.31	19.05
Long-term debt outstanding	(9.30)	(7.18)
other liabilities	(2.16)	(4.96)
Total liabilities	(11.46)	(12.14)
Net assets:		
Invested in capital assets, net of related debt	11.42	11.33
Restricted for:		
Debt services	.45	.47
Capital project	1.65	1.11
Other specified purpose	.24	.53
Unrestricted	(6.92)	(6.38)
Net Assets	\$ 6.85	\$ 6.91

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Management Discussion and Analysis
June 30, 2005

Components of Net Assets (in millions)



Net assets of the Municipality's governmental activities decreased by \$.06 million ((\$6.91 million Compared to \$6.85 million). *Unrestricted* net assets, the part of net assets that can be used to finance day-to-day operations without constraints established by debt covenants, enabling legislation or other legal requirements, changed from approximately \$(6.38) million at June 30, 2004 to a \$(6.92) million at June 30, 2005. The following is a condensed presentation of the Municipality's results of operations, as reported in the government-wide financial statements:

Comparative Condensed Statement of Activities:

	2005	2004
Revenues:		
Program revenues:		
Operating grants and contributions	\$ 2,797,555	\$ 1,854,710
Capital grants and contributions	2,218,357	2,855,218
Charges for services	1,046,815	108,505
General revenues:		
Property taxes	1,430,068	1,650,331
Municipal license taxes	281,401	289,796
Construction excise taxes		667,446
Unrestricted intergovernmental contributions and reimbursements	4,774,038	4,566,060
Unrestricted interest on deposit	20,685	58,561
Other	404,522	369,642
Special items-		
Gain on Sale of capital assets	483,140	118,456
Total revenues	<u>13,456,581</u>	<u>12,538,725</u>
Expenses:		
General government	6,020,246	2,914,565
Urban and economic development		1,309,850
Public Safety	1,173,292	957,240
Public work and sanitation	2,028,433	1,983,559
Culture and recreation	646,020	40,356
Health and welfare	3,451,785	2,188,705
Interest and bonds, notes and capital lease obligations	183,983	361,717
Total expenses	<u>13,503,759</u>	<u>9,755,992</u>
Net increase in net assets	(47,178)	2,782,731
Net assets-at the beginning of the year, as restated	<u>6,894,655</u>	<u>4,111,922</u>
Net assets- at end of the year	<u>6,847,477</u>	<u>6,894,655</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Management Discussion and Analysis
June 30, 2005

Financial analysis of the Municipality's Governmental Funds

The Municipality uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. The focus of the Municipality's governmental fund is to provide information on near-term inflow, outflow, and balance of spend able resources. Such information is useful in assessing the Municipality's financial 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 government fund:

	2005	2004
Comparative Condensed Balance Sheet-Governmental funds:		
Total assets-major funds	3,760,778	4,859,990
Total assets-nonmajor funds	1,948,092	1,992,327
Total assets	5,708,870	6,852,317
Total liabilities-major funds	2,380,777	3,243,940
Total liabilities-nonmajor funds	1,998,387	1,739,475
Total liabilities	4,379,164	4,983,415
Fund Balances:		
Reserved-major funds	2,439,881	1,870,878
Reserved-nonmajor funds	(50,295)	252,852
Unreserved-major funds	(1,059,970)	(254,828)
Total fund balances	1,329,616	1,868,902
Comparative Condensed Statement of Operations-Governmental funds:		
Total revenues-major funds	9,552,230	9,153,939
Total revenues-nonmajor funds	3,128,703	3,154,522
Total revenues	12,680,933	12,308,461
Total expenditures-major funds	10,054,675	10,824,736
Total expenditures-nonmajor funds	3,910,544	4,086,401
Total expenditures	13,965,219	14,911,137
Other Financial Sources-major funds(excluding operating transfers among funds)	145,000	1,943,188
Special items, net	600,000	(1,176,757)
Net changes in fund balances	(539,286)	(1,836,245)

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Management Discussion and Analysis
June 30, 2005

Governmental Activities

Revenues of Municipality's governmental activities increased by 8.0% (\$.91 million) while total expenses increased by 39.0% (3.75 millions). The Municipality of Guánica took the following major actions this year to improve the financial position:

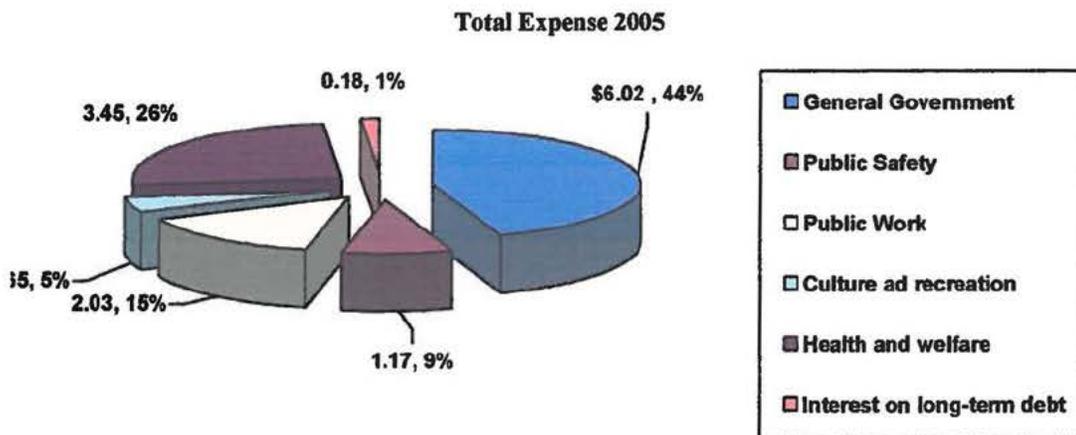
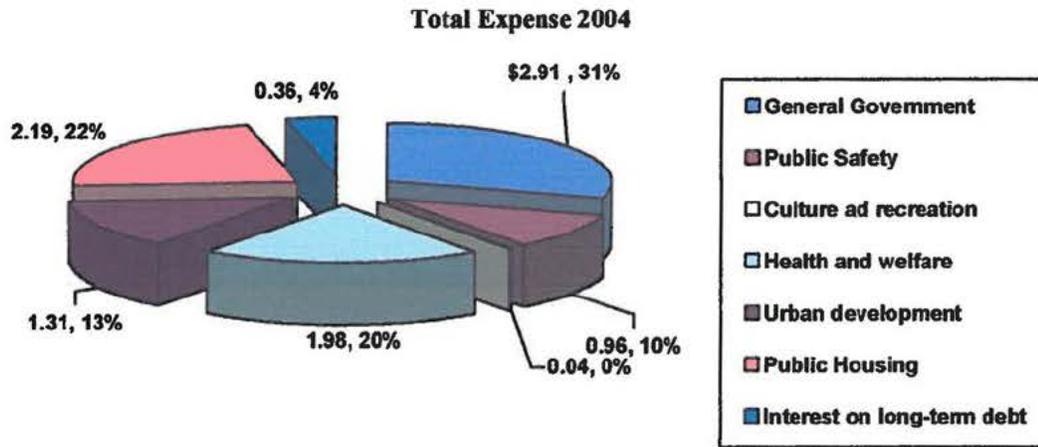
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- The Mayor of the Municipality of Guánica hire a Finance Auxiliar Director to improve the collections of Municipal licensed tax and property tax revenues, supervise the operations of the official and auxiliary collector of the Municipality.
- In the budget respect the administration of the Municipality received the estimated of expenses by each department, and the Budget Director and the Mayor performed the evaluation to those expenses and determine the needed of each one, looking for the reduction of those unnecessary expenses without affecting the daily operations.

Expenses during the fiscal year ended June 30, 2005 was substantially related to the following:

Table 2
Governmental Activities
(in Millions)

	Total expenses	
	2005	2004
General Government	\$6.02	\$2.91
Public Safety	1.17	.96
Public Work	2.03	
Culture, recreation and education	.65	.04
Health and welfare	3.45	1.98
Urban Development		1.31
Legal Service		
Public Housing		2.19
Interest on long term debt	.18	.36
Depreciation		
Totals	\$13.50	\$9.75

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
 Management Discussion and Analysis
 June 30, 2005



The cost of all governmental activities this year was \$13.50 million compared to \$9.75 million last year. Table 2 presents the cost of each of the Municipality of Guanica's largest programs.

The major governmental revenue sources are property taxes, other, grant and contributions not restricted, which in total represent \$6.62 (90%) and \$7.38 (96%) of all revenues in 2005 and 2004, respectively. Changes within these sources of revenues were a decrease \$.76 million.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
 Management Discussion and Analysis
 June 30, 2005

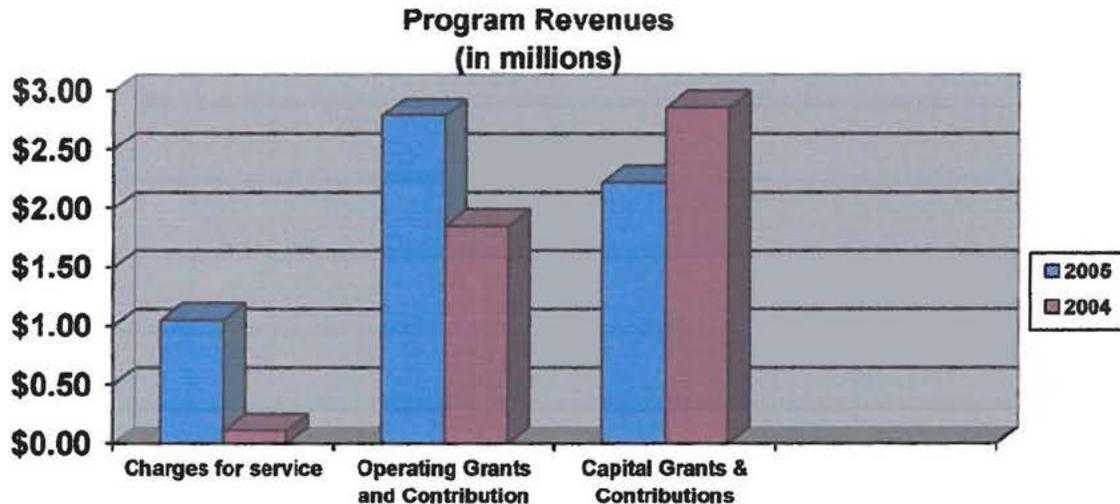
Table 3
Governmental Activities
(in Millions)

	General Revenues by major sources	
	2005	2004
	Property taxes	\$1.43
Other	.42	1.16
Grants and contributions	4.77	4.57
Totals	\$6.62	\$7.38

Table 4
Governmental Activities
(in Millions)

	Program Revenues by major sources	
	2005	2004
	Charges for service	\$1.05
Operating Grants and Contribution	2.79	1.85
Capital Grants and Contributions	2.22	2.86
Totals	\$6.06	\$4.82

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Management Discussion and Analysis
June 30, 2005



THE MUNICIPALITY'S FUND

As the Municipality completed the year, its governmental funds reported a combined fund balance of \$1.33 million, which is lower than last year total of \$2.45 million.

In addition, these other changes in fund balance should be noted:

- The Municipality experienced an increase in the collection of Licenses and Permits due to the developments of construction project which began during the year. The taxes paid to the Municipality related to those constructions permits increases as result of the developments of the city organization plan.
- This year the Municipality decreases the property tax.

General Fund Budgetary Highlights

Over the course of the year, the Municipal Assembly revised the Municipality of Guanica budget several times. These budget amendments fall into various categories. The first category includes amendments and supplemental appropriations that were approved shortly after the beginning of the year and reflect the actual beginning balances (versus the amounts we estimated in May 2004).

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Management Discussion and Analysis
June 30, 2005

CAPITAL ASSET AND DEBT ADMINISTRATION

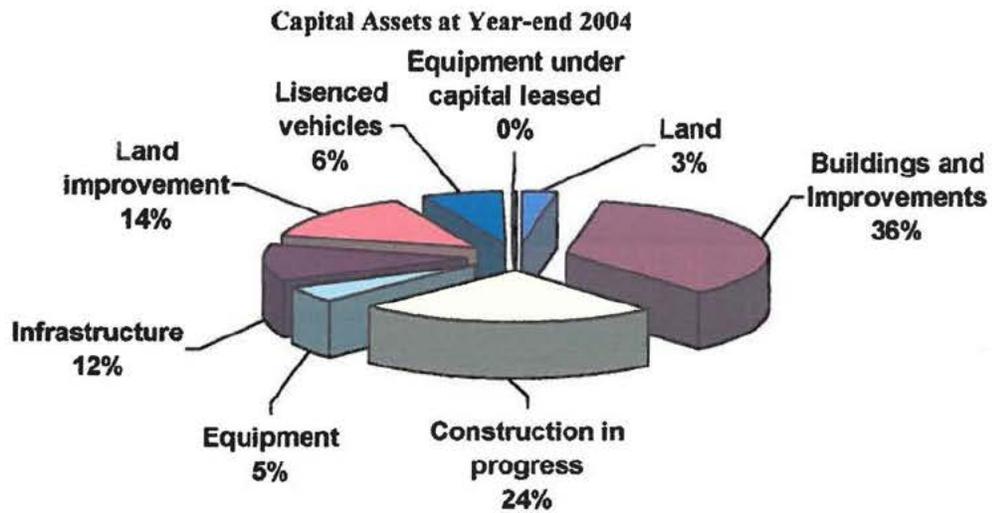
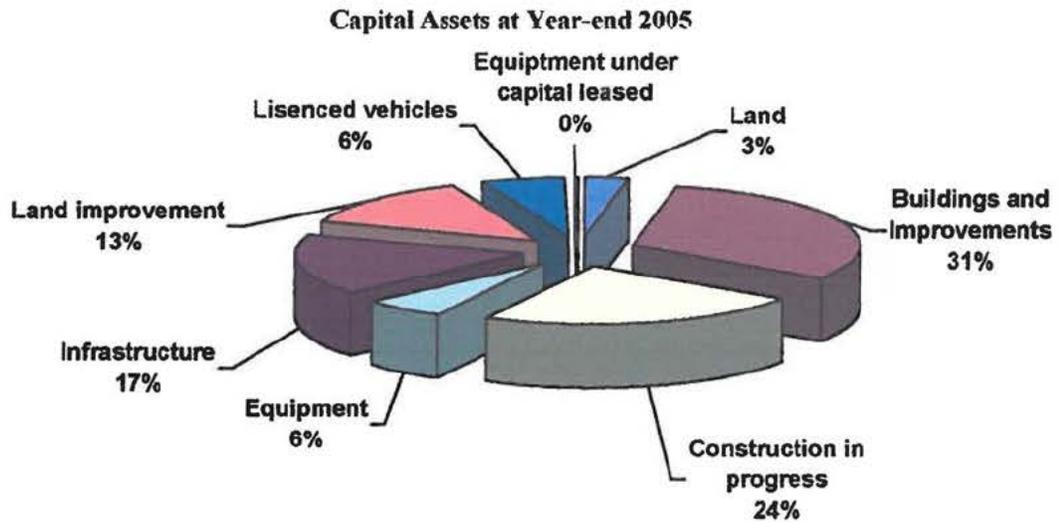
Capital Assets

As of June 30, 2005, the Municipality of Guánica had \$ 21.44 million invested in a broad range of capital assets, including buildings, parks, roads, bridges, and equipment. (See Table 5). This amount represents a net increase (including additions and deductions) of just over under \$20.28 million, or 5.7 percent, over last year. In this table you see few changes in amount compared to last year due to reclassifications of real property to proper division.

Table 5
Capital Assets at Year-end
(At cost, in Thousands)

	<i>Governmental Activities</i>	
	2005	2004
Land	\$.67	\$.57
Land improvement	2.88	2.88
Buildings and Improvements	6.69	7.25
Construction in progress	5.04	4.92
Licensed vehicles	1.29	1.29
Equipment	1.21	.99
Equipment under capital leases	.04	.04
Infrastructure	3.62	2.34
Totals	\$ 21.44	\$ 20.28

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Management Discussion and Analysis
June 30, 2005



More detailed information about the Municipality's capital assets is presented in Note 5 to the financial statements.

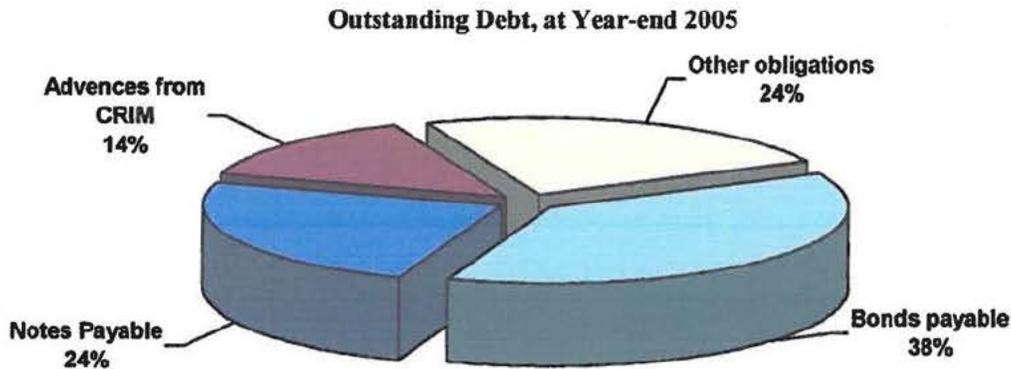
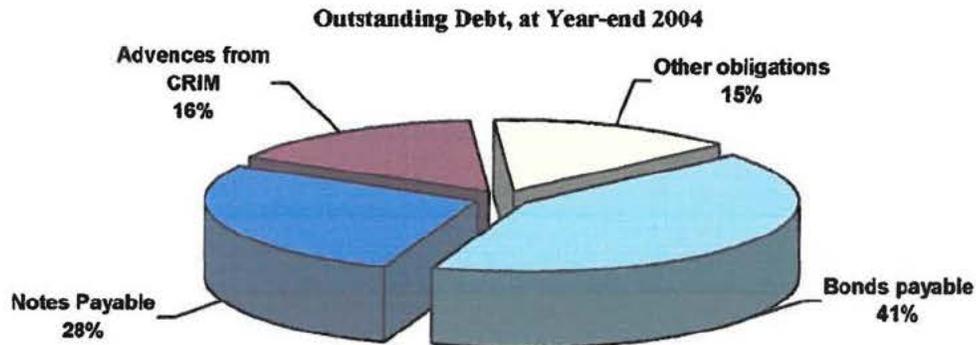
COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
 Management Discussion and Analysis
 June 30, 2005

Debt

At year-end, the Municipality had \$ 9.31 million in bonds and notes outstanding versus \$ 8.56 million last year, an increase of 8.6 percent, as shown in Table 6.

Table 6
Outstanding Debt, at Year-End
(in Thousands)

	Governmental Activities	
	2005	2004
Bonds payable	\$3.51	\$3.59
Notes Payable	2.25	2.36
Advances from CRIM	1.33	1.35
Other obligations	2.22	1.36
Totals	\$9.31	\$8.56



COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Management Discussion and Analysis
June 30, 2005

New bonds in the amount of \$.145 million were issued. The Municipality is required to limit the amount of general obligation debt to 10% of the total assessment of property located within the Municipality, for bonds to be repaid with the proceeds of property taxes restricted for debt services. Other obligations include accrued vacation and sick leave, claims and judgments, and landfill obligation. More detailed information about the Municipality's long-term liabilities is presented in Note 7 to the financial statements.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

The Municipality's elected and appointed officials considered many factors when setting the fiscal-year 2005 budget. Unemployment in the Municipality now stands at 25.6 percent.

Amounts available for appropriations in the General Fund for the fiscal year 2006 are \$.82 million, a decrease of 66 percent under the final 2005 budget of \$7.65 million.

Budgeted expenditures are expected to rise accordingly to the increase in budgeted revenues.

If these estimates are realized, the Municipality's budgetary General Fund balance is expected to increase modestly by the close of 2006.

CONTACTING THE MUNICIPALITY'S FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, taxpayers, and creditors with a general overview of the Municipality's finances and to show the accountability for the money it receives. If you have questions about this report or need additional financial information, contact us at Municipality of Guánica, PO Box 785, Guánica, Puerto Rico 00653.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA
STATEMENT OF NET ASSETS
JUNE 30, 2005**

ASSETS	Governmental Activities
Cash and cash equivalents	\$ 1,930,939
Receivables, net of allowance for uncollectible accounts:	
Due from governmental agencies	848,376
Restricted Assets:	
Cash in fiscal agents	1,231,002
Deferred bond issuance costs	26,105
Capital assets (note 5):	
Nondepreciable assets:	
Land and construction in progress	5,606,557
Depreciable assets:	
Other capital assets, net	8,666,670
	14,273,227
Total assets	\$ 18,309,649
LIABILITIES	
Accounts payable and accrued liabilities	\$ 736,014
Due to governmental agencies	445,456
Deferred revenues	836,369
Interest payable	141,379
Long term liabilities (note 7) :	
Due within one year	605,260
Due in more than one year	8,697,694
Total liabilities	11,462,172
NET ASSETS	
Invested in capital assets, net of related debt	11,423,741
Restricted for:	
Debt service	452,162
Capital Projects	1,650,488
Other specified purposes	242,915
Unrestricted (deficit)	(6,921,829)
Total net assets	\$ 6,847,477

The accompanying notes are an integral part of this statement.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA
STATEMENT OF ACTIVITIES
YEAR ENDED JUNE 30, 2005**

<u>Functions</u>	<u>Program Revenues</u>			<u>Net (expense) revenue and changes in net assets</u>	
	<u>Expenses</u>	<u>Fees, Fines and Charges for Services</u>	<u>Operating Grants and Contributions</u>		<u>Capital Grants and Contributions</u>
Governmental Activities:					
General government	\$ 6,020,246	\$ 1,046,815	\$ 549,292	\$ 95,911	\$ (4,328,228)
Public safety	1,173,292	-	212,341	-	(960,951)
Public works and sanitation	2,028,433	-	53,395	1,348,921	(626,117)
Culture and recreation	646,020	-	-	8,750	(637,270)
Health and welfare	3,451,785	-	1,982,527	764,775	(704,483)
Interest on long term debt	183,983	-	-	-	(183,983)
Total	<u>\$ 13,503,759</u>	<u>\$ 1,046,815</u>	<u>\$ 2,797,555</u>	<u>\$ 2,218,357</u>	<u>(7,441,032)</u>

General revenues :

Taxes

Property taxes

1,430,068

Municipal licenses taxes

281,401

Grants contributions not restricted to specific programs

4,774,038

Interest

20,685

Other

404,522

Special item:

Gain on sale of capital asset

483,140

Total general revenues and special item:

7,393,854

Change in net assets

(47,178)

Net assets-beginning, as restated (note 11)

6,894,655

Net assets-ending

\$ 6,847,477

The accompanying notes are an integral part of this statement.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA
BALANCE SHEET
JUNE 30, 2005

	General	State Legislative Joint Resolutions	Debt Service	Fema-Hazard Mitigation Grant Program	Other Governmental Funds	Total Governmental Funds
ASSETS AND OTHER DEBITS						
Cash and cash equivalents	\$ -	\$ 1,072,531	\$ -	\$ -	\$ 858,408	\$ 1,930,939
Receivables, net of allowance for uncollectable accounts:						
Due from governmental agencies	95,589	-	47,876	81,632	623,279	848,376
Due from other funds	721,245	874,214	-	-	103,004	1,698,463
Restricted Assets:						
Cash in fiscal agents	-	-	499,781	367,820	363,401	1,231,002
TOTAL ASSETS	\$ 816,834	\$ 1,946,745	\$ 547,657	\$ 449,452	\$ 1,948,092	\$ 5,708,780
LIABILITIES						
Accounts payable and accrued liabilities	\$ 349,007	\$ -	\$ -	\$ -	\$ 387,007	\$ 736,014
Due to governmental agencies	445,251	-	-	-	205	445,456
Due to other funds	527,767	76,811	-	449,452	644,433	1,698,463
Deferred revenues	258,519	-	-	-	966,742	1,225,261
Matured bonds due and payable	-	-	179,000	-	-	179,000
Matured Interest due and payable	-	-	94,970	-	-	94,970
TOTAL LIABILITIES	1,580,544	76,811	273,970	449,452	1,998,387	4,379,164
FUND BALANCES						
Reserved for:						
Encumbrances	296,260	-	-	-	-	296,260
Capital projects	-	1,869,934	-	-	(111,226)	1,758,708
Debt service	-	-	273,687	-	-	273,687
Other specified purposes	-	-	-	-	60,907	60,907
Unreserved	(1,059,970)	-	-	-	24	(1,059,946)
TOTAL FUND BALANCES	(763,710)	1,869,934	273,687	-	(50,295)	1,329,616
TOTAL LIABILITIES AND FUND BALANCES	\$ 816,834	\$ 1,946,745	\$ 547,657	\$ 449,452	\$ 1,948,092	\$ 5,708,780

The accompanying notes are an integral part of this statement

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA
RECONCILIATION OF TOTAL GOVERNMENTAL FUND BALANCE
TO NET ASSETS OF GOVERNMENTAL ACTIVITIES
JUNE 30, 2005**

Total fund balances- governmental funds	\$	1,329,616
<p>Amounts reported for governmental activities in the Statement of Net Assets are different because:</p>		
<p>Capital assets used in governmental activities are not current financial resources and therefore are not reported in the governmental funds balance sheet:</p>		14,273,227
<p>Other assets used in governmental activities are not current financial resources and therefore are not reported in the funds:</p>		
Deferred Charges		26,105
<p>Other assets are not available to pay current-period expenditures and therefore are deferred in the funds:</p>		
Receivable - christmas bonus reimbursement	\$ 95,590	
Receivable - EDA	111,294	
Receivable - Public Order Code	182,008	388,892
<p>Interest liabilities are not due and payable in the current period and therefore, are not reported in the funds:</p>		(46,409)
<p>Long term liabilities, including bonds payable, are not due and payable in the current period and therefore are not reported in the funds:</p>		(9,123,954)
Net assets of governmental activities:	\$	6,847,477

The accompanying notes are an integral part of this statement.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCE (DEFICIT)
YEAR ENDED JUNE 30, 2005

	General	State Legislative Joint Resolutions	Debt Service	Fema-Hazard Mitigation Grant Program	Other Governmental Funds	Total Governmental Funds
REVENUES						
Property taxes	\$ 1,135,579	\$ -	\$ 294,489	\$ -	\$ -	\$ 1,430,068
Municipal license tax	281,401	-	-	-	-	281,401
Licenses, permits and other local taxes	904,313	-	-	-	-	904,313
Charges for services	-	-	-	-	14,046	14,046
Fines and forfeitures	16,620	-	-	-	-	16,620
Interest	6,836	-	4,552	-	9,297	20,685
Intergovernmental:						
Federal operating grants	-	-	-	449,452	401,610	851,062
Federal capital grants	-	-	-	-	1,898,200	1,898,200
State operating grants	-	1,222,878	-	-	602,687	1,825,565
State capital grants	-	6,000	-	-	202,863	208,863
Other operating grants and contributions	4,738,752	-	-	-	-	4,738,752
Rent	111,836	-	-	-	-	111,836
Other	379,522	-	-	-	-	379,522
Total revenues	7,574,859	1,228,878	299,041	449,452	1,128,703	12,680,933
EXPENDITURES:						
Current:						
General government	4,236,801	-	-	-	817,584	5,054,385
Public safety	792,468	-	-	-	300,825	1,093,293
Public works and sanitation	1,741,393	-	-	-	164,818	1,906,211
Culture and recreation	414,361	56,368	-	-	22,548	493,277
Health and welfare	987,451	915,172	-	449,452	1,071,912	3,423,985
Capital Outlays	6,100	70,601	-	-	1,530,014	1,606,715
Debt service:						
Principal	-	-	200,000	-	-	200,000
Interest	-	-	184,508	-	-	184,508
Bond issuance costs	-	-	-	-	2,843	2,843
Total expenditures	8,178,574	1,042,141	384,508	449,452	3,910,544	13,965,222
Excess (deficiency) of revenues over (under) expenditures	(603,715)	186,737	(85,467)	-	(781,841)	(1,284,303)
OTHER FINANCING SOURCES (USES):						
Proceeds from issuance of long-term debt	-	-	-	-	145,000	145,000
Transfers in	13,849	-	176,025	-	342,991	532,865
Transfers out	519,016	-	4,552	-	9,297	532,865
Total other financing sources	(505,167)	-	171,473	-	478,694	145,000
SPECIAL ITEM:						
Proceeds from sale of capital asset	600,000	-	-	-	-	600,000
EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES AND OTHER SOURCES (USES)	(508,882)	186,737	86,006	-	(303,147)	(539,293)
FUND BALANCE (DEFICIENCY) AS RESTATED, JULY 1, 2004	(254,828)	1,683,197	187,681	-	252,852	1,869,902
FUND BALANCE (DEFICIENCY), JUNE 30, 2005	\$ (763,710)	\$ 1,869,934	\$ 273,687	\$ -	\$ (50,295)	\$ 1,332,326

The accompanying notes are an integral part of this statement.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA
RECONCILIATION OF STATEMENT OF REVENUES, EXPENDITURES AND CHANGES
IN FUND BALANCES OF GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES
YEAR ENDED JUNE 30, 2005

Net change in fund balances - total governmental funds: **\$ (539,286)**

Amounts reported for governmental activities in the Statement of Activities are different because:

Governmental funds reports capital assets outlays as expenditures. However, in the Statement of Activities the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense:

Expenditures for capital assets	\$ 1,606,715	
Less: current year depreciation	(485,007)	1,121,708

Governmental funds report the effect of bond issuance costs as expenditure when debt is first issued, whereas these amounts are deferred and amortized in the Statement of Activities. This is the net effect of these differences:

Bond issuance costs	2,843	
Amortization of deferred charges	(2,879)	(36)

Governmental funds only report the proceeds received in the disposal of assets. In the Statement of Activities, a gain or loss is reported for each disposal. Thus, the change in net assets differs from the change in fund balance by the cost of the disposed asset:

(541,860)

Revenues in the Statement of Activities that do not provide current financial resources are not reported as revenues in the funds:

Christmas bonus reimbursement	95,590	
EDA	111,294	
Public Order Code	120,928	
Capital asset received in a non monetary exchange	425,000	
Donated Capital Assets	25,000	777,812

Revenues reported in funds which are not reported as revenues in the Statement of Activities:

Christmas bonus reimbursement-prior year		(60,304)
--	--	----------

Proceeds from general obligation bonds are other financing sources in funds but as liabilities in the Statement of Net Assets:

(145,000)

Expenditures reported in funds which are not reported as expenses in the Statement of Activities:

Matured bonds principal payments (net change)	(25,000)	
Prior year accounts payable (net change)	(64,322)	(89,322)

Repayment of long term debt is an expenditure in the governmental funds, but reduces long-term liabilities in the Statement of Net Assets:

General obligation bonds and notes	225,000	
Other long term liabilities	483,281	708,281

Some expenses reported in the Statement of Activities do not require the use of current financial resources and therefore are not reported as expenditures in the governmental funds:

Compensated absences	(197,477)	
Current Year Property Taxes	(56,138)	
Judgment and Claims	(123,543)	
Disallowed costs-FEMA	(750,467)	
Accrued interest (net change)	17,468	
Christmas bonus	(169,014)	(1,279,171)

Change in net assets of governmental activities:

\$ (47,178)

The accompanying notes are an integral part of this statement.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Notes to Basic Financial Statements
June 30, 2005

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) 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), as amended by GASB Statement No. 39 - *Determining Whether Certain Organizations are Component Units* (GASB No. 39) 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. GASB Statement No. 39 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 raise 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, 2005 nor for the year then ended.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Notes to Basic Financial Statements
June 30, 2005

b) *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, 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.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Notes to Basic Financial Statements
June 30, 2005

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, 2005, 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) public safety, (3) public works and sanitation, (4) culture and recreation, (5) health and welfare (6) capital outlays. The governmental operations of the Municipality's departments and operational units are classified within the following functions/programs in the accompanying basic financial statements:

General government:

- Municipal legislature
- Mayor's office
- Department of finance and budget
- Department of human resources
- Department of municipal secretary
- Department of federal programs
- Department of internal audit

Public safety:

- Department of municipal police
- Department of emergency management

Public works and sanitation:

- Department of public works
- Department of sanitation

COMMONWEALTH OF PUERTO RICO
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June 30, 2005

Culture and recreation:

Department of recreation and sports
Department of tourism

Health and welfare

Department of health
Department of elderly affairs

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:

- **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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
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June 30, 2005

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. 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:

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Notes to Basic Financial Statements
June 30, 2005

- **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 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.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Notes to Basic Financial Statements
June 30, 2005

Under current standards 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.

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 or based on the Municipality's official's criteria, if the fund is particularly important to financial statement users. 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 mean 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:

General Fund: The General Fund is the general operations fund of the Municipality. It is used to account for all financial resources except those required to be accounted in another fund.

State Legislative Joint Resolutions Fund: State Legislative Joint Resolutions fund is used to account for revenue sources to be used for the construction and improvement of capital facilities and for welfare purposes.

Debt Service Fund: Debt Service Fund is used to account for the accumulation of resources for, and the payment of, general long-term debt principal and interest.

Hazard Mitigation Grant Program Fund (HMGP): HMGP fund is used to account for revenues sources for the acquisition of property ("buyouts") severely damaged or destroyed in a natural disaster.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Notes to Basic Financial Statements
June 30, 2005

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).

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 current standards, 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 types 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.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
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June 30, 2005

- 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 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, 2005, 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, 2005. 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.

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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, 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.

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).

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

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

Under current standards all general capital assets and the unmatured long-term liabilities (determined using the modified accrual basis of accounting) are incorporated into the accompanying statement of net assets.

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f) *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 the Secretary of the Treasury of the Commonwealth, in the Municipality's name.

Restricted assets include cash and cash equivalents in 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.

g) *Unrestricted and Restricted Accounts Receivable*

In the accompanying GWFS, receivables consist of all revenues earned but not collected at June 30, 2005. Major receivable balances for the governmental activities include property taxes and intergovernmental receivables.

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 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).

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.

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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.

h) Inventories

The Municipality purchases gasoline, oil and other expendable supplies held for consumption. The cost of those purchases is recorded as expenditure when incurred in the appropriate fund but the year-end inventory is not recorded in the Statement of Net Assets, as management believes is not significant.

i) Deferred Charges

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

j) 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.

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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:

	<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.

k) 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.

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l) Compensated Absences

The Municipality's employees accumulate vacation, sick leave and compensatory time based on continuous service. Compensated absences are recorded as a liability if (1) are earned on the basis of services already performed by employees, (2) it is probable that will be paid (in the form of paid time off, cash payments at termination or retirement, or some other means) and (3) are not contingent on a specific event (such as illness).

The compensated absences are accumulated on the basis of 2½ days per month of vacation and 1½ days per month of sick pay and compensatory time up to a maximum of 60 days of vacations and 90 days of sick leave. Upon separation from employment the accumulated vacations are liquidated up to the maximum number of days. Accumulated sick leave, which is accrued based on all vesting amounts for which payment is probable, is liquidated to employees with 10 years or more service up to the maximum number of days.

The accrual of compensated absences includes estimated payments that are related to payroll. The entire compensated absence liability is reported on the government-wide financial statements. For governmental fund financial statements, the current portion of unpaid compensated absences is the amount that is normally expected to be paid using expendable available financial resources. The non-current portion of the liability is not reported.

m) 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.

n) 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:

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- 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 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.

o) Accounting for Pension Costs

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.

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.

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p) 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 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, 2005. In the past three years, the Municipality has not settled claims that exceeded insurance coverage.

q) 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:

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

r) 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.

s) 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.

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t) Future Adoption of Accounting Pronouncements

The GASB has issued the following statements, which the Municipality has not yet adopted:

Statement	To be Adopted in Fiscal year ended,
42 Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries	June 30, 2006
43 Financial Reporting for Post employment Benefits Plans Other Than Pension Plans	June 30, 2008
44 Economic Condition Reporting: The Statistical Section – an amendment of NCGA Statement No. 1	June 30, 2006
45 Accounting and Financial Reporting by Employers for Post employment Benefits Other Than Pensions	June 30, 2009
46 Net Assets Restricted by Enabling Legislation, an amendment of GASB Statement No. 34	June 30, 2007
47 Accounting for Termination Benefits	June 30, 2006; for termination benefits provided through an existing defined benefit OPEB plan, the provisions of this Statement should be implemented simultaneously with the requirements of Statement 45.

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

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2. CUSTODIAL CREDIT RISK - DEPOSITS

Custodial credit risk is the risk that in the event of a bank failure, the government's deposits may not be returned to it. The Municipality maintains cash deposits in commercial and governmental banks located in Puerto Rico.

Under Commonwealth of Puerto Rico statutes, public funds deposited in commercial banks must be fully collateralized for the amount deposited in excess of federal deposit insurance. All securities pledged as collateral by the Municipality are held by the Secretary of Treasury of Puerto Rico in the Municipality's name. At year end the Municipality's bank balance in commercial banks amounts to \$2,211,860.

Deposits in governmental banks are uninsured and uncollateralized. At year end the Municipality's bank balance in governmental banks amounts to \$1,231,002.

3. DUE FROM (TO) GOVERNMENTAL ENTITIES

a. Amounts due from governmental entities as of June 30, 2005 follows:

	Commonwealth Government	Federal Government
Municipal Revenue Collection Center (CRIM) – property taxes (debt service fund)	\$ 47,876	\$ -
Puerto Rico Department of Family – Child Care	-	71,231
US Department of Justice-COPS	-	999
US Federal Emergency Management Agency – HMGP	-	81,632
Office of Commissioner of Municipal Affairs – CDBG	-	43,968
US Department of Housing and Urban Development – Section 8	-	99
US Department of Commerce – EDA	-	111,294
Puerto Rico Department of Labor – Law 52	206,764	-
Puerto Rico Police Department – Public Order Code	182,008	-
Puerto Rico Rural Development Corporation – Other governmental funds	6,916	-
Puerto Rico Department of Treasury – Christmas bonus reimbursement	95,589	-
	\$ 539,153	\$ 309,223

The amounts due from Puerto Rico Department of Treasury – Christmas bonus (\$95,589), US Department of Commerce – EDA (111,294) and Puerto Rico Police Department – Public Order Code (182,008) are recorded as deferred revenue in the governmental funds statements since are not available as required by current standards.

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b. Amounts due to governmental entities as of June 30, 2005 follows:

	Commonwealth Entities
Puerto Rico Aqueduct and Sewer Authority (PRASA)	\$ 15,517
Puerto Rico General Services Administration	30,236
Puerto Rico Employee Retirement System Administration	42,292
Puerto Rico Industrial Development Corporation (PRIDCO)	16,366
Puerto Rico Department of Labor - unemployment	340,840
Other entities	205
	\$ 445,456

4. INTERFUND TRANSACTIONS

a. Due from/to other funds:

Amounts due from/to other funds represent temporary advances to other funds for payroll and payroll taxes expenditures and to record the overdrawn of pool cash by the general fund to other special funds as follows:

Receivable Fund	Payable Fund	Amount
General Fund	Major fund – State Legislative Joint Resolutions	\$ 76,811
General Fund	Other governmental funds -Public Order Code	192,040
General Fund	Other governmental funds-Law 52	208,672
General Fund	Other governmental funds -CDBG	94,151
General Fund	Other governmental funds-Child Care	110,000
General Fund	Other governmental funds-others	39,571
Major Fund – State Legislative Joint Resolutions	General Fund	424,763
Major Fund – State Legislative Joint Resolutions	Major fund – FEMA HMGP	449,451
Other governmental funds –Citizens Participation	General Fund	99,713
Other governmental funds -others	General Fund	3,291
		\$ 1,698,463
Total:		

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b. Operating transfers:

Transfers between individual funds were made for operational purposes. Transfers includes: interest earned on restricted cash with fiscal agents in the debt service fund and operating and capital improvement loans in other governmental funds which is transferred to the general fund; principal and interest payments of general long term debt transferred from the general fund to the debt service fund; and transfers of funds from general fund to other special funds for matching purposes or to finance unreimbursable funds from governmental agencies.

5. CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2005, was as follows:

	Balance July 1, 2004	Increases	Decreases	Balance June 30, 2005
<u>Governmental activities:</u>				
Capital assets, not being depreciated:				
Land	\$ 565,795	99,213	-	\$ 665,008
Construction in progress	4,923,631	1,392,175	1,275,044	5,040,762
Total capital assets not being depreciated:	5,489,426	1,491,388	1,275,044	5,705,770
Capital assets, being depreciated:				
Buildings, structures and building improvements	7,252,712	350,987	912,606	6,691,093
Infrastructure	2,342,946	1,275,044	-	3,617,990
Land improvements	2,884,899	-	-	2,884,899
Licensed vehicles	1,286,328	-	-	1,286,328
Machinery and equipment	991,731	214,340	-	1,206,071
Equipment under capital leases	43,572	-	-	43,572
Total capital assets being depreciated	14,802,188	1,840,371	912,606	15,729,953
Less accumulated depreciation for:				
Buildings, structures and building improvements	2,768,368	145,054	370,746	2,542,676
Infrastructure	996,574	117,147	-	1,113,721
Land improvements	1,823,769	85,323	-	1,909,092
Licensed vehicles	773,871	88,410	-	862,281
Machinery and equipment	666,755	49,073	-	715,828
Equipment under capital leases	18,898	-	-	18,898
Total accumulated depreciation	7,048,235	485,007	370,746	7,162,496
Total capital assets being depreciated, net	7,753,953	1,355,364	541,860	8,567,457
Governmental activities capital assets, net	<u>\$ 13,243,379</u>	<u>\$ 2,846,752</u>	<u>\$ 1,816,904</u>	<u>\$ 14,273,227</u>

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

Governmental activities:

General government	\$	102,245
Public safety		80,000
Health and welfare		27,797
Culture and recreation		152,743
Public works and sanitation		<u>122,222</u>
 Total depreciation expense, governmental activities	 \$	 <u>485,007</u>

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, inter alia, 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.

6. DEFERRED REVENUES

The Municipality reports deferred revenue on its GFFS and GWFS as follows:

	Resources not available	Resources received before legal claim
EDA Fund	\$ 111,294	\$ -
Unearned volume of municipal license taxes	-	162,930
Christmas bonus	95,589	-
Citizens Participation Fund	-	366,234
Federal Emergency Management Agency	-	65,002
Public Order Code Fund	182,008	-
Section 8 Fund	-	132,045
Solid Waste Authority Fund	-	96,603
Others	-	13,555
	<u>\$ 388,892</u>	<u>\$ 836,369</u>

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7. 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, 2005, the Municipality is in compliance with the debt limitation requirements.

The general long-term debt activity for the year ended June 30, 2005 was as follows:

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	Balance at July 1, 2004, as restated	Increases	Decreases	Balance at June 30, 2005	Due within one year
Bonds payable	\$ 3,594,000	\$ 145,000	\$ 225,000	\$ 3,514,000	\$ 200,000
Notes payable to:					
PR Treasury					
Department:					
Loan for payment of legal settlement	1,634,702	-	972	1,633,730	1,002
Financing agreement for the excess of property tax over advances thorough fiscal year 2003	499,196	-	11,216	487,980	12,037
PR Department of Labor and Human Resources	79,457	-	79,457	-	-
PR Land Authority	125,020	-	4,205	120,815	2,751
PR Aqueduct and Sewer Authority	19,358	-	19,358	-	-
CRIM:					
Act No. 42 – Financing agreement for the excess of property tax advances over tax collections through fiscal year 2000	1,041,998	-	13,994	1,028,004	14,868
LIMS Financing of delinquent property tax accounts sold	107,732	-	12,539	95,193	12,391
Payable to CRIM - Excess of property tax advances over actual collections	-	56,138	-	56,138	-
Payable to FEMA	-	750,467	-	750,467	-
Compensated absences	924,437	197,477	-	1,121,914	50,087
Claims and judgments	175,448	129,700	140,488	164,660	124,146
Obligation under capital leases	27,746	-	5,549	22,197	6,722
Christmas bonus	129,835	169,014	129,835	169,014	169,014
	<u>\$ 8,563,439</u>	<u>\$ 1,447,796</u>	<u>\$ 708,281</u>	<u>\$ 9,302,954</u>	<u>\$ 605,260</u>

a) Bonds Payable and operational loans

The Municipality issues general and special (public improvements) obligations bonds and operational loans 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, 2005 is composed of the following debts:

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	<u>Outstanding Amount</u>
<u>General Obligation Bonds:</u>	
1992 serial bonds, original amount of \$375,000, due in annual principal installments ranging from \$25,000 to \$50,000; plus interest due in semiannual installments at variable rates from 5.00% to 7.81% (5.00% at June 30, 2005) through July 1, 2009	\$ 220,000
2002 serial bonds, original amount of \$530,000, due in annual principal installments ranging from \$10,000 to \$40,000; plus interest due in semiannual installments at variable rates from 2.70% to 5.60% (2.89% at June 30, 2005) through July 1, 2026	500,000
<u>Public Improvement Bonds:</u>	
1981 serial bonds, original amount of \$217,000, due in annual principal installments ranging from \$5,000 to 13,000; plus interest due in annual installments at rates of 5.00% through January, 1, 2006	13,000
1983 serial bonds, original amount of \$127,000, due in annual principal installments ranging from \$3,000 to \$8,000; plus interest due in annual installments at rates of 5.00% through January 1, 2006	8,000
1995 serial bonds, original amount of \$1,125,000, due in annual principal installments ranging from \$20,000 to \$110,000; plus interest due in semiannual installments at variable rates from 4.70% to 6.63% (5.925% at June 30, 2005) through July 1, 2016	860,000
<u>Operational loans:</u>	
1986 original issue amount of \$280,000, due in annual principal installments of \$14,000, plus interest due in semiannual installments at variable rates from 5.00% to 8.50% (5.00% at June 30, 2005) through July 1, 2006	28,000
2000 original issue amount of \$135,000, due in annual principal installments ranging from \$10,000 to \$20,000; plus interest due in semiannual installments at variable rates from 5.00% to 7.81% (5.00% at June 30, 2005) through July 1, 2009	80,000
2002 original amount of \$1,740,000, due in annual installments ranging from \$10,000 to \$130,000; plus interest due in semiannual installments at variable rates from 5.00% to 6.00% (5.00% at June 30, 2005) through July 1, 2026	1,660,000
2005 original amount of \$145,000, due in annual principal installments ranging from \$10,000 to \$20,000; plus interest due in annual installments at rates of 5.00% through July 1, 2014	145,000
	<u>\$ 3,514,000</u>

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

June 30	Principal	Interest
2006	\$ 200,000	\$ 181,985
2007	189,000	190,448
2008	185,000	179,759
2009	195,000	168,832
2010	210,000	157,057
2011-2015	845,000	638,002
2016-2020	705,000	382,089
2021-2025	660,000	202,508
2026-2029	325,000	21,740
Totals	<u>\$ 3,514,000</u>	<u>\$ 2,122,420</u>

b) Notes Payable to Puerto Rico Treasury Department

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, 2005, the balance of this note, net of the unamortized discount of \$287,186, amounted to \$1,633,730, with an accrued interest of \$4,084. This amount will be repaid with unrestricted funds. The principal and discount amortization (recorded as interest expense) maturities are as follows:

June 30	Principal	Interest
2006	\$ 1,002	\$ 48,996
2007	102,419	47,325
2008	105,534	44,202
2009	159,437	40,164
2010	164,287	35,303
2011-2014	1,101,051	71,196
Totals	<u>\$ 1,633,730</u>	<u>\$ 287,186</u>

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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 \$487,980 and \$2,879, respectively, at June 30, 2005. This amount will be repaid with unrestricted funds. The principal and interest maturities are as follows:

June 30	Principal	Interest
2006	\$ 12,037	\$ 34,092
2007	12,917	33,207
2008	13,862	32,256
2009	14,876	31,236
2010	15,964	30,142
2011-2015	99,137	131,277
2016-2020	141,101	89,067
2021-2025	178,086	29,417
Totals	<u>\$ 487,980</u>	<u>\$ 410,694</u>

c) 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, 2005, the balance of this note, net of the unamortized discount of \$102,540, amounted to \$120,815, with an accrued interest of \$6,645. This amount will be repaid with unrestricted funds. The principal and discount amortization (recorded as interest expense) maturities are as follows:

June 30	Principal	Interest
2006	\$ 2,751	\$ 7,098
2007	2,916	6,924
2008	3,091	6,739
2009	3,277	6,543
2010	3,473	6,335
2011-2015	20,753	28,106
2016-2020	16,537	22,554
2021-2025	33,366	14,798
2026-2029	34,651	3,443
Totals	<u>\$ 120,815</u>	<u>\$ 102,540</u>

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d) 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 were 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 a rate of 6.2%. The outstanding principal and accrued interest balances of the note payable to CRIM amounted \$1,028,004 and \$31,804 respectively, at June 30, 2005. This amount will be repaid with unrestricted funds. The principal and interest maturities are as follows:

June 30	Principal	Interest
2006	\$ 14,873	\$ 63,021
2007	15,807	61,958
2008	16,801	60,994
2009	17,876	59,845
2010	19,028	58,689
2011-2015	114,354	273,585
2016-2020	155,496	231,312
2021-2025	210,317	174,436
2026-2030	284,641	91,153
2031-2033	178,811	10,995
Totals	<u>\$ 1,028,004</u>	<u>\$ 1,085,988</u>

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, 2005, the balance of this note, net of the unamortized discount of \$20,511, amounted to \$95,193. This amount will be repaid with unrestricted funds. The principal and discount amortization (recorded as interest expense) maturities are as follows:

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June 30	Principal	Interest
2006	\$ 12,391	\$ 5,421
2007	13,139	4,669
2008	13,932	3,871
2009	14,774	3,026
2010	15,666	2,129
2011-2012	25,291	1,395
Totals	\$ 95,193	\$ 20,511

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 is 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 \$65,668 to the principal on this agreement. At June 30, 2005, the outstanding principal amounted to \$138,842. The principal and interest maturities are as follows:

June 30	Principal	Interest
2006	\$ 12,242	\$ 9,025
2007	-	7,566
2008	-	8,229
2009	2,177	8,165
2010	2,323	8,019
2011-2015	14,165	37,543
2016-2020	19,588	32,121
2021-2025	27,086	24,622
2026-2030	37,456	14,253
2031-2033	23,805	2,049
Totals	\$ 138,842	\$ 151,592

- e) **Other payable to CRIM - Excess of property tax advances over actual collections** – The \$56,138 represents the balance owed as of June 30, 2005 to CRIM for excess of advances of property tax and other subsidies over final amount of property tax collections for the fiscal year ended June 30, 2005 (see note 8). This amount will be repaid with unrestricted funds.
- f) **Note Payable to FEMA** – This amount represents final disallowed costs as determined by an audit performed by the Governor's Authorized Representative (GAR) of FEMA funds related to Hurricane Georges. As of June 30, 2005, the outstanding balance amounts to \$750,467. The Municipality intends to pay the amount through a payment plan with FEMA which will be financed with unrestricted funds.

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- g) **Compensated absences** - Includes accrued vacations, sick leave benefits and other benefits with similar characteristics such as compensatory time, represents the Municipality's commitment to fund such costs from future operations. As of June 30, 2005 the outstanding balance amounts to \$1,121,914. This amount will be repaid with unrestricted funds.
- h) **Other claims and judgments** - Represent the final costs of legal cases paid subsequent to June 30, 2005 and other claims outstanding as of that date. The awarded amounts will be paid with unrestricted funds. As of June 30, 2005 the outstanding balance amounts to \$164,660.
- i) **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, 2005, 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. The present value of the future minimum capital lease payments at June 30, 2005 reported in the accompanying government-wide statement of net assets is as follows:

Year ending June 30,	Amount
2006	\$ 8,542
2007	7,152
2008	6,756
2009	<u>3,184</u>
Total future minimum lease payments	25,634
Less: amount representing future interest cost at 8.00%	<u>(3,437)</u>
Present value of minimum lease payments	22,197
Less:	
Current portion of obligation under capital leases	<u>6,722</u>
Obligation under capital leases, excluding current portion	<u>\$ 15,475</u>

- j) **Christmas bonus** - Represent the accrued portion corresponding to fiscal year 2004-2005 of the Christmas bonus to be paid in December 2005.

COMMONWEALTH OF PUERTO RICO
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8. PROPERTY TAXES

The Municipal Revenue Collection Center (CRIM) of the Commonwealth of Puerto Rico is responsible for the assessment, collection and distribution of real and personal property taxes. The tax on personal property is self-assessed by the taxpayer. The assessment is made on a return, which must be filed with the CRIM by May 15 of each year and is based on the current value at the date of the assessment. Real property is assessed by the CRIM. The tax is general assessed on January 1 on all taxable property located within the Municipality and is based on the current value existing in the year 1957. For personal property the tax is due with the return filed on or before May 15. Taxes on real property may be paid on two equal installments, July 1st and January 1st.

The tax rates in force as of June 30, 2005 are 8.78% for real property (of which 8.58% is paid by the taxpayer and .20% is reimbursed by the Puerto Rico Treasury Department) and 6.58% for personal property (of which 6.38% is paid by the taxpayer and .20% is reimbursed by the Puerto Rico Treasury Department). For both tax rates 1.03% belongs to the Commonwealth and 7.75% and 5.75%, respectively, belongs to the Municipality. Of the portion belonging to the Municipality, 6% on real property and 4% on personal property represents the Municipality's portion which is appropriated for general purposes and accounted in the general fund. The remaining portion of 1.75% on both tax rates belonging to the Municipality is restricted for debt service and accounted in the debt service fund.

Residential real property occupied by its owner is exempt by law from property taxes on the first \$15,000 of the assessed value. For such exempted amounts, the Puerto Rico Department of Treasury assumes payment of the basic tax to the Municipality, except for residential units assessed at less than \$3,500 on which a complete exemption is granted. Revenue related to exempt property is recorded in the General Fund. The Municipality grants a complete exemption from personal property taxes up to an assessment value of \$50,000 to retailers with annual net sales of less than \$150,000.

The CRIM advances funds to the Municipality based on an estimate of special governmental subsidies and the property taxes to be levied and which are collected in subsequent periods. This distribution includes advances of property tax and amounts of municipal equalization fund from the Commonwealth government. The CRIM is required by law to prepare a settlement statement on a fiscal year basis, whereby a comparison is made between the amounts advanced to the Municipality and amounts actually collected from taxpayers. The CRIM prepares a preliminary settlement not later than three months after fiscal year-end and a final settlement not later than six months after fiscal year-end. If actual collections exceed the advances a receivable from CRIM is recorded. However, if advances exceed actual collections, a payable to CRIM is recorded. The Municipality has a net payable to the CRIM of \$ 56,138 resulting from the final settlement for fiscal year 2004-2005. The total amount is recorded as a long term debt in the government-wide statement since will not be paid with expendable available resources.

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9. 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, 2005, 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 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 \$162,930 at June 30, 2005, which represents municipal licenses collected in advance for the taxable year 2005-2006.

10. INTERGOVERNMENTAL REVENUES

Intergovernmental revenues in the General Fund are comprised of the following:

	Amount
Amount of municipal equalization fund and subsidy send by CRIM	\$ 3,684,757
Compensation in lieu of tax from the Puerto Rico Electric Power Authority (PREPA)	917,793
Reimbursement from Commonwealth Government - Christmas Bonus expenditures	131,920
Other intergovernmental revenues	4,282
	\$ 4,738,752

COMMONWEALTH OF PUERTO RICO
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11. FUND BALANCE RESTATEMENTS

a. Fund balances

The beginning fund balances of the General Fund and Public Order Code fund included in other governmental funds have been restated to recognize corrections of accounting errors. In the general fund corrections include: overstatement of assets for \$91,324 and understatement of liabilities for \$424,633. The following schedule reconciles the fund balance at July 1, 2004 as previously reported to the beginning fund balance, as restated:

Fund	Prior period adjustments		
	Balance at beginning of year, as previously reported	Correction of errors	Balance at beginning of year, as Restated
General fund	\$ 261,129	\$ (515,957)	\$ (254,828)
Other governmental funds	313,931	(61,079)	252,852

b. Net assets

Net assets at beginning of year have been adjusted to reflect the following restatements:

	Amount
Net assets at beginning of year as previously reported:	\$ 7,052,053
Restatements:	
Overstatement of assets	(91,324)
Understatement of other long-term debt	(39,154)
Understatement of accrued interest payable	(26,920)
Net assets at beginning of year as restated:	\$ 6,894,655

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12. 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 issues 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 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 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.

COMMONWEALTH OF PUERTO RICO
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June 30, 2005

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 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</u> <u>ended June 30,</u>	<u>Act No. 447</u>	<u>System 2000</u>
2005	<u>\$68,503</u>	<u>\$130,816</u>
2004	<u>\$74,224</u>	<u>\$74,481</u>
2003	<u>\$80,633</u>	<u>\$20,775</u>

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June 30, 2005

13. COMMITMENTS AND CONTINGENCIES

a. Encumbrances and construction commitments

The Municipality has reported, outstanding encumbrances amounting to \$296,260 in the general fund at June 30, 2005. 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.

The Municipality has commitments at June 30, 2005 of approximately \$572,224 for design, construction, improvements or renovation of certain municipal facilities.

b. Operating leases

The Municipality leases office equipment under operating lease agreements, which generally have terms of one year or less and are automatically renewed for the same terms. Rental expenses amounted approximately \$ 8,641. Management believes that the summary of the future minimum rental commitments under noncancelable operating leases with terms exceeding one year is not significant

c. Federal and State Grants

Projects financed by the Federal and State Grants are subject to audits by grantors and other governmental agencies in order to determine its expenditures to comply with the conditions of such grants. During fiscal period and as disclosed in Note 7(f) the Municipality accrued in the GWFS \$750,467 representing disallowed costs as determined by an audit performed by the Governor's Authorized Representative (GAR) of FEMA funds related to Hurricane Georges. As of June 30, 2005 the GAR informed the Municipality that additional funds in the amount of 296,635 may be disallowed since certain projects have not been completed. The final outcome of this matter is undeterminable.

It is the Municipality's opinion that no additional material unrecorded liabilities will arise from audits previously performed or to perform.

d. Litigations

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 \$164,660 for awarded or anticipated unfavorable judgments as of June 30, 2005. Management believes that any unfavorable outcome in relation to pending or threatened litigation would not be significantly in excess of recorded amounts.

14. FUND BALANCE DEFICITS

Certain special funds included as other governmental funds in the fund statements disclosed fund balance deficits as follows:

	<u>Amount</u>
Economic Development Administration-EDA	\$ 111,226
Public Order Code	\$ 181,999

The deficits results from the accrual of expenditures without accruing intergovernmental revenues for reimbursement of expenditures. As required by current standards, the Municipality recorded intergovernmental revenues for reimbursement-based (expenditure-driven) grants on fund statements when all applicable eligibility requirements have been met and the resources are available.

15. SPECIAL ITEM

During fiscal year the Municipality sold a building and corresponding land with a book value of \$541,860 for \$600,000 in cash and a building and corresponding land valued at \$425,000. The transaction falls under the definition of special item set forth by GASB 34, as it is a transaction of unusual or infrequent nature within the control of Municipality's management.

16. SUBSEQUENT EVENTS

- a. On July 26, 2005 the Municipality agreed to sell a parcel of land for a total amount of \$612,265. The Municipality received \$50,000 as an advance on June 20, 2005 and \$562,265 on August 1, 2005. The amount received as an advance was recorded as deposit payable in the financial statements.
- b. On September 9, 2005, the Governmental Development Bank of Puerto Rico (GDB) approved the issuance of a \$1,310,000 public improvement bond to the Municipality to finance various capital projects, including roads improvements and construction of ceilings for various basketball courts. Payments are due in annual installments through year 2025, bearing interest at a variable rate (LIBOR + 1.25%). Principal and interest payments will be financed through the Municipality's debt service fund.

**COMMONWEALTH OF PUERTO RICO
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BUDGETARY COMPARISON SCHEDULE - GENERAL FUND
YEAR ENDED JUNE 30, 2005**

	<u>Budgeted Amounts</u>		<u>Actual Amounts (Budgetary Basis)</u>	<u>Variance w Final Budg Positive (Neg:</u>
	<u>Original</u>	<u>Final</u>		
REVENUES:				
Property taxes	\$ 1,034,707	\$1,034,707	\$ 1,135,579	\$ 100
Municipal license tax	285,000	285,000	281,401	(3)
Licenses, permits and other local taxes	861,500	861,500	904,313	42
Fines and forfeitures	1,000	1,000	16,620	15
Interest	50,000	50,000	20,685	(29)
Intergovernmental:				
Other operating grants and contributions	5,441,864	5,441,864	4,668,802	(773)
Rent	95,000	95,000	111,836	16
Other	65,000	65,000	768,260	703
Total revenues	<u>7,834,071</u>	<u>7,834,071</u>	<u>7,907,496</u>	<u>73</u>
EXPENDITURES:				
Current:				
General government	3,839,109	3,986,278	4,084,830	(98)
Public safety	960,366	825,796	799,375	26
Public works and sanitation	1,764,817	1,764,177	1,743,638	20
Culture and recreation	415,686	436,701	427,624	9
Health and welfare	674,013	641,039	603,369	37
Total expenditures	<u>7,653,991</u>	<u>7,653,991</u>	<u>7,658,836</u>	<u>(4)</u>
Excess (deficiency) of revenues over (under) expenditures	180,080	180,080	248,660	68
Other financing sources (uses)				
Transfers out	180,080	180,080	176,025	4
Total other financing sources (uses)	<u>(180,080)</u>	<u>(180,080)</u>	<u>(176,025)</u>	<u>4</u>
Excess (deficiency) of revenues and other financing sources over expenditures and other financing uses	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 72,635</u>	<u>\$ 72</u>

The accompanying notes are an integral part of this required supplementary information.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Notes to Required Supplementary Information-
Budgetary Comparison Schedule-General Fund
June 30, 2005

1. 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 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, public safety, public works and sanitation, culture and recreation and health 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.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Notes to Required Supplementary Information-
Budgetary Comparison Schedule-General Fund
June 30, 2005

2. 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.

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, 2005. 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, 2005, 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.

3. Budget to GAAP Reconciliation

The accompanying budgetary comparison schedule presents comparisons of the original and final legally adopted budget with actual data on a budgetary basis. Since accounting principles applied for the purposes of developing data on a budgetary basis differ significantly from those used to present accounting principles generally accepted in the United States, the following budget to GAAP reconciliation is presented:

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA
Notes to Required Supplementary Information -
Budgetary Comparison Schedule-General Fund
June 30,2005

Excess of revenues and other financing sources over expenditures and other financing uses (budgetary basis):	\$	72,635
Budget to GAAP differences:		
Entity differences:		
Non budgeted funds recorded as revenues for financial reporting purposes:		265,545
Non budgeted funds recorded as expenditures for financial reporting:		(438,374)
Non budgeted transfers out:		(342,991)
Basis of accounting differences:		
Revenues recorded in budgetary basis purposes but not in financial reporting:		(50,000)
Expenditures recorded for financial reporting purposes but not in budgetary basis:		(249,032)
Timing differences:		
Current year encumbrances recorded as expenditures for budgetary reporting purposes:		233,336
Net change in fund balance (GAAP basis):	\$	<u>(508,882)</u>

ESTADO LIBRE ASOCIADO DE PUERTO RICO
MUNICIPIO DE GUANICA
AUDITORIA INTERNA

¡Viva Guánica!

Erica Keilaskumary Nazario
Auditor Interno

March 30, 2006

Lic. Angel M. Castillo Rodriguez
Commissioner
OCAM
PO BOX 70167
San Juan, P.R. 00936-8167

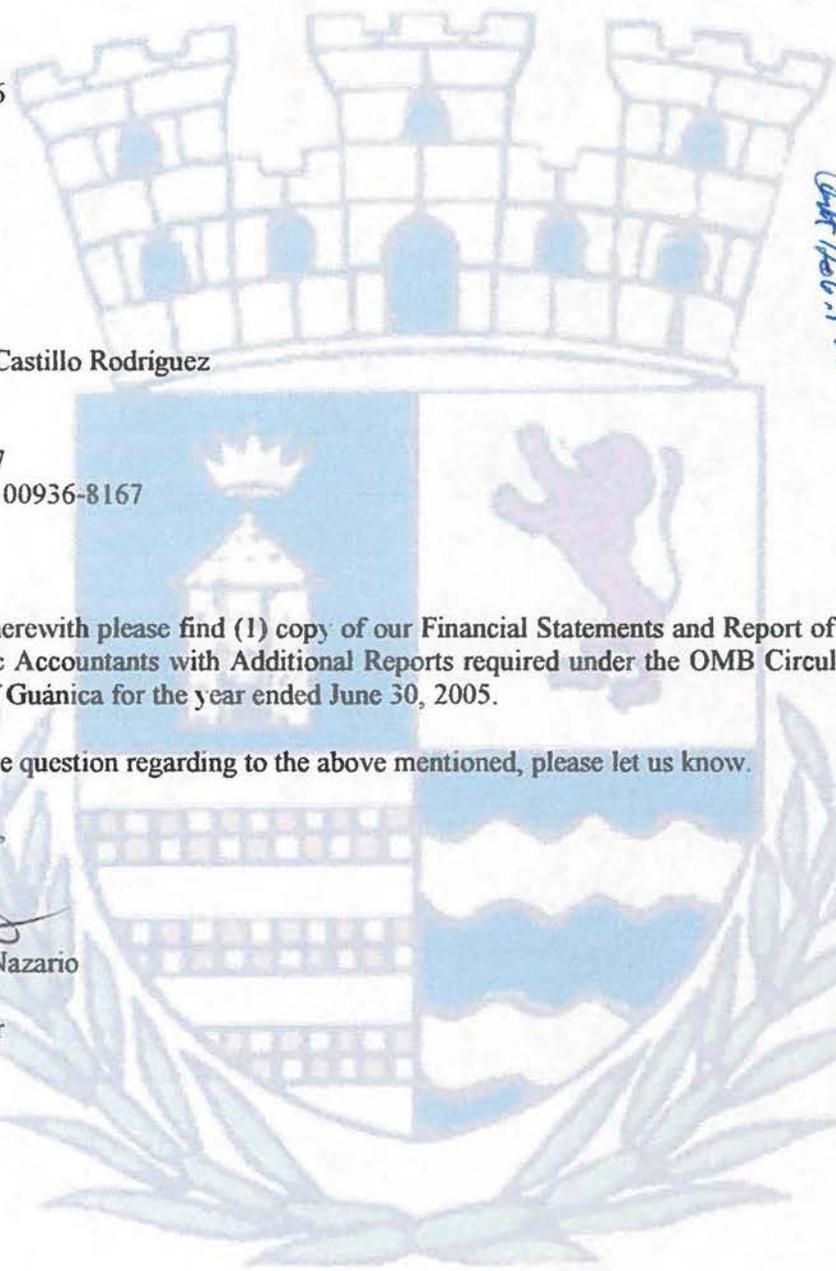
Gentleman:

Accompanied herewith please find (1) copy of our Financial Statements and Report of Independent Certified Public Accountants with Additional Reports required under the OMB Circular A-133 for Municipality of Guánica for the year ended June 30, 2005.

Should you have question regarding to the above mentioned, please let us know.

Cordially yours,


Keilaskumary Nazario
Director
Internal Auditor



RECIBIDO
UNIDAD DE CORREO
06 MAR 30 AM 1: 04
Cant 126.1376

OCAM
DIVISION REGULATORIA
E INTERVENCION
06 MAR 31 PM 4: 08

Apartado 785 Guánica, Puerto Rico 00653
Tel. 787-821-5016 Fax 787-821-5016

FORM **SF-SAC**
(5-2004)

U.S. DEPT. OF COMM. - Econ. and Stat. Admin. - U.S. CENSUS BUREAU
ACTING AS COLLECTING AGENT FOR
OFFICE OF MANAGEMENT AND BUDGET

**Data Collection Form for Reporting on
AUDITS OF STATES, LOCAL GOVERNMENTS, AND NON-PROFIT ORGANIZATIONS
for Fiscal Year Ending Dates in 2004, 2005, or 2006**

▶ Complete this form, as required by OMB Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations."

**RETURN
TO**

**Federal Audit Clearinghouse
1201 E. 10th Street
Jeffersonville, IN 47132**

PART I GENERAL INFORMATION (To be completed by auditee, except for Items 4 and 7)

1. Fiscal period ending date for this submission Month Day Year 06 / 30 / 2005 Fiscal Period End Dates Must Be In 2004, 2005, or 2006		2. Type of Circular A-133 audit 1 <input checked="" type="checkbox"/> Single audit 2 <input type="checkbox"/> Program-specific audit	
3. Audit period covered 1 <input checked="" type="checkbox"/> Annual 2 <input type="checkbox"/> Biennial 3 <input type="checkbox"/> Other - <input type="text"/> Months		4. FEDERAL GOVERNMENT USE ONLY Date received by Federal clearinghouse	
5. Auditee Identification Numbers			
a. Primary Employer Identification Number (EIN) 66 - 0433496		b. Are multiple EINs covered in this report? 1 <input type="checkbox"/> Yes 2 <input checked="" type="checkbox"/> No	
d. Data Universal Numbering System (DUNS) Number 09 - 105 - 9964		e. Are multiple DUNS covered in this report? 1 <input type="checkbox"/> Yes 2 <input checked="" type="checkbox"/> No	
f. If Part I, Item 5e = "Yes," complete Part I, Item 5f on the continuation sheet on Page 4.			

6. AUDITEE INFORMATION

a. Auditee name
MUNICIPALITY OF GUANICA

b. Auditee address (Number and street)
P.O. BOX 785
City
GUANICA
State ZIP + 4 Code
PR 00653

c. Auditee contact Name
MR. LUIS A. PACHECO-SANTIAGO
Title
FINANCE DIRECTOR

d. Auditee contact telephone
(787) 821 - 0633

e. Auditee contact FAX
(787) 821 - 1748

f. Auditee contact E-mail

7. AUDITOR INFORMATION (To be completed by auditor)

a. Auditor name
RODRIGUEZ, RIVERA & TORO, LLP

b. Auditor address (Number and street)
P.O. BOX 1080
City
MAYAGUEZ
State ZIP + 4 Code
PR 00681 - 1080

c. Auditor contact Name
MR. JOSE A. TORO-MERCADO, CPA
Title
MANAGING PARTNER

d. Auditor contact telephone
(787) 834 - 3100

e. Auditor contact FAX
(787) 831 - 2909

f. Auditor contact E-mail
JTORO@RRTLPP.COM

g. AUDITEE CERTIFICATION STATEMENT - This is to certify that, to the best of my knowledge and belief, the auditee has: (1) engaged an auditor to perform an audit in accordance with the provisions of OMB Circular A-133 for the period described in Part I, Items 1 and 3; (2) the auditor has completed such audit and presented a signed audit report which states that the audit was conducted in accordance with the provisions of the Circular; and, (3) the information included in **Parts I, II, and III** of this data collection form is accurate and complete. I declare that the foregoing is true and correct.

Signature of certifying official Date
 3 / 28 / 06
 Printed Name of certifying official
 MR. LUIS A. PACHECO-SANTIAGO
 Printed Title of certifying official
 FINANCE DIRECTOR

9. AUDITOR STATEMENT - The data elements and information included in this form are limited to those prescribed by OMB Circular A-133. The information included in Parts II and III of the form, except for Part III, Items 7, 8, and 9a-9f, was transferred from the auditor's report(s) for the period described in Part I, Items 1 and 3, and is **not a substitute** for such reports. The auditor has not performed any auditing procedures since the date of the auditor's report(s). A copy of the reporting package required by OMB Circular A-133, which includes the complete auditor's report(s), is available in its entirety from the auditee at the address provided in Part I of this form. As required by OMB Circular A-133, the information in **Parts II and III** of this form was entered in this form by the auditor based on information included in the reporting package. The auditor has not performed any additional auditing procedures in connection with the completion of this form.

Signature of auditor Date
 3 / 28 / 06
 Printed Name of auditor
 RODRIGUEZ, RIVERA & TORO, LLP

PART II FINANCIAL STATEMENTS (To be completed by auditor)

- 1. Type of audit report
Mark either: 1 Unqualified opinion **OR**
any combination of: 2 Qualified opinion 3 Adverse opinion 4 Disclaimer of opinion
- 2. Is a "going concern" explanatory paragraph included in the audit report? 1 Yes 2 No
- 3. Is a reportable condition disclosed? 1 Yes 2 No - SKIP to Item 5
- 4. Is any reportable condition reported as a material weakness? 1 Yes 2 No
- 5. Is a material noncompliance disclosed? 1 Yes 2 No

PART III FEDERAL PROGRAMS (To be completed by auditor)

- 1. Does the auditor's report include a statement that the auditee's financial statements include departments, agencies, or other organizational units expending \$500,000 or more in Federal awards that have separate A-133 audits which are not included in this audit? (AICPA Audit Guide, Chapter 12) 1 Yes 2 No
- 2. What is the dollar threshold to distinguish Type A and Type B programs? (OMB Circular A-133 § __ .520(b)) \$ 300,000
- 3. Did the auditee qualify as a low-risk auditee? (§ __ .530) 1 Yes 2 No
- 4. Is a reportable condition disclosed for any major program? (§ __ .510(a)(1)) 1 Yes 2 No -SKIP to Item 6
- 5. Is any reportable condition reported as a material weakness? (§ __ .510(a)(1)) 1 Yes 2 No
- 6. Are any known questioned costs reported? (§ __ .510(a)(3) or (4)) 1 Yes 2 No
- 7. Were Prior Audit Findings related to **direct** funding shown in the Summary Schedule of Prior Audit Findings? (§ __ .315(b)) 1 Yes 2 No

8. Indicate which **Federal** agency(ies) have current year audit findings related to **direct** funding or prior audit findings shown in the Summary Schedule of Prior Audit Findings related to **direct** funding. (Mark (X) all that apply or None)
- | | | | |
|--|--|---|--|
| 98 <input type="checkbox"/> U.S. Agency for International Development | 83 <input type="checkbox"/> Federal Emergency Management Agency | 43 <input type="checkbox"/> National Aeronautics and Space Administration | 96 <input type="checkbox"/> Social Security Administration |
| 10 <input type="checkbox"/> Agriculture | 39 <input type="checkbox"/> General Services Administration | 89 <input type="checkbox"/> National Archives and Records Administration | 19 <input type="checkbox"/> U.S. Department of State |
| 23 <input type="checkbox"/> Appalachian Regional Commission | 93 <input type="checkbox"/> Health and Human Services | 05 <input type="checkbox"/> National Endowment for the Arts | 20 <input type="checkbox"/> Transportation |
| 11 <input checked="" type="checkbox"/> Commerce | 97 <input type="checkbox"/> Homeland Security | 06 <input type="checkbox"/> National Endowment for the Humanities | 21 <input type="checkbox"/> Treasury |
| 94 <input type="checkbox"/> Corporation for National and Community Service | 14 <input type="checkbox"/> Housing and Urban Development | 07 <input type="checkbox"/> National Science Foundation | 82 <input type="checkbox"/> United States Information Agency |
| 12 <input type="checkbox"/> Defense | 03 <input type="checkbox"/> Institute of Museum and Library Services | 47 <input type="checkbox"/> Office of National Drug Control Policy | 64 <input type="checkbox"/> Veterans Affairs |
| 84 <input type="checkbox"/> Education | 15 <input type="checkbox"/> Interior | 09 <input type="checkbox"/> Small Business Administration | 00 <input type="checkbox"/> None |
| 81 <input type="checkbox"/> Energy | 16 <input type="checkbox"/> Justice | | <input type="checkbox"/> Other - Specify: |
| 66 <input type="checkbox"/> Environmental Protection Agency | 17 <input type="checkbox"/> Labor | | <input type="text"/> |
| | 09 <input type="checkbox"/> Legal Services Corporation | | <input type="text"/> |

Each agency identified is required to receive a copy of the reporting package.

In addition, one copy each of the reporting package is required for:

- the Federal Audit Clearinghouse archives
- and, if not marked above, the Federal cognizant agency

Count total number of boxes marked above and submit this number of reporting packages 3

FORM SF-SAC (5-2004)

PART III FEDERAL PROGRAMS - Continued

9. FEDERAL AWARDS EXPENDED DURING FISCAL YEAR

10. AUDIT FINDINGS

CFDA Number		Research and development (c)	Name of Federal program (d)	Amount expended (e)	Direct award (f)	Major program (g)		Type(s) of compliance requirement(s) ⁴ (a)	Audit finding reference number(s) ⁵ (b)
Federal Agency Prefix ¹ (a)	Extension ² (b)					Major program (g)	If yes, type of audit report ³ (h)		
1	0	558	CHILD AND ADULT CARE FOOD PROGRAM	\$ 9,835.00	2 <input checked="" type="checkbox"/> No	2 <input checked="" type="checkbox"/> No		O	N/A
1	1	300	GRANT FOR PUBLIC WORKS AND ECONOMIC DEVELOPMENT	\$ 856,842.00	1 <input checked="" type="checkbox"/> Yes	1 <input checked="" type="checkbox"/> Yes	U	CDN	2005 III-1, 2005 III-2, 2005 III-3
1	4	228	COMMUNITY DEVELOPMENT BLOCK GRANT-STATES PROGRAM	\$ 1,238,559.00	2 <input checked="" type="checkbox"/> No	1 <input checked="" type="checkbox"/> Yes	Q	CDN	2005 III-4, 2005 III-5, 2005 III-6
1	4	871	SECTION 8 HOUSING CHOICE VOUCHERS PROGRAM	\$ 187,510.00	2 <input checked="" type="checkbox"/> No	2 <input checked="" type="checkbox"/> No		O	N/A
1	6	710	PUBLIC SAFETY PARTNERSHIP AND COMMUNITY POLICY GRANTS (COPS)	\$ 41,411.00	2 <input checked="" type="checkbox"/> No	2 <input checked="" type="checkbox"/> No		O	N/A
9	3	575	CHILD CARE AND DEVELOPMENT BLOCK GRANT	\$ 142,806.00	2 <input checked="" type="checkbox"/> No	2 <input checked="" type="checkbox"/> No		O	N/A
9	7	039	HAZARD MITIGATION GRANT PROGRAM	\$ 449,452.00	2 <input checked="" type="checkbox"/> No	1 <input checked="" type="checkbox"/> Yes	Q	L	2005 III-7
1	6	592	LOCAL LAW ENFORCEMENT BLOCK GRANT	\$ 50,000.00	2 <input checked="" type="checkbox"/> No	2 <input checked="" type="checkbox"/> No		O	N/A
				\$.00	2 <input type="checkbox"/> No	2 <input type="checkbox"/> No			
				\$.00	2 <input type="checkbox"/> No	2 <input type="checkbox"/> No			

TOTAL FEDERAL AWARDS EXPENDED →

\$ 2,976,415.00

IF ADDITIONAL LINES ARE NEEDED, PLEASE PHOTOCOPY THIS PAGE, ATTACH ADDITIONAL PAGES TO THE FORM, AND SEE INSTRUCTIONS

¹ See Appendix 1 of instructions for valid Federal Agency two-digit prefixes.

² Or other identifying number when the Catalog of Federal Domestic Assistance (CFDA) number is not available. (See Instructions)

³ If major program is marked "Yes," enter only one letter (U = Unqualified opinion, Q = Qualified opinion, A = Adverse opinion, D = Disclaimer of opinion) corresponding to the type of audit report in the adjacent box. If major program is marked "No," leave the type of audit report box blank.

⁴ Enter the letter(s) of all type(s) of compliance requirement(s) that apply to audit findings (i.e., noncompliance, reportable conditions (including material weaknesses), questioned costs, fraud, and other items reported under § .510(a)) reported for each Federal program.

- A. Activities allowed or unallowed
- B. Allowable costs/cost principles
- C. Cash management
- D. Davis - Bacon Act

- E. Eligibility
- F. Equipment and real property management
- G. Matching, level of effort, earmarking
- H. Period of availability of Federal funds

- I. Procurement and suspension and debarment
- J. Program income
- K. Real property acquisition and relocation assistance

- L. Reporting
- M. Subrecipient monitoring
- N. Special tests and provisions
- O. None

⁵ N/A for NONE

PART I **Item 5 Continuation Sheet**

c. List the multiple Employer Identification Numbers (EINs) covered in this report.

f. List the multiple DUNS covered in the report.

1	N	/	A	21	-	41	-	1	N	/	A	21	-
2	-			22	-	42	-	2	-			22	-
3	-			23	-	43	-	3	-			23	-
4	-			24	-	44	-	4	-			24	-
5	-			25	-	45	-	5	-			25	-
6	-			26	-	46	-	6	-			26	-
7	-			27	-	47	-	7	-			27	-
8	-			28	-	48	-	8	-			28	-
9	-			29	-	49	-	9	-			29	-
10	-			30	-	50	-	10	-			30	-
11	-			31	-	51	-	11	-			31	-
12	-			32	-	52	-	12	-			32	-
13	-			33	-	53	-	13	-			33	-
14	-			34	-	54	-	14	-			34	-
15	-			35	-	55	-	15	-			35	-
16	-			36	-	56	-	16	-			36	-
17	-			37	-	57	-	17	-			37	-
18	-			38	-	58	-	18	-			38	-
19	-			39	-	59	-	19	-			39	-
20	-			40	-	60	-	20	-			40	-

IF ADDITIONAL LINES ARE NEEDED, PLEASE PHOTOCOPY THIS PAGE, ATTACH ADDITIONAL PAGES TO THE FORM, AND SEE INSTRUCTIONS