

OFICINA DEL COMISIONADO DE ASUNTOS MUNICIPALES

AREA DE ASESORAMIENTO, REGLAMENTACION E INTERVENCION FISCAL

AREA DE ARCHIVO DIGITAL

MUNICIPIO DE GUANICA
AUDITORIA 2005-2006

30 DE JUNIO DE 2006

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**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA**

*FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT*

FISCAL YEAR ENDED JUNE 30, 2006

**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, 2006, 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. 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 balances and their corresponding interfund receivable balances as of June 30, 2006 recorded in the General Fund, Commonwealth Legislature Resolutions Fund and Other Governmental Funds 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 balances and their corresponding interfund receivable balances as of June 30, 2006 recorded in the General Fund, Commonwealth Legislature Resolutions Fund and Other Governmental Funds, the financial statements referred to in the first paragraph present fairly, in all material respects, the respective financial position of the General Fund, Commonwealth Legislature Resolutions Fund and the aggregate remaining fund information of the Municipality of Guanica, Puerto Rico as of June 30, 2006, 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 Debt Service Fund, the FEMA-Hazard Mitigation Grant Program Fund and the \$1,310,000 Bond Issuance Fund of the Municipality of Guanica, Puerto Rico as of June 30, 2006, 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 3 through 15 and the Budgetary Comparison Schedule – General Fund on page 61 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.

2196515



Rodriguez, Rivera & Toro LLP

MANAGEMENT DISCUSSION AND ANALYSIS

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Management Discussion and Analysis
June 30, 2006

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, 2006. 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 \$21.24 million in the accompanying statement of net assets, of which most significant are capital assets and accounts receivable due from governmental entities amounting to \$15.89 million and \$2.68 million respectively.
- The Municipality's capital assets increase as a result of this year's operations. Capital assets as of June 30, 2006 are \$15.89 million, as compared to \$14.44 million for the year ended June 30, 2005, for a 10% of increase.
- The assets of the Municipality exceeded its liabilities by \$7.9 million at June 30, 2006, represented as "net assets" in the accompanying statements of net assets. Restricted and unrestricted (deficit) net assets amounted to \$2.31 million and \$(7.18) million, respectively. Net assets invested in capital assets amounted \$12.80 million.
- During the year, the Municipality reported revenues of \$7.90 million in the General Fund of total revenues restricted and unrestricted of \$11.58 million.
- Long term liabilities principal payments were \$.735 million. During the year ended June 30, 2006, the Municipality issued \$1.31 million on bonds payable.
- The Municipality has reported total expenses amounting to \$11.79 million 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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Management Discussion and Analysis
June 30, 2006

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 asses 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
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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.

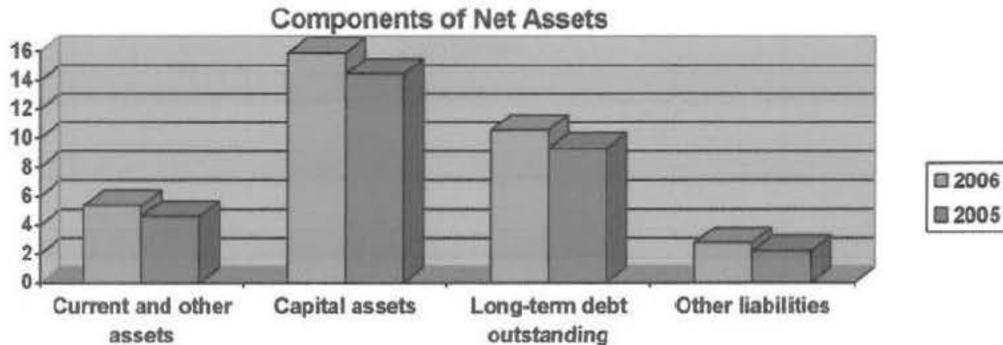
THE MUNICIPALITY AS A WHOLE

The Municipality's *combined* net assets increases from a year ago, from \$7.55 million to \$7.93 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	2006
Current and other assets	\$4.60	\$5.35
Capital assets	14.44	15.89
Total assets	19.04	21.24
Long-term debt outstanding	(9.30)	(10.55)
other liabilities	(2.18)	(2.76)
Total liabilities	(11.48)	(13.31)
Net assets:		
Invested in capital assets, net of related debt	11.59	12.80
Restricted for:		
Debt service	.45	.42
Capital project	1.63	1.86
Other specified purposes	.24	.03
	(6.36)	(7.18)
Unrestricted	(6.36)	(7.18)
Net Assets	\$ 7.55	\$ 7.93

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
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Net assets of the Municipality's governmental activities increased by \$.38 million (\$7.93 million compared to \$7.55 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 \$(6.36) million at June 30, 2005 to a \$(7.18) million at June 30, 2006. 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	2006
Revenues:		
Program revenues:		
Operating grants and contributions	\$ 3,362,047	\$ 1,272,210
Capital grants and contributions	2,218,357	2,292,583
Charges for services	1,046,815	418,676
General revenues:		
Property taxes	1,430,068	1,036,814
Municipal license taxes	281,401	304,620
Construction excise taxes		
Unrestricted intergovernmental contributions and reimbursements	4,774,038	6,094,125
Unrestricted interest on deposit	20,685	75,516
Other	404,522	136,579
Special items-		
Gain on sale of capital assets	483,140	533,368
Total revenues	<u>14,021,073</u>	<u>12,164,491</u>
Expenses:		
General government	6,020,246	4,824,656
Public Safety	1,173,292	1,290,543
Public work and sanitation	1,860,051	2,417,080
Culture and recreation	646,020	526,173
Health and welfare	3,451,785	2,308,078
Interest and bonds, notes and capital lease obligations	183,983	422,072
Total expenses	<u>13,335,377</u>	<u>11,788,601</u>
Net increase in net assets	685,696	375,890
Net assets-at the beginning of the year, as restated	6,869,535	7,555,230
Net assets- at end of the year	<u>\$ 7,555,230</u>	<u>\$ 7,931,119</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Management Discussion and Analysis
June 30, 2006

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	2006
Comparative Condensed Balance Sheet-Governmental funds:		
Total assets-major funds	\$ 3,760,778	\$ 5,621,673
Total assets-nonmajor funds	1,948,092	2,016,207
Total assets	5,708,870	7,637,880
Total liabilities-major funds	2,380,777	4,082,194
Total liabilities-nonmajor funds	2,023,507	2,171,675
Total liabilities	4,404,284	6,253,869
Fund Balances:		
Reserved-major funds	2,500,788	3,072,817
Reserved-nonmajor funds	(136,346)	140,805
Unreserved-major funds	(1,059,970)	(1,533,338)
Unreserved-nonmajor funds	24	(296,272)
Total fund balances	1,304,496	1,384,011
Comparative Condensed Statement of Operations-Governmental funds:		
Total revenues-major funds	9,552,230	9,060,165
Total revenues-nonmajor funds	3,128,703	2,515,454
Total revenues	12,680,933	11,575,618
Total expenditures-major funds	10,054,675	11,209,284
Total expenditures-nonmajor funds	3,910,544	2,626,385
Total expenditures	13,965,219	13,835,669
Other Financial Sources-major funds(excluding operating transfers among funds)	145,000	1,727,302
Special items, net	600,000	612,265
Net changes in fund balances	\$ (539,286)	\$ 79,516

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Management Discussion and Analysis
June 30, 2006

Governmental Activities

Programs revenues of Municipality's governmental activities decreased by 39.89% (\$2.64 million) while total expenses decreased by 11.6% (1.54 million). The Municipality of Guánica took the following major actions this year to improve the financial position:

- The Mayor of the Municipality of Guánica still has a Finance Auxiliary 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 estimate 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.

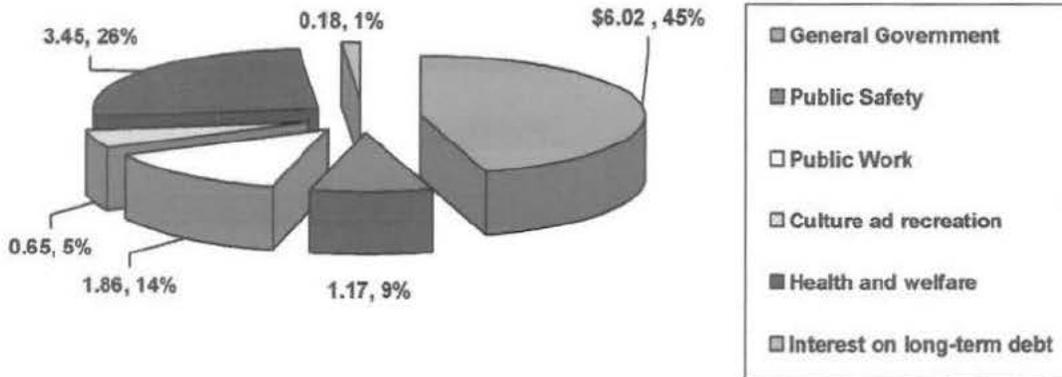
Expenses during the fiscal year ended June 30, 2006 was substantially related to the following:

Table 2
Governmental Activities
(in Million)

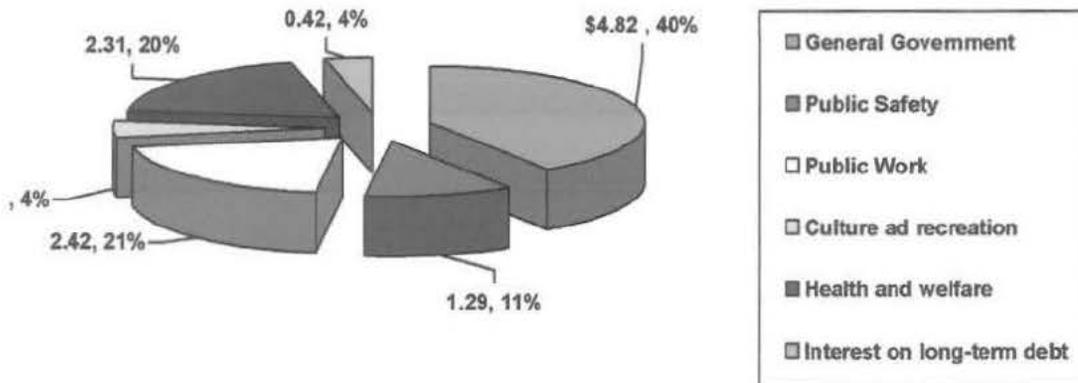
	Total expenses	
	2005	2006
General Government	\$ 6.02	\$4.82
Public Safety	1.17	1.29
Public Work	1.86	2.42
Culture, recreation and education	.65	.53
Health and welfare	3.45	2.31
Interest on long term debt	.18	.42
Totals	\$ 13.33	\$ 11.79

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
 Management Discussion and Analysis
 June 30, 2006

Total Expense 2005



Total Expense 2006



The cost of all governmental activities this year was \$11.79 million compared to \$13.33 million last year. Table 2 presents the cost of each of the Municipality of Guanica's largest programs.

The major sources of general revenue are property taxes, municipal license taxes, and grant and contributions not restricted, which in total represent \$7.43 (61%) and \$6.48 (46%) of all revenues in 2006 and 2005, respectively.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Management Discussion and Analysis
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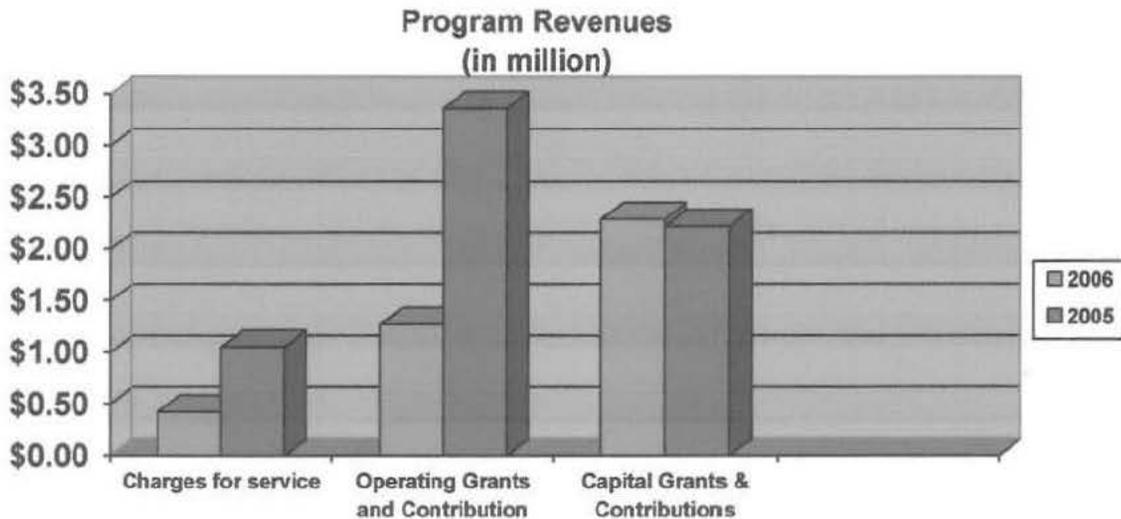
Table 3
Governmental Activities
(in Million)

	General Revenues By major sources	
	2005	2006
	Property taxes	\$1.43
Municipal license taxes	.28	.30
Grants and contributions	4.77	6.09
Totals	\$6.48	\$7.43

Table 4
Governmental Activities
(in Million)

	Program Revenues by major sources	
	2005	2006
	Charges for service	\$ 1.05
Operating Grants and Contribution	3.36	1.27
Capital Grants and Contributions	2.22	2.29
Totals	\$6.63	\$3.98

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Management Discussion and Analysis
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THE MUNICIPALITY'S FUND

As the Municipality completed the year, its governmental funds reported a combined fund balance of \$1.38 million, which is upper than last year total of \$1.30 million.

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

- The Municipality experienced an increase in the other operating grants and contributions by \$1.5 million
- 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 Guánica 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 2005).

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Management Discussion and Analysis
June 30, 2006

CAPITAL ASSET AND DEBT ADMINISTRATION

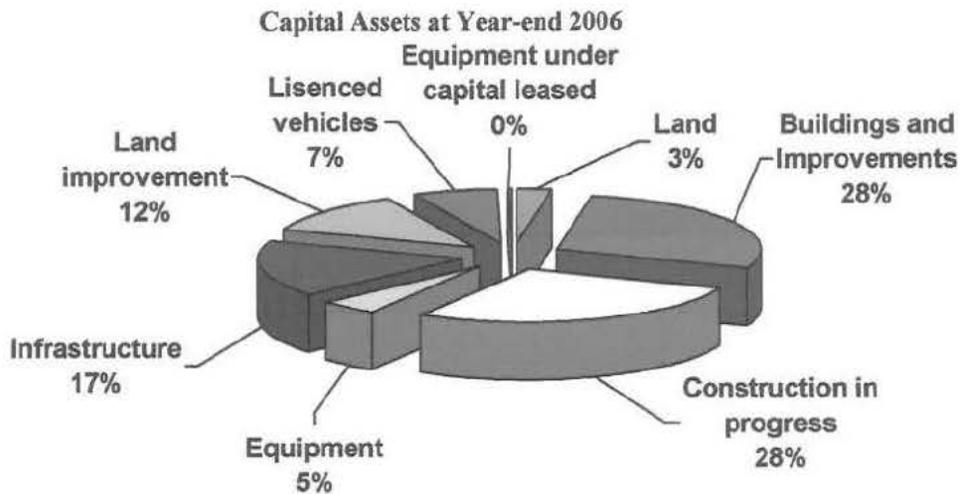
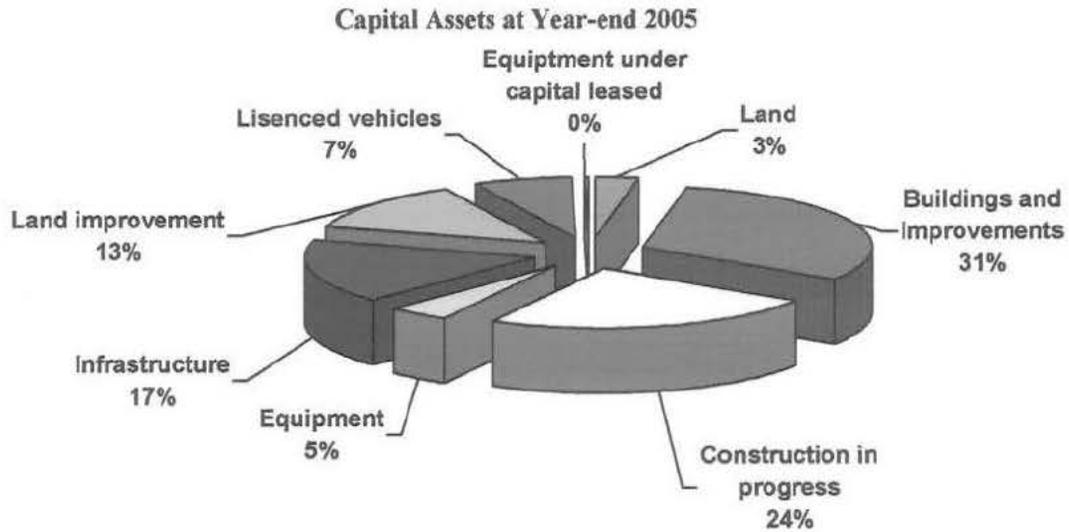
Capital Assets

As of June 30, 2006, the Municipality of Guánica had \$ 23.50 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 \$1.90 million, or 9 %, 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)

	Governmental Activities	
	2005	2006
Land	\$.67	\$.67
Land improvement	2.88	2.89
Buildings and Improvements	6.69	6.55
Construction in progress	5.16	6.60
Licensed vehicles	1.5	1.61
Equipment	.99	1.13
Equipment under capital leases	.04	.04
Infrastructure	3.67	4.01
Totals	\$21.60	\$23.50

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Management Discussion and Analysis
June 30, 2006



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

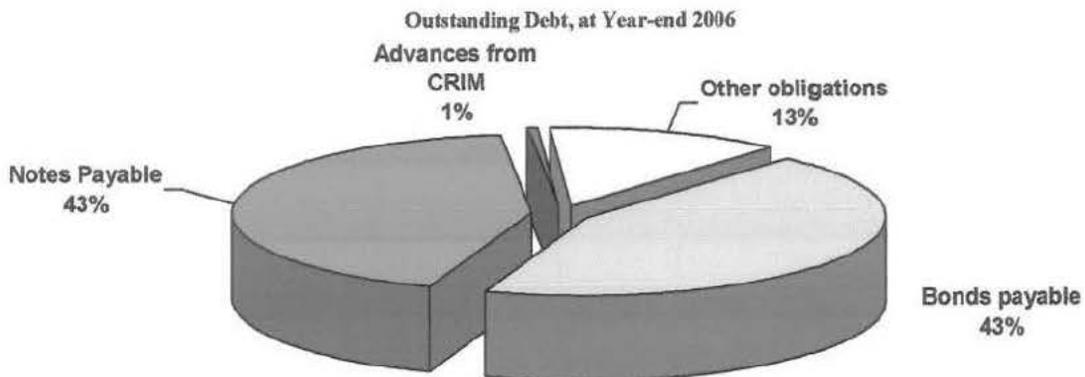
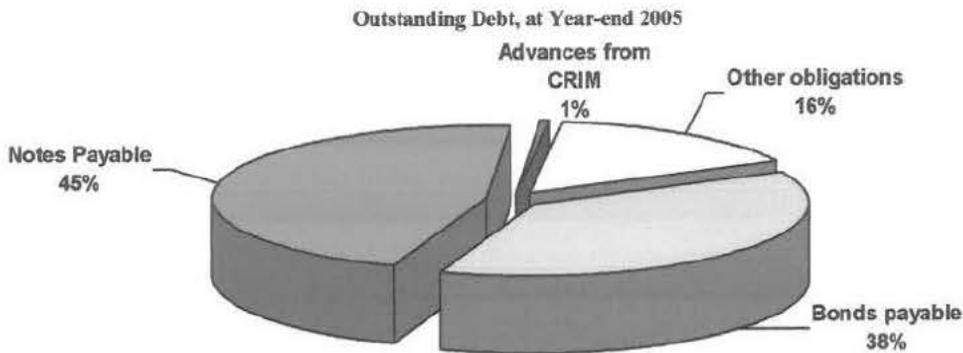
COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Management Discussion and Analysis
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Debt

At year-end, the Municipality had \$ 10.55 million in bonds and notes outstanding versus \$ 9.31 million last year, an increase of 13.3 percent, as shown in Table 6.

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

	Governmental Activities	
	2005	2006
Bonds payable	\$3.51	\$4.62
Notes Payable	4.26	4.51
Advances from CRIM	.06	.06
Other obligations	1.48	1.36
Totals	9.31	\$10.55



COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
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June 30, 2006

New bonds in the amount of \$1.31 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 Christmas bonus. 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 2006 budget. Unemployment in the Municipality now stands at 14.4 percent.

Amounts available for appropriations in the General Fund for the fiscal year 2007 are \$7.82 million, a decrease of 5 percent under the final 2006 budget of \$8.2 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 2007.

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.

BASIC FINANCIAL STATEMENTS

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA
STATEMENT OF NET ASSETS
JUNE 30, 2006

ASSETS	<u>Governmental Activities</u>
Cash and cash equivalents	\$ 633,599
Receivables, net of allowance for uncollectible accounts:	
Property taxes	
Municipal Licenses	
Grants and contributions	
Due from governmental agencies	2,682,729
Restricted Assets:	
Cash in fiscal agents	2,007,692
Deferred bond issuance costs	30,894
Capital assets (note 5):	
Nondepreciable assets:	
Land and construction in progress	7,170,085
Depreciable assets:	
Other capital assets, net	8,719,374
	<u>15,889,459</u>
Total assets	<u><u>\$ 21,244,372</u></u>
 LIABILITIES 	
Accounts payable and accrued liabilities	\$ 1,317,910
Due to governmental agencies	480,810
Deferred revenues	784,448
Matured bonds due and payable	-
Interest payable	178,506
Long term liabilities (note 7) :	
Due within one year	799,253
Due in more than one year	9,752,326
Total liabilities	<u>13,313,253</u>
 NET ASSETS 	
Invested in capital assets, net of related debt	12,798,707
Restricted for:	
Debt service	426,134
Capital Projects	1,856,135
Other specified purposes	30,418
Unrestricted (deficit)	(7,180,274)
Total net assets	<u><u>\$ 7,931,119</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, 2006

Functions	Program Revenues				Net (expense) revenue and changes in net assets	
	Expenses	Fees, Fines and Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions		
Governmental Activities:						
General government	\$ 4,824,656	\$ 418,676	\$ 517,517	\$ -	\$ (3,888,463)	
Public safety	1,290,543	-	226,551	-	(1,063,992)	
Public works and sanitation	2,417,080	-	-	1,264,143	(1,152,937)	
Culture and recreation	526,173	-	-	871,833	345,660	
Health and welfare	2,308,078	-	528,142	156,607	(1,623,329)	
Interest on long term debt	422,072	-	-	-	(422,072)	
Total	<u>\$ 11,788,601</u>	<u>\$ 418,676</u>	<u>\$ 1,272,210</u>	<u>\$ 2,292,583</u>	<u>(7,805,132)</u>	
General revenues :						
Taxes						
Property taxes						1,036,814
Municipal license taxes						304,620
Grants contributions not restricted to specific programs						6,094,125
Interest						75,516
Other						136,579
Special item:						
Gain on sale of capital assets (note 16)						533,368
Total general revenues:						<u>8,181,022</u>
Change in net assets						375,890
Net assets-beginning, as restated (note 11)						7,555,230
Net assets-ending						<u>\$ 7,931,119</u>

The accompanying notes are an integral part of this statement.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA
BALANCE SHEET
JUNE 30, 2006

	General	Commonwealth Legislature Resolutions	Debt Service	FEMA-Hazard Mitigation Grant	\$1,310,000 Bond Issuance	Other Governmental Funds	Total Governmental Funds
Assets							
Cash and cash equivalents	\$ -	\$ 304,557	\$ -	\$ -	\$ -	\$ 329,041	\$ 633,599
Receivables, net of allowance for uncollectible accounts:							
Due from governmental agencies (note 3)	834,685	401,151	12,554	434,368	4,742	995,229	2,682,729
Due from other funds (note 4)	709,043	1,241,436	-	-	-	363,383	2,313,861
Restricted Assets:							
Cash with fiscal agents	-	-	537,533	26,873	1,114,732	328,554	2,007,692
Total Assets	\$ 1,543,728	\$ 1,947,144	\$ 550,087	\$ 461,241	\$ 1,119,474	\$ 2,016,207	\$ 7,637,880
Liabilities and Fund Balances							
Accounts payable and accrued liabilities	\$ 540,043	\$ 121,726	\$ -	\$ 29,246	\$ 88,500	\$ 538,394	\$ 1,317,919
Due to governmental agencies (note 3)	480,605	-	-	-	-	205	480,810
Due to other funds (note 4)	1,141,663	51,218	-	431,995	-	688,985	2,313,861
Deferred revenues (note 6)	735,868	-	-	113,377	-	944,091	1,793,336
Matured bonds due and payable	-	-	224,000	-	-	-	224,000
Matured interest due and payable	-	-	123,952	-	-	-	123,952
Total Liabilities	2,898,180	172,944	347,952	574,618	88,500	2,171,675	6,253,869
Fund Balances (deficit)							
Reserved for:							
Encumbrances	178,886	-	-	-	-	-	178,886
Capital projects	-	1,774,200	-	-	1,030,974	110,387	2,915,561
Debt service	-	-	202,134	-	-	-	202,134
Other specified purposes	-	-	-	(113,377)	-	30,418	(82,959)
Unreserved	(1,533,338)	-	-	-	-	(296,272)	(1,829,610)
Total Fund Balances (deficit)	(1,354,452)	1,774,200	202,134	(113,377)	1,030,974	(155,467)	1,384,011
Total Liabilities and Fund Balances (deficit)	\$ 1,543,728	\$ 1,947,144	\$ 550,087	\$ 461,241	\$ 1,119,474	\$ 2,016,207	\$ 7,637,880

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, 2006**

Total fund balances- governmental funds	\$	1,384,011
Amounts reported for governmental activities in the Statement of Net Assets are different because:		
Capital assets used in governmental activities are not current financial resources and therefore are not reported in the governmental funds balance sheet:		15,889,459
Other assets used in governmental activities are not current financial resources and therefore are not reported in the funds:		
Deferred bond issuance costs		30,894
Other assets are not available to pay current-period expenditures and therefore are deferred in the funds:		
Receivables:		
P.R. Department of Treasury - Christmas bonus reimbursement	\$	84,634
CRIM - Property taxes (final liquidation)		89,521
FEMA - Hazard Mitigation Grant Program		113,377
P.R. Department of Labor - Law No. 52		298,247
Federal Government - EDA		93,822
P.R. Department of Health - reimbursement of health costs		329,287
		1,008,888
Interest liabilities are not due and payable in the current period and therefore, are not reported in the funds:		(54,554)
Long term liabilities, including bonds payable, are not due and payable in the current period and therefore are not reported in the funds:		(10,327,579)
Net assets of governmental activities:	\$	<u>7,931,119</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, 2006

	General	Commonwealth Legislature Resolutions	Debt Service	FEMA-Hazard Mitigation Grant	\$1,310,000 Bond Issuance	Other Governmental Funds	Total Governmental Funds
Revenues:							
Taxes:							
Property taxes	\$ 815,385	\$ -	\$ 221,429	\$ -	\$ -	\$ -	\$ 1,036,814
Municipal license tax	304,620	-	-	-	-	-	304,620
Licenses and permits	272,183	-	-	-	-	-	272,183
Charges for services	-	-	-	-	-	17,718	17,718
Fines and forfeitures	27,935	-	-	-	-	14,937	42,872
Interest	21,533	217	11,381	-	42,341	44	75,516
Intergovernmental:							
Federal operating grants	-	-	-	239,359	-	312,329	551,688
Federal capital grants	-	-	-	-	-	1,263,716	1,263,716
Commonwealth operating grants	-	500	-	-	-	490,407	490,906
Commonwealth capital grants	-	637,035	-	-	-	409,304	1,046,339
Other operating grants and contributions	6,250,765	-	-	-	-	-	6,250,765
Rent	81,481	4,422	-	-	-	-	85,903
Other	129,579	-	-	-	-	7,000	136,579
Total revenues	7,903,480	642,174	232,810	239,359	42,341	2,515,454	11,575,618
Expenditures:							
Current:							
General government	4,558,316	805	-	-	-	623,165	5,182,286
Public safety	1,080,317	-	-	-	-	119,789	1,200,106
Public works and sanitation	1,964,510	244,945	-	-	-	12,195	2,221,650
Culture and recreation	354,924	4,417	-	-	-	19,069	378,410
Health and welfare	1,285,091	238,940	-	352,736	-	420,749	2,297,516
Capital Outlays	111,980	248,801	-	-	273,941	1,431,418	2,068,140
Debt service:							
Principal	-	-	245,000	-	-	-	245,000
Interest	-	-	234,735	-	-	-	234,735
Bond issuance costs	-	-	-	-	7,827	-	7,827
Total expenditures	9,355,137	737,908	479,735	352,736	283,768	2,626,385	13,835,669
Excess (deficiency) of revenues over (under) expenditures	(1,451,657)	(95,734)	(246,924)	(113,377)	(241,427)	(110,931)	(2,260,051)
Other financing sources (uses):							
Proceeds from issuance of long term debt	417,302	-	-	-	1,310,000	-	1,727,302
Transfers in	45,342	-	183,115	-	-	30,879	259,337
Transfers out	(213,995)	-	(7,743)	-	(37,599)	-	(259,337)
Total other financing sources	248,649	-	175,372	-	1,272,401	30,879	1,727,301
Special item:							
Proceeds from sale of capital assets	612,265	-	-	-	-	-	612,265
Net change in fund balance	(590,743)	(95,734)	(71,553)	(113,377)	1,030,974	(80,052)	79,516
Fund Balance (deficit) at beginning of year, as restated (note 11)	(763,710)	1,869,934	273,687	-	-	(75,415)	1,304,495
Fund balance (deficit), at end of year	\$ (1,354,453)	\$ 1,774,200	\$ 202,134	\$ (113,377)	\$ 1,030,974	\$ (155,467)	\$ 1,384,011

The accompanying notes are an integral part of this statement.

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15/02/2007

**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, 2006**

Net change in fund balances - total governmental funds:	\$	79,516
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	\$ 2,068,140	
Less: current year depreciation	<u>(541,393)</u>	1,526,747
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	7,827	
Amortization of deferred charges	<u>(3,037)</u>	4,790
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:		
		(78,897)
Revenues in the Statement of Activities that do not provide current financial resources are not reported as revenues in the funds:		
P.R. Department of Treasury - Christmas bonus reimbursement	84,634	
Federal Government - EDA	93,822	
CRIM - Property taxes (current year final liquidation)	89,521	
P.R. Department of Labor - Law #52	298,247	
FEMA - Hazard Mitigation Grant Program	113,377	
PR Department of Health - reimbursements of costs	<u>329,287</u>	1,008,888
Revenues reported in funds which are not reported as revenues in the Statement of Activities:		
P.R. Department of Treasury - Christmas bonus reimbursement	(95,590)	
Federal Government - EDA	(111,294)	
OCAM - Public Order Code	(182,008)	
PR Department of Health - reimbursements of costs	<u>(564,492)</u>	(953,384)
Proceeds from notes payable and general obligation bonds are other financing sources in the governmental funds, but increase long-term liabilities in the Statement of Net Assets:		
		(1,727,302)
Expenditures reported in funds which are not reported as expenses in the Statement of Activities:		
Matured bonds principal payments (net change)		45,000
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	200,000	
Other long term liabilities	<u>535,431</u>	735,431
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	(47,301)	
Judgment and Claims	(26,083)	
Accrued interest (net change)	(8,145)	
Christmas bonus	<u>(183,370)</u>	(264,899)
Change in net assets of governmental activities:	\$	<u>375,890</u>

The accompanying notes are an integral part of this statement.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Notes to Basic Financial Statements
June 30, 2006

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 financial reporting entity included in this report consists of the financial statements of the Municipality of Guánica (primary government). To fairly present the financial position and the results of operations of the financial reporting entity, management must determine whether its reporting entity consists of only the legal entity known as the primary government or one or more organizations called component units. The inclusion of a potential component unit in the primary government's reporting entity depends on whether the primary government is financially accountable for the potential component unit or on whether the nature and significance of the relationship with the primary government is such that exclusion would cause the reporting entity's financial statements to be misleading or incomplete. There are two methods of presentation of the component unit in the financial statements: (a) blending the financial data of the component units' balances and transactions in a manner similar to the presentation of the Municipality's balances and (b) discrete presentation of the component unit's financial data in columns separate from the Municipality's balances and transactions.

The basic criteria for deciding financial accountability are any one of the following:

- a. Fiscal dependency of the potential component unit on the primary government, or
- b. The primary government appoints a voting majority of the potential component unit's governing body and,
 1. The primary government can impose its will on the potential component unit and/or,
 2. A financial benefit/ burden exist between the primary government and the potential component unit.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Notes to Basic Financial Statements
June 30, 2006

In addition, a legally separate, tax-exempt organization should be discretely presented as a component unit of a reporting entity if all of the following criteria are met:

- a. The economic resources received or held by the separate organization are entirely or almost entirely for the direct benefit of the primary government, its component units, or its constituents.
- b. The primary government, or its component units, is entitled to, or has the ability to otherwise access, a majority of the economic resources received or held by the separate organization.
- c. The economic resources received or held by an individual organization that the specific primary government, or its component units, is entitled to, or has the ability to otherwise access, are significant to the primary government.

Other organizations should be evaluated as potential component units if they are closely related to, or financially integrated with, the primary government. Professional judgment is applied in determining whether the relationship between a primary government and other organizations for which the primary government is not accountable and that do not meet these criteria is such that exclusion of the organization would render the financial statements of the reporting entity misleading or incomplete.

Based on the above criteria there are no potential component units which should be included as part of the financial statements.

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.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Notes to Basic Financial Statements
June 30, 2006

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.

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, 2006, 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:

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Notes to Basic Financial Statements
June 30, 2006

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

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:

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Notes to Basic Financial Statements
June 30, 2006

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

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

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

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

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Notes to Basic Financial Statements
June 30, 2006

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.

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989 generally are followed in the government-wide financial statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. The Municipality has elected not to follow subsequent statements and interpretations issued by the FASB after November 30, 1989.

d) Governmental Fund Financial Statements

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

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

- **General fund** – The general fund is the Municipality's main operating and major fund, as defined below, used to account for all financial resources and governmental activities, except for financial resources required to be accounted for in another fund. It is presumed that the Municipality's governmental activities have been reported in the general fund except for transactions for which one of the following compelling reasons has required the use of another fund: (1) legal requirements, (2) GAAP requirements or (3) the demands of sound financial administration requiring the use of a governmental fund other than the general fund.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Notes to Basic Financial Statements
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- **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.

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.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Notes to Basic Financial Statements
June 30, 2006

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.

Commonwealth Legislature Resolutions Fund: Commonwealth Legislative 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.

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

\$1,310,000 Bond Issuance Fund: \$1,310,000 Bond Issuance Fund is used to account for capital projects such as community facilities repairs, improvements of certain sport courts, and repavment of municipality roads.

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.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Notes to Basic Financial Statements
June 30, 2006

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.
- 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.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
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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, 2006, 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, 2006. 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 generally recorded as revenues when collected because they are generally not measurable until actually received.

All revenues, expenses, gains, losses and assets resulting from nonexchange transactions are recorded in a similar manner to the GWFS, using the previously discussed criteria set forth by current standards 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.

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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.

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.

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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, 2006. 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.

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.

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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.

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.

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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.

Pursuant to Law No. 152 of August 20, 1996 effective July 1, 1997 the Municipality is required to pay any excess of vacations and sick leave accumulated over 90 days as of December 31 of each year. Payments should be made on or before March 31 of the following year.

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.

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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:

- 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.

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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.

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.

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The Municipality also obtains medical insurance coverage for its employees. The current insurance policies have not been canceled or terminated at June 30, 2006. 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:

- **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:

- **Transfers** – Represent legally required transfers that are reported when incurred as “transfers-in” by the recipient fund and as “transfers-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.

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3. DUE FROM (TO) GOVERNMENTAL AGENCIES

a. Amounts due from governmental agencies as of June 30, 2006 follows:

	Commonwealth Government	Federal Government
Municipal Revenue Collection Center (CRIM) – property taxes (debt service fund)	\$ 12,554	\$ -
Municipal Revenue Collection Center (CRIM)- current year liquidation (general fund)	185,559	-
Puerto Rico Department of Family – Child Care	-	65,706
U.S. Department of Justice-COPS	-	999
U.S. Federal Emergency Management Agency – HMGP	-	434,368
Office of Commissioner of Municipal Affairs – CDBG	-	393,327
U.S. Department of Housing and Urban Development – Section 8	-	99
U.S. Department of Commerce – EDA	-	93,822
Puerto Rico Department of Labor – Law 52	300,063	-
Puerto Rico Department of Labor – Law 82	43,015	-
Puerto Rico Department of Health	564,492	-
Government Development Bank of Puerto Rico	4,742	-
Puerto Rico Office of Management and Budget – Law No. 43 of 2006	64,842	-
Puerto Rico Police Department – Public Order Code	33,356	-
Commonwealth Legislature Resolutions	401,151	-
Puerto Rico Department of Treasury – Christmas bonus reimbursement	84,634	-
	\$ 1,694,408	\$ 988,321

The amounts due from Puerto Rico Department of Treasury – Christmas bonus (\$84,634), Municipal Revenue Collection Center-current year liquidation, (\$89,521), Puerto Rico Department of Health (\$329,287), U.S. Federal Emergency Management Agency (\$113,377), U.S. Department of Commerce – EDA (\$93,822) and Puerto Rico Department of Labor – Law 52 (\$300,063) are recorded as deferred revenue in the governmental funds statements since are not available as required by current standards or represent resources received before allowable expenditures are incurred. See note 6.

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b. Amounts due to governmental agencies as of June 30, 2006 follows:

	Amount
Puerto Rico Aqueduct and Sewer Authority (PRASA)	\$ 32,439
Puerto Rico General Services Administration	124,158
Puerto Rico Employee Retirement System Administration	175,553
Puerto Rico Industrial Development Corporation (PRIDCO)	3,370
Puerto Rico Department of Labor - unemployment	131,131
Puerto Rico Land Authority	1,200
Puerto Rico Treasury Department	5,000
Puerto Rico Electric Power Authority	7,754
Other entities	205
	\$ 480,810

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	\$ 51,173
	Other governmental funds -Public Order Code	36,556
	Other governmental funds-Law 52	290,172
	Other governmental funds-Law 82	50,075
	Other governmental funds -CDBG	150,339
	Other governmental funds-Child Care	91,492
	Other governmental funds-others	39,235
Major Fund – Commonwealth Legislative Resolutions	General Fund	784,464
	Major fund – FEMA HMGP	431,994
	Other governmental funds - CDBG	24,978
Other governmental funds –Citizens Participation	General Fund	321,628
Other governmental funds -CDR	General Fund	28,566
Other governmental funds -others	General Fund	13,189
Total:		\$ 2,313,861

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b. 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, 2006 was as follows:

	<u>Balance July 1, 2005, as restated</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance June 30, 2006</u>
<u>Governmental activities:</u>				
Capital assets, not being depreciated:				
Land	\$ 665,008	-	-	\$ 665,008
Construction in progress	5,155,763	1,448,527	-	6,604,290
Total capital assets not being depreciated:	5,820,771	1,448,527	-	7,269,298
Capital assets, being depreciated:				
Buildings, structures and building improvements	6,691,093	27,470	168,677	6,549,886
Infrastructure	3,671,371	339,424	-	4,010,795
Land improvements	2,884,899	8,097	-	2,892,996
Licensed vehicles	1,500,668	108,768	-	1,609,436
Machinery and equipment	991,731	135,854	-	1,127,585
Equipment under capital leases	43,572	-	-	43,572
Total capital assets being depreciated	15,783,334	619,613	168,677	16,234,270
Less accumulated depreciation for:				
Buildings, structures and building improvements	2,542,676	132,203	89,780	2,585,099
Infrastructure	1,113,721	170,189	-	1,283,910
Land improvements	1,909,092	83,550	-	1,992,642
Licensed vehicles	862,281	111,121	-	973,402
Machinery and equipment	715,827	34,744	-	750,571
Equipment under capital leases	18,898	9,586	-	28,484
Total accumulated depreciation	7,162,495	541,393	89,780	7,614,108
Total capital assets being depreciated, net	8,620,839	78,220	78,897	8,620,162
Governmental activities capital assets, net	<u>\$ 14,441,610</u>	<u>\$ 1,526,747</u>	<u>\$ 78,897</u>	<u>\$ 15,889,459</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	\$	97,201
Public safety		90,437
Health and welfare		28,459
Culture and recreation		147,763
Public works and sanitation		177,533
 Total depreciation expense, governmental activities	 \$	 541,393

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 as follows:

	<u>Resources not available</u>	<u>Resources received before legal claim</u>
Federal Government - EDA	\$ 93,822	\$ -
Unearned volume of municipal license taxes	-	232,426
CRIM-property taxes (liquidation - current year)	89,521	-
P.R. Department of Health	329,287	-
P.R. Department of Treasury-Christmas bonus	84,634	-
Citizens Participation Fund	-	280,577
Federal Emergency Management Agency - HMGP	113,377	-
Federal Emergency Management Agency - others	-	40,956
P.R. Department of Labor - Law #52	300,063	-
Federal Government - Section 8	-	167,550
Rural Development Corporation	-	28,566
Others	-	32,557
	\$ 1,010,704	\$ 782,632

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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, 2006, the Municipality is in compliance with the debt limitation requirements.

The general long-term debt activity for the year ended June 30, 2006 was as follows:

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	<u>Balance at July 1, 2005</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance at June 30, 2006</u>	<u>Due within one year</u>
Bonds payable	\$ 3,514,000	\$ 1,310,000	\$ 200,000	\$ 4,624,000	\$ 224,000
Notes payable to:					
PR Treasury					
Department:					
Loan for payment of					
legal settlement	1,633,730	-	1,002	1,632,728	102,419
Financing agreement					
for the excess of					
property tax over					
advances thorough					
fiscal year 2003	487,980	-	12,037	475,943	12,917
PR Department of					
Labor and Human					
Resources	-	417,302	105,940	311,362	120,668
PR Land Authority	120,815	-	2,751	118,064	2,916
CRIM:					
Act No. 42 –					
Financing					
agreement for the					
excess of property					
tax advances over					
tax collections					
through fiscal year					
2000	1,028,004	-	14,873	1,013,131	15,807
LIMS	95,193	-	12,391	82,802	13,139
Financing of					
delinquent					
property tax					
accounts sold	138,842	-	12,242	126,600	-
Payable to CRIM -					
Excess of property tax					
advances over actual					
collections	56,138	-	-	56,138	56,138
Payable to FEMA	750,467	-	-	750,467	-
Compensated absences	1,121,914	47,301	73,699	1,095,516	45,000
Claims and judgments	164,660	26,083	126,219	64,524	15,284
Obligation under capital					
leases	22,197	-	5,263	16,934	7,595
Christmas bonus	169,014	183,370	169,014	183,370	183,370
	<u>\$ 9,302,954</u>	<u>\$ 1,984,056</u>	<u>\$ 735,431</u>	<u>\$ 10,551,579</u>	<u>\$ 799,253</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, 2006 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% (6.00% at June 30, 2006) through July 1, 2009	\$ 180,000
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% (3.21% at June 30, 2006) through July 1, 2026	490,000
2005 serial bonds, original amount of \$1,310,000, due in annual principal installments ranging from \$35,000 to \$105,000; plus interest due in semiannual installments at variable rates from 4.23% to 5.33% (4.23% at June 30, 2006) through July 1, 2025	1,310,000
<u>Public Improvement Bonds:</u>	
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% (6.00% at June 30, 2006) through July 1, 2016	815,000
<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% (6.00% at June 30, 2006) through July 1, 2006	14,000
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% (6.00% at June 30, 2006) through July 1, 2009	65,000
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% (6.00% at June 30, 2006) through July 1, 2026	1,615,000
2005 original amount of \$145,000, 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 8.00% (6.25% at June 30, 2006) through July 1, 2014	135,000
	\$ 4,624,000

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

<u>June 30</u>	<u>Principal</u>	<u>Interest</u>
2007	\$ 224,000	\$ 260,008
2008	220,000	250,997
2009	235,000	227,117
2010	255,000	213,489
2011	190,000	201,094
2012-2016	1,165,000	824,501
2017-2021	990,000	507,385
2022-2026	1,175,000	222,964
2027	170,000	5,020
Totals	<u>\$ 4,624,000</u>	<u>\$ 2,712,575</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, 2006, the balance of this note, net of the unamortized discount of \$238,190 amounted to \$1,632,728 with an accrued interest of \$4,082. This amount will be repaid with unrestricted funds. The principal and discount amortization (recorded as interest expense) maturities are as follows:

<u>June 30</u>	<u>Principal</u>	<u>Interest</u>
2007	\$ 102,419	\$ 47,325
2008	105,534	44,202
2009	159,437	40,164
2010	164,287	35,303
2011	169,284	30,293
2012-2014	931,767	40,903
Totals	<u>\$ 1,632,728</u>	<u>\$ 238,190</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 \$475,973 and \$2,808, respectively, at June 30, 2006. This amount will be repaid with unrestricted funds. The principal and interest maturities are as follows:

<u>June 30</u>	<u>Principal</u>	<u>Interest</u>
2007	\$ 12,917	\$ 33,207
2008	13,862	32,256
2009	14,876	31,236
2010	15,964	30,142
2011	17,131	28,967
2012-2016	106,389	123,983
2017-2021	151,422	78,685
2022-2025	143,382	18,125
Totals	<u>\$ 475,943</u>	<u>\$ 376,601</u>

c) Note payable to Puerto Rico Department of Labor

On December 22, 2005, the Municipality entered into a financing agreement with the P.R. Department of Labor for a total amount of \$417,302 for unemployment benefits paid by the Commonwealth of Puerto Rico in behalf of the municipality. The agreement is payable in monthly installments of \$10,989, including interest of 11.08% and due in January 5, 2009. The outstanding principal balance of the note payable amounted to \$311,362 at June 30, 2006. The note is being paid from unrestricted funds. Debt service requirements in future years are as follows:

<u>June 30</u>	<u>Principal</u>	<u>Interest</u>
2007	\$ 120,668	\$ 26,538
2008	116,537	14,255
2009	74,157	2,080
Totals	<u>\$ 311,362</u>	<u>\$ 42,873</u>

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d) Notes Payable to Puerto Rico Land Authority

On October 22, 2003, the Municipality acquired a parcel of land from the Puerto Rico Land Authority in the amount of \$250,000 for which the Municipality issue a note payable. The note bears no interest and has an imputed interest rate of 6.00%. The note was originally recorded at its present value of \$135,020, net of an unamortized discount of \$114,980, at inception. At June 30, 2006, the balance of this note, net of the unamortized discount of \$95,442 amounted to \$118,064 with an accrued interest of \$6,494. This amount will be repaid with unrestricted funds. The principal and discount amortization (recorded as interest expense) maturities are as follows:

<u>June 30</u>	<u>Principal</u>	<u>Interest</u>
2007	\$ 2,916	\$ 6,923
2008	3,091	6,739
2009	3,277	6,543
2010	3,473	6,336
2011	3,682	6,116
2012-2016	21,999	26,791
2017-2021	17,529	21,507
2022-2026	35,367	12,687
2027-2029	26,730	1,800
Totals	<u>\$ 118,064</u>	<u>\$ 95,442</u>

e) 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.

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 \$1,013,131 and \$31,344 respectively, at June 30, 2006. This amount will be repaid with unrestricted funds. The principal and interest maturities are as follows:

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<u>June 30</u>	<u>Principal</u>	<u>Interest</u>
2007	\$ 15,807	\$ 61,958
2008	16,801	60,944
2009	17,856	59,845
2010	18,978	58,689
2011	20,171	57,459
2012-2016	121,533	265,978
2017-2021	164,823	221,349
2022-2026	223,532	160,822
2027-2031	303,155	78,737
2032-2033	110,475	10,995
Totals	<u>\$ 1,013,131</u>	<u>\$ 1,036,776</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, 2006, the balance of this note, net of the unamortized discount of \$15,091, amounted to \$82,802. This amount will be repaid with unrestricted funds. The principal and discount amortization (recorded as interest expense) maturities are as follows:

<u>June 30</u>	<u>Principal</u>	<u>Interest</u>
2007	\$ 13,139	\$ 4,669
2008	13,933	3,872
2009	14,774	3,026
2010	15,666	2,130
2011	16,612	1,179
2012	8,678	215
Totals	<u>\$ 82,802</u>	<u>\$ 15,091</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 \$12,242 to the principal on this agreement. At June 30, 2006, the outstanding principal amounted to \$126,600. The principal and interest maturities are as follows:

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<u>June 30</u>	<u>Principal</u>	<u>Interest</u>
2007	\$ -	\$ 8,229
2008	-	8,229
2009	2,177	8,153
2010	2,323	8,007
2011	2,478	7,850
2012-2016	15,114	36,513
2017-2021	20,900	37,381
2022-2026	28,901	22,651
2027-2031	39,965	11,528
2032-2033	14,742	689
Totals	<u>\$ 126,600</u>	<u>\$ 149,230</u>

- f) **Other payable to CRIM - Excess of property tax advances over actual collections** – The \$56,138 represents the balance owed as of June 30, 2006 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.
- g) **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, 2006, 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.
- h) **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, 2006 the outstanding balance amounts to \$1,095,516. This amount will be repaid with unrestricted funds.
- i) **Other claims and judgments** - Represent the final costs of legal cases paid subsequent to June 30, 2006 and other claims outstanding as of that date. The awarded amounts will be paid with unrestricted funds. As of June 30, 2006 the outstanding balance amounts to \$64,524.
- j) **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, 2006, the capitalized costs and the related accumulated amortization of the leased equipment amounted to \$43,572 and \$28,484, 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, 2006 reported in the accompanying government-wide statement of net assets is as follows:

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Year ending <u>June 30,</u>	<u>Amount</u>
2007	8,940
2008	6,756
2009	<u>3,184</u>
Total future minimum lease payments	18,880
Less: amount representing future interest cost at 8.00%	<u>(1,946)</u>
Present value of minimum lease payments	16,934
Less:	
Current portion of obligation under capital leases	<u>7,595</u>
Obligation under capital leases, excluding current portion	<u><u>\$ 9,339</u></u>

- k) ***Christmas bonus*** - Represent the accrued portion corresponding to fiscal year 2005-2006 of the Christmas bonus to be paid in December 2006.

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, 2006 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 6.78% for personal property (of which 6.58% 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.

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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 receivable of 185,559 resulting from the final settlement for fiscal year 2005-2006 and a net payable to the CRIM of \$ 56,138 resulting from the final settlement for fiscal year 2004-2005. The net payable amount is recorded as a long term debt in the government-wide statement since will not be paid with expendable available resources.

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, 2006, the municipal tax rates imposed by the Municipality were 1.50% for financing institutions and 0.40% 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 \$232,426 at June 30, 2006, which represents municipal licenses collected in advance for the taxable year 2006-2007.

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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	\$ 4,358,155
Compensation in lieu of tax from the Puerto Rico Electric Power Authority (PREPA)	948,576
Reimbursement from Commonwealth Government - Christmas Bonus expenditures	144,337
P.R. Department of Health-reimbursement of costs	799,697
	\$ 6,250,765

11. FUND BALANCE RESTATEMENTS

a. Fund balances

The beginning fund balance of the EDA fund included in other governmental funds has been restated to recognize corrections of accounting errors. The corrections include an understatement of liabilities for \$25,120. The following schedule reconciles the fund balance at July 1, 2005 as previously reported to the beginning fund balance, as restated:

Fund	Prior period adjustments		Balance at beginning of year, as Restated
	Balance at beginning of year, as previously reported	Correction of errors	
Other governmental funds	\$ (50,295)	\$ (25,120)	\$ (75,415)

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:	\$ 6,847,477
Restatements:	
Understatement of accounts payable, EDA	(25,120)
Understatement of accounts receivable, P.R. Department of Health	564,492
Understatement of capital assets, EDA construction in progress	168,381
Net assets at beginning of year as restated:	\$ 7,555,230

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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 benefit 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 full time public employees working for the central government, the municipalities of Puerto Rico and certain public corporations not having their own retirement systems.

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 ended June 30,</u>	<u>Act No. 447</u>	<u>System 2000</u>
2006	\$ 60,926	\$ 140,455
2005	\$ 68,503	\$ 130,816
2004	\$ 74,224	\$ 74,481

13. POSTEMPLOYMENT BENEFITS

Pursuant to Law No. 157 of June 27, 2003, the Municipality is required to cover annually the 3% increase in the retirement plan of its retired employees. For the fiscal year ended the post employment benefits paid to retired employees under this requirement amounted to \$ 461.

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14. COMMITMENTS AND CONTINGENCIES

a. Encumbrances and construction commitments

The Municipality has reported, outstanding encumbrances amounting to \$178,886 in the general fund at June 30, 2006. 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, 2006 of approximately \$814,546 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 \$ 7,126. 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. As of June 30, 2006 and as disclosed in Note 7(g) 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, 2006 the GAR informed the Municipality that additional funds in the amount of \$293,698 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 \$64,524 for awarded or anticipated unfavorable judgments as of June 30, 2006. Management believes that any unfavorable outcome in relation to pending or threatened litigation would not be significantly in excess of recorded amounts.

15. 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	\$ 93,821
P.R. Department of Labor – Law #52	\$ 296,271

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.

16. SPECIAL ITEM

On July 26, 2005 the Municipality agreed to sell a parcel of land and the appended buildings with a book value of \$78,797 for a total amount of \$612,265. 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.

17. SUBSEQUENT EVENTS

a. Sales Tax Implementation

Effective on August, 2006 the Municipality imposed a sales tax of 1% to be applicable over all direct sales to consumers, including certain services as approved by the Municipal Legislature. Subsequently on November 14, 2006 this tax was raised to 1.50% as amended by the Municipal Legislature to be in conformity with Commonwealth Government Sales Tax Law (Act No. 117 of July 4, 2006)

Section 6189 of the Puerto Rico Internal Revenue Code of 1994, as amended, authorizes the Municipalities in Puerto Rico to impose a sales and use tax to consumers. This tax must be imposed in conformity with the base, exemptions and limitations contained in Subtitle BB of the Code. The Municipal Sales Tax is specifically imposed over all sales transactions of taxable items and combined transactions (as defined by the municipal internal regulation) taken place within municipal limits. The Municipal Sales Tax is also specifically imposed over the purchase price for the use, storage or consumption of taxable transactions (as defined by the municipal internal regulation) taken place within Municipal limits.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Notes to Basic Financial Statements
June 30, 2006

b. Issuance of general obligation bonds

On November 27, 2006, the Governmental Development Bank of Puerto Rico (GDB) approved the issuance of a \$335,000 general obligation bond to the Municipality to finance the purchase of equipment for the new City Hall. Payments are due in annual installments through year 2011, bearing interest at a variable rate (LIBOR + 1.25%). Principal and interest payments will be financed through the Municipality's debt service fund.

REQUIRED SUPPLEMENTARY INFORMATION

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA
BUDGETARY COMPARISON SCHEDULE - GENERAL FUND
YEAR ENDED JUNE 30, 2006

	<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	\$ 1,000,607	\$ 1,000,607	\$ 1,000,607	\$ -
Municipal license tax	300,000	300,000	304,620	4,620
Licenses, permits and other local taxes	851,500	851,500	272,183	(579,317)
Fines and forfeitures	15,000	15,000	27,935	12,935
Interest	10,000	10,000	66,875	56,875
Intergovernmental:				
Other operating grants and contributions	5,297,079	5,297,079	5,157,566	(139,513)
Rent	100,000	100,000	81,481	(18,519)
Other	665,000	665,000	652,587	(12,413)
Total revenues	<u>8,239,186</u>	<u>8,239,186</u>	<u>7,563,853</u>	<u>(675,332)</u>
Expenditures:				
Current:				
General government	4,259,881	4,259,881	4,542,265	(282,384)
Public safety	1,091,056	1,091,056	1,094,947	(3,891)
Public works and sanitation	1,866,194	1,866,194	1,789,793	76,401
Culture and recreation	346,495	346,495	365,365	(18,870)
Health and welfare	483,171	483,171	480,517	2,653
Total expenditures	<u>8,046,796</u>	<u>8,046,796</u>	<u>8,272,886</u>	<u>(226,091)</u>
Excess (deficiency) of revenues over (under) expenditures	<u>192,390</u>	<u>192,390</u>	<u>(709,033)</u>	<u>(901,423)</u>
Other financing sources (uses):				
Transfers-out	(192,390)	(192,390)	(183,115)	9,275
Total other financing sources (uses)	<u>(192,390)</u>	<u>(192,390)</u>	<u>(183,115)</u>	<u>9,275</u>
Net change in fund balance	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (892,148)</u>	<u>\$ (892,148)</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, 2006

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, 2006

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, 2006. 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, 2006, 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 varies 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 30,2006

Excess of revenues and other financing sources over expenditures and other financing uses (budgetary basis):	\$	(892,148)
Budget to GAAP differences:		
Entity differences:		
Non budgeted funds recorded as revenues for financial reporting purposes:		838,954
Non budgeted funds recorded as expenditures for financial reporting:		(812,735)
Non budgeted transfers out:		(30,880)
Basis of accounting differences:		
Revenues recorded for financial reporting purposes but not in budgetary basis:		146,038
Expenditures recorded in budgetary basis but not for financial reporting purposes:		273,463
Expenditures recorded for financial reporting purposes but not in budgetary basis:		(362,073)
Other financing sources (uses):		417,302
Timing differences:		
Current year encumbrances recorded as expenditures for budgetary reporting purposes:		127,196
Prior year encumbrances recorded as expenditures for financial reporting purposes:		(295,861)
Net change in fund balance (GAAP basis):	\$	<u>(590,743)</u>

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**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, 2006

FINANCIAL SECTION

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA**

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Independent Auditors' 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, (the Municipality) as of and for the year ended June 30, 2006, 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 balances and their corresponding interfund receivable balances as of June 30, 2006 recorded in the General Fund, Commonwealth Legislature Resolutions Fund and Other Governmental Funds 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 balances and their corresponding interfund receivable balances as of June 30, 2006 recorded in the General Fund, Commonwealth Legislature Resolutions Fund and Other Governmental Funds, the financial statements referred to in the first paragraph present fairly, in all material respects, the respective financial position of the General Fund, Commonwealth Legislature Resolutions Fund and the aggregate remaining fund information of the Municipality of Guanica, Puerto Rico as of June 30, 2006, 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 Debt Service Fund, the FEMA-Hazard Mitigation Grant Program Fund and the \$1,310,000 Bond Issuance Fund of the Municipality of Guanica, Puerto Rico as of June 30, 2006, 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, 2006 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 61 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 Financial Data Schedule is presented for purposes of additional analysis as required by the U.S. Department of Housing and Urban Development, Real Estate Assessment Center and is not a required part of the basic financial statements. The accompanying Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis as required by the 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 have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.



Rodriguez, Rivera & Toro LLP

MANAGEMENT DISCUSSION AND ANALYSIS

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Management Discussion and Analysis
June 30, 2006

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, 2006. 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 \$21.24 million in the accompanying statement of net assets, of which most significant are capital assets and accounts receivable due from governmental entities amounting to \$15.89 million and \$2.68 million respectively.
- The Municipality's capital assets increase as a result of this year's operations. Capital assets as of June 30, 2006 are \$15.89 million, as compared to \$14.44 million for the year ended June 30, 2005, for a 10% of increase.
- The assets of the Municipality exceeded its liabilities by \$7.9 million at June 30, 2006, represented as "net assets" in the accompanying statements of net assets. Restricted and unrestricted (deficit) net assets amounted to \$2.31 million and (\$7.18) million, respectively. Net assets invested in capital assets amounted \$12.80 million.
- During the year, the Municipality reported revenues of \$7.90 million in the General Fund of total revenues restricted and unrestricted of \$11.58 million.
- Long term liabilities principal payments were \$.735 million. During the year ended June 30, 2006, the Municipality issued \$1.31 million on bonds payable.
- The Municipality has reported total expenses amounting to \$11.79 million 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, 2006

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 statements: 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 asses 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 Statements: 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, 2006

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

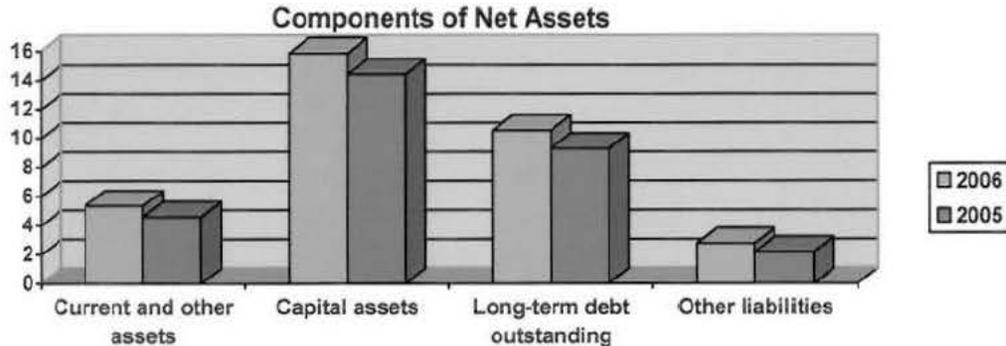
THE MUNICIPALITY AS A WHOLE

The Municipality's *combined* net assets increases from a year ago, from \$7.55 million to \$7.93 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	2006
Current and other assets	\$4.60	\$5.35
Capital assets	14.44	15.89
Total assets	19.04	21.24
Long-term debt outstanding	(9.30)	(10.55)
other liabilities	(2.18)	(2.76)
Total liabilities	(11.48)	(13.31)
Net assets:		
Invested in capital assets, net of related debt	11.59	12.80
Restricted for:		
Debt service	.45	.42
Capital project	1.63	1.86
Other specified purposes	.24	.03
Unrestricted	(6.36)	(7.18)
Net Assets	\$ 7.55	\$ 7.93

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Management Discussion and Analysis
June 30, 2006



Net assets of the Municipality's governmental activities increased by \$.38 million (\$7.93 million compared to \$7.55 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 \$(6.36) million at June 30, 2005 to a (\$7.18) million at June 30, 2006. 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	2006
Revenues:		
Program revenues:		
Operating grants and contributions	\$ 3,362,047	\$ 1,272,210
Capital grants and contributions	2,218,357	2,292,583
Charges for services	1,046,815	418,676
General revenues:		
Property taxes	1,430,068	1,036,814
Municipal license taxes	281,401	304,620
Construction excise taxes		
Unrestricted intergovernmental contributions and reimbursements	4,774,038	6,094,125
Unrestricted interest on deposit	20,685	75,516
Other	404,522	136,579
Special items-		
Gain on sale of capital assets	483,140	533,368
Total revenues	<u>14,021,073</u>	<u>12,164,491</u>
Expenses:		
General government	6,020,246	4,824,656
Public Safety	1,173,292	1,290,543
Public work and sanitation	1,860,051	2,417,080
Culture and recreation	646,020	526,173
Health and welfare	3,451,785	2,308,078
Interest and bonds, notes and capital lease obligations	183,983	422,072
Total expenses	<u>13,335,377</u>	<u>11,788,601</u>
Net increase in net assets	685,696	375,890
Net assets-at the beginning of the year, as restated	6,869,535	7,555,230
Net assets- at end of the year	<u>\$ 7,555,230</u>	<u>\$ 7,931,119</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Management Discussion and Analysis
June 30, 2006

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:

	<u>2005</u>	<u>2006</u>
Comparative Condensed Balance Sheet-Governmental funds:		
Total assets-major funds	\$ 3,760,778	\$ 5,621,673
Total assets-nonmajor funds	1,948,092	2,016,207
Total assets	<u>5,708,870</u>	<u>7,637,880</u>
Total liabilities-major funds	2,380,777	4,082,194
Total liabilities-nonmajor funds	2,023,507	2,171,675
Total liabilities	<u>4,404,284</u>	<u>6,253,869</u>
Fund Balances:		
Reserved-major funds	2,500,788	3,072,817
Reserved-nonmajor funds	(136,346)	140,805
Unreserved-major funds	(1,059,970)	(1,533,338)
Unreserved-nonmajor funds	24	(296,272)
Total fund balances	<u>\$ 1,304,496</u>	<u>\$ 1,384,011</u>
Comparative Condensed Statement of Operations-Governmental funds:		
Total revenues-major funds	\$ 9,552,230	\$ 9,060,165
Total revenues-nonmajor funds	3,128,703	2,515,454
Total revenues	<u>12,680,933</u>	<u>11,575,618</u>
Total expenditures-major funds	10,054,675	11,209,284
Total expenditures-nonmajor funds	3,910,544	2,626,385
Total expenditures	<u>13,965,219</u>	<u>13,835,669</u>
Other Financial Sources-major funds(excluding operating transfers among funds)	<u>145,000</u>	<u>1,727,302</u>
Special items, net	<u>600,000</u>	<u>612,265</u>
Net changes in fund balances	<u>\$ (539,286)</u>	<u>\$ 79,516</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Management Discussion and Analysis
June 30, 2006

Governmental Activities

Programs revenues of Municipality's governmental activities decreased by 39.89% (\$2.64 million) while total expenses decreased by 11.6% (1.54 million). The Municipality of Guánica took the following major actions this year to improve the financial position:

- The Mayor of the Municipality of Guánica still has a Finance Auxiliary 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 estimate 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.

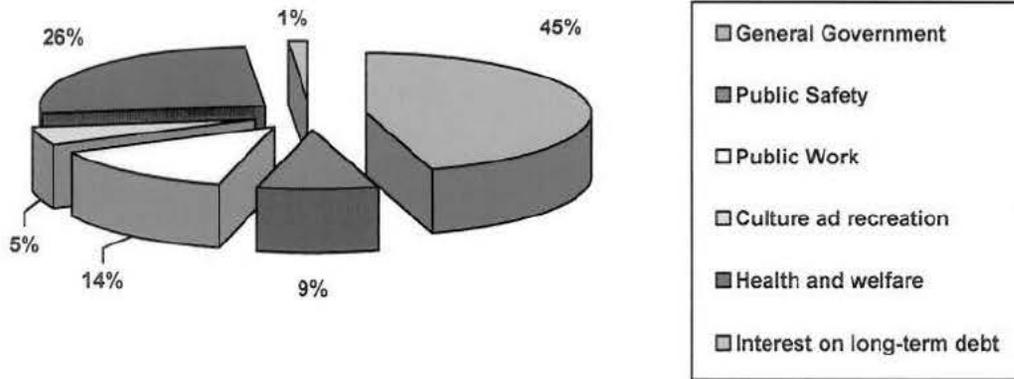
Expenses during the fiscal year ended June 30, 2006 was substantially related to the following:

Table 2
Governmental Activities
(in Million)

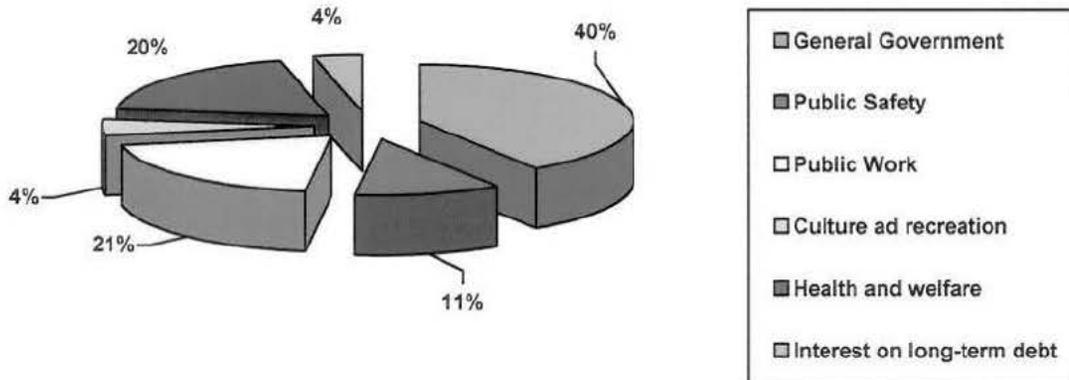
	Total expenses	
	2005	2006
General Government	\$ 6.02	\$4.82
Public Safety	1.17	1.29
Public Work	1.86	2.42
Culture, recreation and education	.65	.53
Health and welfare	3.45	2.31
Interest on long term debt	.18	.42
Totals	\$ 13.33	\$ 11.79

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Management Discussion and Analysis
June 30, 2006

Total Expenses 2005



Total Expenses 2006



The cost of all governmental activities this year was \$11.79 million compared to \$13.33 million last year. Table 2 presents the cost of each of the Municipality of Guanica's largest programs.

The major sources of general revenue are property taxes, municipal license taxes, and grant and contributions not restricted, which in total represent \$7.43 (61%) and \$6.48 (46%) of all revenues in 2006 and 2005, respectively.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
 Management Discussion and Analysis
 June 30, 2006

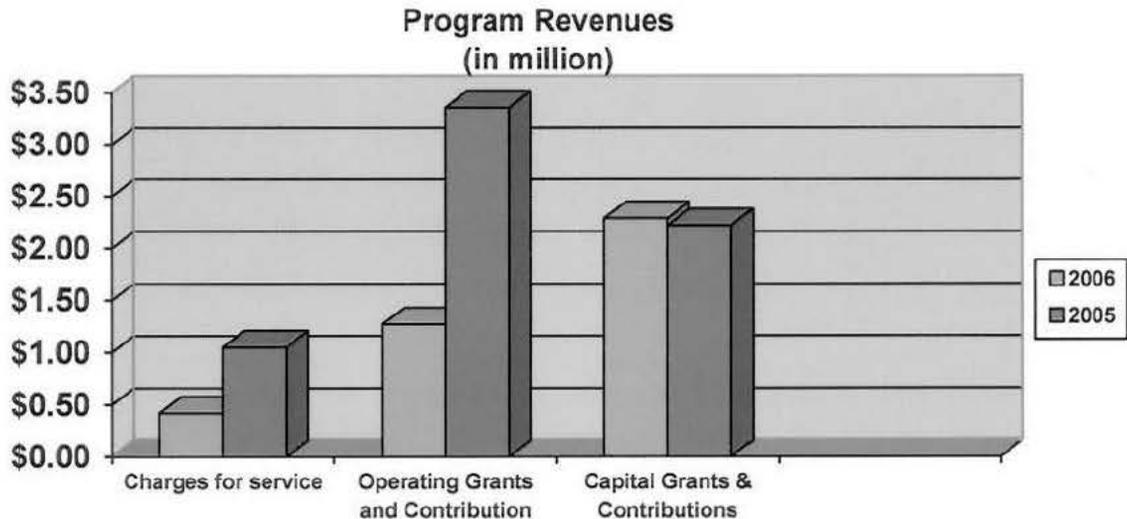
Table 3
Governmental Activities
(in Million)

	General Revenues	
	By major sources	
	2005	2006
Property taxes	\$1.43	\$1.04
Municipal license taxes	.28	.30
Grants and contributions	4.77	6.09
Totals	\$6.48	\$7.43

Table 4
Governmental Activities
(in Million)

	Program Revenues	
	by major sources	
	2005	2006
Charges for service	\$ 1.05	\$.42
Operating Grants and Contribution	3.36	1.27
Capital Grants and Contributions	2.22	2.29
Totals	\$6.63	\$3.98

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THE MUNICIPALITY'S FUND

As the Municipality completed the year, its governmental funds reported a combined fund balance of \$1.38 million, which is upper than last year total of \$1.30 million.

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

- The Municipality experienced an increase in the other operating grants and contributions by \$1.5 million
- 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 Guánica 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 2005).

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CAPITAL ASSET AND DEBT ADMINISTRATION

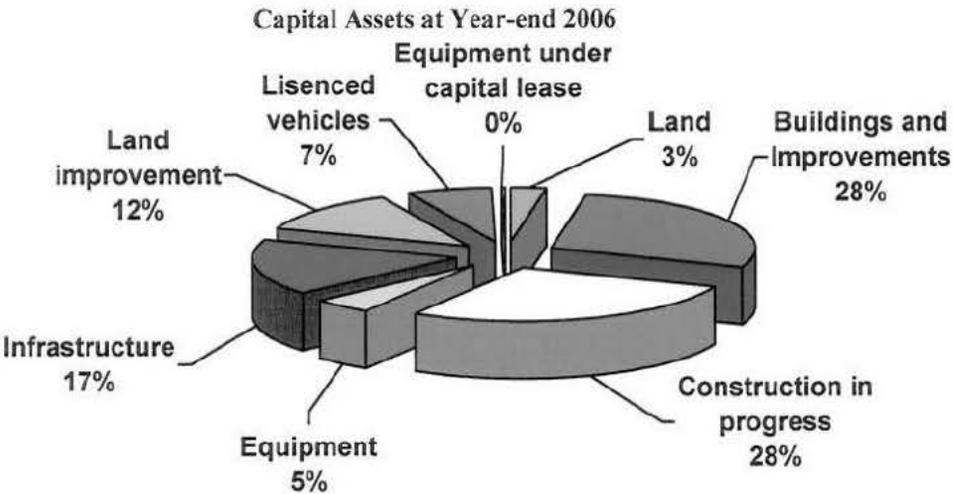
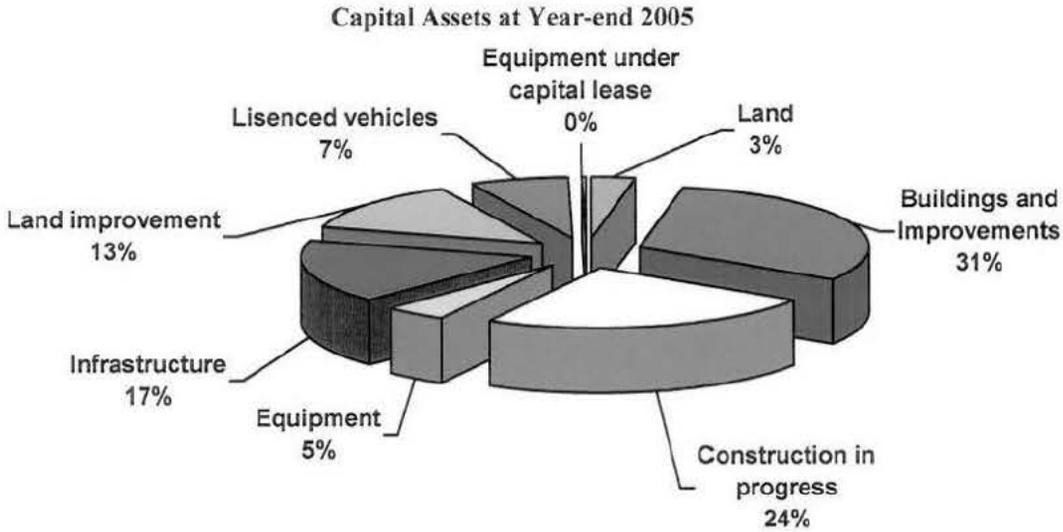
Capital Assets

As of June 30, 2006, the Municipality of Guánica had \$ 23.50 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 \$1.90 million, or 9 %, 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)

	Governmental Activities	
	2005	2006
Land	\$.67	\$.67
Land improvement	2.88	2.89
Buildings and Improvements	6.69	6.55
Construction in progress	5.16	6.60
Licensed vehicles	1.50	1.61
Equipment	.99	1.13
Equipment under capital lease	.04	.04
Infrastructure	3.67	4.01
Totals	\$21.60	\$23.50

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

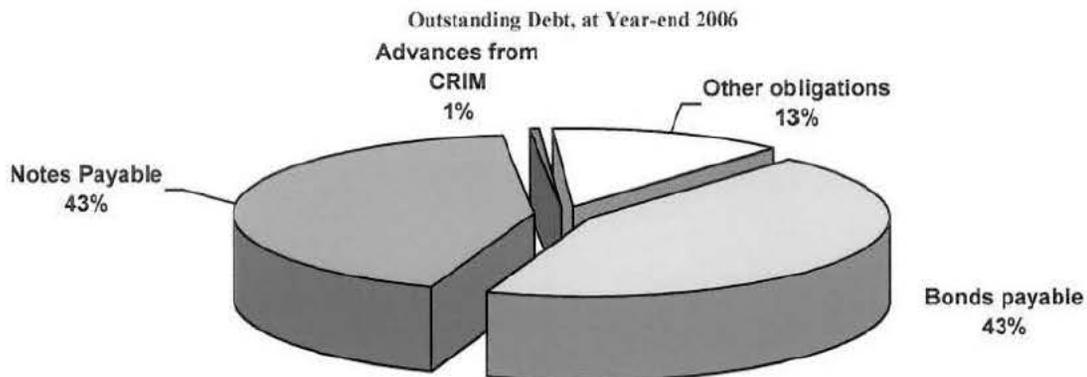
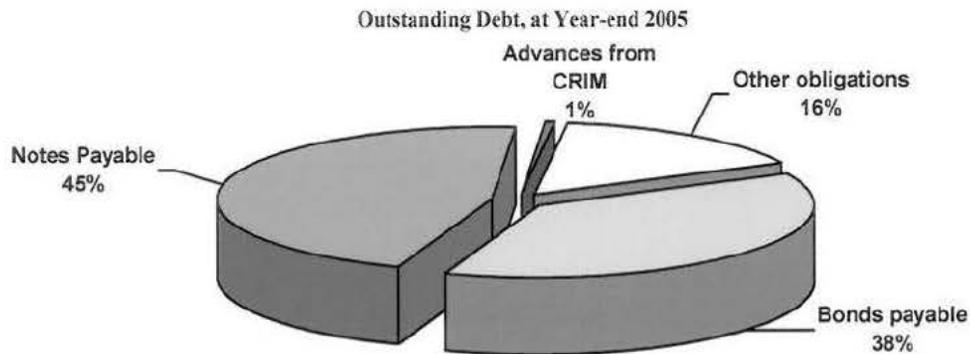
COMMONWEALTH OF PUERTO RICO
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June 30, 2006

Debt

At year-end, the Municipality had \$ 10.55 million in bonds and notes outstanding versus \$ 9.31 million last year, an increase of 13.3 percent, as shown in Table 6.

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

	Governmental Activities	
	2005	2006
Bonds payable	\$3.51	\$4.62
Notes Payable	4.26	4.51
Advances from CRIM	.06	.06
Other obligations	1.48	1.36
Totals	9.31	\$10.55



COMMONWEALTH OF PUERTO RICO
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New bonds in the amount of \$1.31 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 Christmas bonus. 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 2006 budget. Unemployment in the Municipality now stands at 14.4 percent.

Amounts available for appropriations in the General Fund for the fiscal year 2007 are \$7.82 million, a decrease of 5 percent under the final 2006 budget of \$8.2 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 2007.

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.

BASIC FINANCIAL STATEMENTS

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA
STATEMENT OF NET ASSETS
JUNE 30, 2006

ASSETS	<u>Governmental Activities</u>
Cash and cash equivalents	\$ 633,599
Receivables, net of allowance for uncollectible accounts:	
Due from governmental agencies	2,682,729
Restricted Assets:	
Cash in fiscal agents	2,007,692
Deferred bond issuance costs	30,894
Capital assets (note 5):	
Nondepreciable assets:	
Land and construction in progress	7,170,085
Depreciable assets:	
Other capital assets, net	8,719,374
	<u>15,889,459</u>
Total assets	<u><u>\$ 21,244,372</u></u>
LIABILITIES	
Accounts payable and accrued liabilities	\$ 1,317,910
Due to governmental agencies	480,810
Deferred revenues	784,448
Interest payable	178,506
Long term liabilities (note 7) :	
Due within one year	799,253
Due in more than one year	9,752,326
Total liabilities	<u>13,313,253</u>
NET ASSETS	
Invested in capital assets, net of related debt	12,798,707
Restricted for:	
Debt service	426,134
Capital Projects	1,856,135
Other specified purposes	30,418
Unrestricted (deficit)	(7,180,274)
Total net assets	<u><u>\$ 7,931,119</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, 2006**

<u>Functions</u>	<u>Expenses</u>	<u>Program Revenues</u>			<u>Net (expense) revenue and changes in net assets</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	\$ 4,824,656	\$ 418,676	\$ 517,517	\$ -	\$ (3,888,463)
Public safety	1,290,543	-	226,551	-	(1,063,992)
Public works and sanitation	2,417,080	-	-	1,264,143	(1,152,937)
Culture and recreation	526,173	-	-	871,833	345,660
Health and welfare	2,308,078	-	528,142	156,607	(1,623,329)
Interest on long term debt	422,072	-	-	-	(422,072)
Total	<u>\$ 11,788,601</u>	<u>\$ 418,676</u>	<u>\$ 1,272,210</u>	<u>\$ 2,292,583</u>	<u>(7,805,132)</u>
General revenues :					
Taxes					
					1,036,814
					304,620
					6,094,125
					75,516
					136,579
Special item:					
					533,368
					<u>8,181,022</u>
					375,890
					7,555,230
					<u>\$ 7,931,119</u>

The accompanying notes are an integral part of this statement.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA
BALANCE SHEET
JUNE 30, 2006

	General	Commonwealth Legislature Resolutions	Debt Service	FEMA-Hazard Mitigation Grant	\$1,310,000 Bond Issuance	Other Governmental Funds	Total Governmental Funds
Assets							
Cash and cash equivalents	\$ -	\$ 304,557	\$ -	\$ -	\$ -	\$ 329,041	\$ 633,599
Receivables, net of allowance for uncollectible accounts:							
Due from governmental agencies (note 3)	834,685	401,151	12,554	434,368	4,742	995,229	2,682,729
Due from other funds (note 4)	709,043	1,241,436	-	-	-	363,383	2,313,861
Restricted Assets:							
Cash with fiscal agents	-	-	537,533	26,873	1,114,732	328,554	2,007,692
Total Assets	\$ 1,543,728	\$ 1,947,144	\$ 550,087	\$ 461,241	\$ 1,119,474	\$ 2,016,207	\$ 7,637,880
Liabilities and Fund Balances							
Accounts payable and accrued liabilities	\$ 540,043	\$ 121,726	\$ -	\$ 29,246	\$ 88,500	\$ 538,394	\$ 1,317,910
Due to governmental agencies (note 3)	480,605	-	-	-	-	205	480,810
Due to other funds (note 4)	1,141,663	51,218	-	431,995	-	688,985	2,313,861
Deferred revenues (note 6)	735,868	-	-	113,377	-	944,091	1,793,336
Matured bonds due and payable	-	-	224,000	-	-	-	224,000
Matured interest due and payable	-	-	123,952	-	-	-	123,952
Total Liabilities	2,898,180	172,944	347,952	574,618	88,500	2,171,675	6,253,869
Fund Balances (deficit)							
Reserved for:							
Encumbrances	178,886	-	-	-	-	-	178,886
Capital projects	-	1,774,200	-	-	1,030,974	110,387	2,915,561
Debt service	-	-	202,134	-	-	-	202,134
Other specified purposes	-	-	-	(113,377)	-	30,418	(82,959)
Unreserved	(1,533,338)	-	-	-	-	(296,272)	(1,829,610)
Total Fund Balances (deficit)	(1,354,452)	1,774,200	202,134	(113,377)	1,030,974	(155,467)	1,384,011
Total Liabilities and Fund Balances (deficit)	\$ 1,543,728	\$ 1,947,144	\$ 550,087	\$ 461,241	\$ 1,119,474	\$ 2,016,207	\$ 7,637,880

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, 2006**

Total fund balances- governmental funds	\$	1,384,011
Amounts reported for governmental activities in the Statement of Net Assets are different because:		
Capital assets used in governmental activities are not current financial resources and therefore are not reported in the governmental funds balance sheet:		
		15,889,459
Other assets used in governmental activities are not current financial resources and therefore are not reported in the funds:		
Deferred bond issuance costs		30,894
Other assets are not available to pay current-period expenditures and therefore are deferred in the funds:		
Receivables:		
P.R. Department of Treasury - Christmas bonus reimbursement	\$ 84,634	
CRIM - Property taxes (final liquidation)	89,521	
FEMA - Hazard Mitigation Grant Program	113,377	
P.R. Department of Labor - Law No. 52	298,247	
Federal Government - EDA	93,822	
P.R. Department of Health - reimbursement of health costs	329,287	1,008,888
Interest liabilities are not due and payable in the current period and therefore, are not reported in the funds:		
		(54,554)
Long term liabilities, including bonds payable, are not due and payable in the current period and therefore are not reported in the funds:		
		(10,327,579)
Net assets of governmental activities:	\$	7,931,119

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, 2006

	General	Commonwealth Legislature Resolutions	Debt Service	FEMA-Hazard Mitigation Grant	\$1,310,000 Bond Issuance	Other Governmental Funds	Total Governmental Funds
Revenues:							
Taxes:							
Property taxes	\$ 815,385	\$ -	\$ 221,429	\$ -	\$ -	\$ -	\$ 1,036,814
Municipal license tax	304,620	-	-	-	-	-	304,620
Licenses and permits	272,183	-	-	-	-	-	272,183
Charges for services	-	-	-	-	-	17,718	17,718
Fines and forfeitures	27,935	-	-	-	-	14,937	42,872
Interest	21,533	217	11,381	-	42,341	44	75,516
Intergovernmental:							
Federal operating grants	-	-	-	239,359	-	312,329	551,688
Federal capital grants	-	-	-	-	-	1,263,716	1,263,716
Commonwealth operating grants	-	500	-	-	-	490,407	490,906
Commonwealth capital grants	-	637,035	-	-	-	409,304	1,046,339
Other operating grants and contributions	6,250,765	-	-	-	-	-	6,250,765
Rent	81,481	4,422	-	-	-	-	85,903
Other	129,579	-	-	-	-	7,000	136,579
Total revenues	7,903,480	642,174	232,810	239,359	42,341	2,515,454	11,575,618
Expenditures:							
Current:							
General government	4,558,316	805	-	-	-	623,165	5,182,286
Public safety	1,080,317	-	-	-	-	119,789	1,200,106
Public works and sanitation	1,964,510	244,945	-	-	-	12,195	2,221,650
Culture and recreation	354,924	4,417	-	-	-	19,069	378,410
Health and welfare	1,285,091	238,940	-	352,736	-	420,749	2,297,516
Capital Outlays	111,980	248,801	-	-	275,941	1,431,418	2,068,140
Debt service:							
Principal	-	-	245,000	-	-	-	245,000
Interest	-	-	234,735	-	-	-	234,735
Bond issuance costs	-	-	-	-	7,827	-	7,827
Total expenditures	9,355,137	737,908	479,735	352,736	283,768	2,626,385	13,835,669
Deficiency of revenues under expenditures	(1,451,657)	(95,734)	(246,924)	(113,377)	(241,427)	(110,931)	(2,260,051)
Other financing sources (uses):							
Proceeds from issuance of long term debt	417,302	-	-	-	1,310,000	-	1,727,302
Transfers in	45,342	-	183,115	-	-	30,879	259,337
Transfers out	(213,995)	-	(7,743)	-	(37,599)	-	(259,337)
Total other financing sources	248,649	-	175,372	-	1,272,401	30,879	1,727,301
Special item:							
Proceeds from sale of capital assets	612,265	-	-	-	-	-	612,265
Net change in fund balance	(590,743)	(95,734)	(71,553)	(113,377)	1,030,974	(80,052)	79,516
Fund Balance (deficit) at beginning of year, as restated (note 11)	(763,710)	1,869,934	273,687	-	-	(75,415)	1,304,495
Fund balance (deficit), at end of year	\$ (1,354,452)	\$ 1,774,200	\$ 202,134	\$ (113,377)	\$ 1,030,974	\$ (155,467)	\$ 1,384,011

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, 2006

Net change in fund balances - total governmental funds:	\$	79,516
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	\$ 2,068,140	
Less: current year depreciation	<u>(541,393)</u>	1,526,747
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	7,827	
Amortization of deferred charges	<u>(3,037)</u>	4,790
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:		
		(78,897)
Revenues in the Statement of Activities that do not provide current financial resources are not reported as revenues in the funds:		
P.R. Department of Treasury - Christmas bonus reimbursement	84,634	
Federal Government - EDA	93,822	
CRIM - Property taxes (current year final liquidation)	89,521	
P.R. Department of Labor - Law #52	298,247	
FEMA - Hazard Mitigation Grant Program	113,377	
PR Department of Health - reimbursements of costs	<u>329,287</u>	1,008,888
Revenues reported in funds which are not reported as revenues in the Statement of Activities:		
P.R. Department of Treasury - Christmas bonus reimbursement	(95,590)	
Federal Government - EDA	(111,294)	
OCAM - Public Order Code	(182,008)	
PR Department of Health - reimbursements of costs	<u>(564,492)</u>	(953,384)
Proceeds from notes payable and general obligation bonds are other financing sources in the governmental funds, but increase long-term liabilities in the Statement of Net Assets:		
		(1,727,302)
Expenditures reported in funds which are not reported as expenses in the Statement of Activities:		
Matured bonds principal payments (net change)		45,000
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	200,000	
Other long term liabilities	<u>535,431</u>	735,431
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	(47,301)	
Judgment and Claims	(26,083)	
Accrued interest (net change)	(8,145)	
Christmas bonus	<u>(183,370)</u>	(264,899)
Change in net assets of governmental activities:	\$	<u>375,890</u>

The accompanying notes are an integral part of this statement.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Notes to Basic Financial Statements
June 30, 2006

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 financial reporting entity included in this report consists of the financial statements of the Municipality of Guánica (primary government). To fairly present the financial position and the results of operations of the financial reporting entity, management must determine whether its reporting entity consists of only the legal entity known as the primary government or one or more organizations called component units. The inclusion of a potential component unit in the primary government's reporting entity depends on whether the primary government is financially accountable for the potential component unit or on whether the nature and significance of the relationship with the primary government is such that exclusion would cause the reporting entity's financial statements to be misleading or incomplete. There are two methods of presentation of the component unit in the financial statements: (a) blending the financial data of the component units' balances and transactions in a manner similar to the presentation of the Municipality's balances and (b) discrete presentation of the component unit's financial data in columns separate from the Municipality's balances and transactions.

The basic criteria for deciding financial accountability are any one of the following:

- a. Fiscal dependency of the potential component unit on the primary government, or
- b. The primary government appoints a voting majority of the potential component unit's governing body and,
 1. The primary government can impose its will on the potential component unit and/or,
 2. A financial benefit/ burden exist between the primary government and the potential component unit.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Notes to Basic Financial Statements
June 30, 2006

In addition, a legally separate, tax-exempt organization should be discretely presented as a component unit of a reporting entity if all of the following criteria are met:

- a. The economic resources received or held by the separate organization are entirely or almost entirely for the direct benefit of the primary government, its component units, or its constituents.
- b. The primary government, or its component units, is entitled to, or has the ability to otherwise access, a majority of the economic resources received or held by the separate organization.
- c. The economic resources received or held by an individual organization that the specific primary government, or its component units, is entitled to, or has the ability to otherwise access, are significant to the primary government.

Other organizations should be evaluated as potential component units if they are closely related to, or financially integrated with, the primary government. Professional judgment is applied in determining whether the relationship between a primary government and other organizations for which the primary government is not accountable and that do not meet these criteria is such that exclusion of the organization would render the financial statements of the reporting entity misleading or incomplete.

Based on the above criteria there are no potential component units which should be included as part of the financial statements.

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.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Notes to Basic Financial Statements
June 30, 2006

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.

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, 2006, 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:

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Notes to Basic Financial Statements
June 30, 2006

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

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:

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

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

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

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

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

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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.

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989 generally are followed in the government-wide financial statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. The Municipality has elected not to follow subsequent statements and interpretations issued by the FASB after November 30, 1989.

d) *Governmental Fund Financial Statements*

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

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

- ***General fund*** – The general fund is the Municipality's main operating and major fund, as defined below, used to account for all financial resources and governmental activities, except for financial resources required to be accounted for in another fund. It is presumed that the Municipality's governmental activities have been reported in the general fund except for transactions for which one of the following compelling reasons has required the use of another fund: (1) legal requirements, (2) GAAP requirements or (3) the demands of sound financial administration requiring the use of a governmental fund other than the general fund.

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- **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.

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.

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By definition, the Municipality's general fund is always considered a major governmental fund for financial reporting purposes. In addition, any other fund is considered a major fund for financial reporting purposes if its total assets, liabilities, revenues or expenditures of that individual governmental fund are at least 10 percent of the corresponding element total (assets, liabilities, revenues or expenditures) for all governmental funds 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.

Commonwealth Legislature Resolutions Fund: Commonwealth Legislative 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.

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

\$1,310,000 Bond Issuance Fund: \$1,310,000 Bond Issuance Fund is used to account for capital projects such as community facilities repairs, improvements of certain sport courts, and improvements to municipality roads.

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.

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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.
- 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.

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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, 2006, 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, 2006. 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 generally recorded as revenues when collected because they are generally not measurable until actually received.

All revenues, expenses, gains, losses and assets resulting from nonexchange transactions are recorded in a similar manner to the GWFS, using the previously discussed criteria set forth by current standards 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.

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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.

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.

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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, 2006. 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.

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.

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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.

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.

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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.

Pursuant to Law No. 152 of August 20, 1996 effective July 1, 1997 the Municipality is required to pay any excess of vacations and sick leave accumulated over 90 days as of December 31 of each year. Payments should be made on or before March 31 of the following year.

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.

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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:

- 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.

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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.

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.

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The Municipality also obtains medical insurance coverage for its employees. The current insurance policies have not been canceled or terminated at June 30, 2006. 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:

- ***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:

- ***Transfers*** – Represent legally required transfers that are reported when incurred as “transfers-in” by the recipient fund and as “transfers-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.

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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.

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,
43 Financial Reporting for Post employment Benefits Plans Other Than Pension Plans	June 30, 2008
45 Accounting and Financial Reporting by Employers for Post employment Benefits Other Than Pensions	June 30, 2009
48 Sales and Pledges of Receivables and Future Revenues and Intra-entity Transfers of Assets and Future Revenues	June 30, 2008

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

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 \$402,715.

Deposits in governmental banks, all of which are uninsured and uncollateralized, are exposed to custodial credit risk. At year end the Municipality's bank balance in governmental banks amounts to \$1,876,838.

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3. DUE FROM (TO) GOVERNMENTAL AGENCIES

a. Amounts due from governmental agencies as of June 30, 2006 follows:

	<u>Commonwealth Government</u>	<u>Federal Government</u>
Municipal Revenue Collection Center (CRIM) – property taxes (debt service fund)	\$ 12,554	\$ -
Municipal Revenue Collection Center (CRIM)- current year liquidation (general fund)	185,559	-
Puerto Rico Department of Family – Child Care	-	65,706
U.S. Department of Justice-COPS	-	999
U.S. Federal Emergency Management Agency – HMGP	-	434,368
Office of Commissioner of Municipal Affairs – CDBG		393,327
U.S. Department of Housing and Urban Development – Section 8	-	99
U.S. Department of Commerce – EDA	-	93,822
Puerto Rico Department of Labor – Law 52	300,063	-
Puerto Rico Department of Labor – Law 82	43,015	-
Puerto Rico Department of Health	564,492	-
Government Development Bank of Puerto Rico	4,742	-
Puerto Rico Office of Management and Budget – Law No. 43 of 2006	64,842	-
Puerto Rico Police Department – Public Order Code	33,356	-
Commonwealth Legislature Resolutions	401,151	-
Puerto Rico Department of Treasury – Christmas bonus reimbursement	84,634	-
	<u>\$ 1,694,408</u>	<u>\$ 988,321</u>

The amounts due from Puerto Rico Department of Treasury – Christmas bonus (\$84,634), Municipal Revenue Collection Center-current year liquidation, (\$89,521), Puerto Rico Department of Health (\$329,287), U.S. Federal Emergency Management Agency (\$113,377), U.S. Department of Commerce – EDA (\$93,822) and Puerto Rico Department of Labor – Law 52 (\$300,063) are recorded as deferred revenue in the governmental funds statements since are not available as required by current standards or represent resources received before allowable expenditures are incurred. See note 6.

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b. Amounts due to governmental agencies as of June 30, 2006 follows:

	Amount
Puerto Rico Aqueduct and Sewer Authority (PRASA)	\$ 32,439
Puerto Rico General Services Administration	124,158
Puerto Rico Employee Retirement System Administration	175,553
Puerto Rico Industrial Development Corporation (PRIDCO)	3,370
Puerto Rico Department of Labor - unemployment	131,131
Puerto Rico Land Authority	1,200
Puerto Rico Treasury Department	5,000
Puerto Rico Electric Power Authority	7,754
Other entities	205
	\$ 480,810

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	\$ 51,173
	Other governmental funds -Public Order Code	36,556
	Other governmental funds-Law 52	290,172
	Other governmental funds-Law 82	50,075
	Other governmental funds -CDBG	150,339
	Other governmental funds-Child Care	91,492
	Other governmental funds-others	39,235
Major Fund – Commonwealth Legislative Resolutions	General Fund	784,464
	Major fund – FEMA HMGP	431,994
	Other governmental funds - CDBG	24,978
Other governmental funds –Citizens Participation	General Fund	321,628
Other governmental funds -CDR	General Fund	28,566
Other governmental funds -others	General Fund	13,189
Total:		\$ 2,313,861

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b. 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, 2006 was as follows:

	<u>Balance July 1, 2005, as restated</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance June 30, 2006</u>
<u>Governmental activities:</u>				
Capital assets, not being depreciated:				
Land	\$ 665,008	-	-	\$ 665,008
Construction in progress	5,155,763	1,448,527	-	6,604,290
Total capital assets not being depreciated:	5,820,771	1,448,527	-	7,269,298
Capital assets, being depreciated:				
Buildings, structures and building improvements	6,691,093	27,470	168,677	6,549,886
Infrastructure	3,671,371	339,424	-	4,010,795
Land improvements	2,884,899	8,097	-	2,892,996
Licensed vehicles	1,500,668	108,768	-	1,609,436
Machinery and equipment	991,731	135,854	-	1,127,585
Equipment under capital leases	43,572	-	-	43,572
Total capital assets being depreciated	15,783,334	619,613	168,677	16,234,270
Less accumulated depreciation for:				
Buildings, structures and building improvements	2,542,676	132,203	89,780	2,585,099
Infrastructure	1,113,721	170,189	-	1,283,910
Land improvements	1,909,092	83,550	-	1,992,642
Licensed vehicles	862,281	111,121	-	973,402
Machinery and equipment	715,827	34,744	-	750,571
Equipment under capital leases	18,898	9,586	-	28,484
Total accumulated depreciation	7,162,495	541,393	89,780	7,614,108
Total capital assets being depreciated, net	8,620,839	78,220	78,897	8,620,162
Governmental activities capital assets, net	<u>\$ 14,441,610</u>	<u>\$ 1,526,747</u>	<u>\$ 78,897</u>	<u>\$ 15,889,459</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	\$	97,201
Public safety		90,437
Health and welfare		28,459
Culture and recreation		147,763
Public works and sanitation		177,533
 Total depreciation expense, governmental activities	 \$	 541,393

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 as follows:

	Resources not available	Resources received in advance
Federal Government - EDA	\$ 93,822	\$ -
Unearned volume of municipal license taxes	-	232,426
CRIM-property taxes (liquidation – current year)	89,521	-
P.R. Department of Health	329,287	-
P.R. Department of Treasury-Christmas bonus	84,634	-
Citizens Participation Fund	-	280,577
Federal Emergency Management Agency - HMGP	113,377	-
Federal Emergency Management Agency - others	-	40,956
P.R. Department of Labor - Law No.52	300,063	-
Federal Government - Section 8	-	167,550
Rural Development Corporation	-	28,566
Others	-	32,557
	\$ 1,010,704	\$ 782,632

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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, 2006, the Municipality is in compliance with the debt limitation requirements.

The general long-term debt activity for the year ended June 30, 2006 was as follows:

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	<u>Balance at July 1, 2005</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance at June 30, 2006</u>	<u>Due within one year</u>
Bonds payable	\$ 3,514,000	\$ 1,310,000	\$ 200,000	\$ 4,624,000	\$ 224,000
Notes payable to:					
PR Treasury					
Department:					
Loan for payment of					
legal settlement	1,633,730	-	1,002	1,632,728	102,419
Financing agreement					
for the excess of					
property tax over					
advances thorough					
fiscal year 2003	487,980	-	12,037	475,943	12,917
PR Department of					
Labor and Human					
Resources	-	417,302	105,940	311,362	120,668
PR Land Authority	120,815	-	2,751	118,064	2,916
CRIM:					
Act No. 42 -					
Financing					
agreement for the					
excess of property					
tax advances over					
tax collections					
through fiscal year					
2000	1,028,004	-	14,873	1,013,131	15,807
LIMS	95,193	-	12,391	82,802	13,139
Financing of					
delinquent					
property tax					
accounts sold	138,842	-	12,242	126,600	-
Payable to CRIM -					
Excess of property tax					
advances over actual					
collections	56,138	-	-	56,138	56,138
Payable to FEMA	750,467	-	-	750,467	-
Compensated absences	1,121,914	47,301	73,699	1,095,516	45,000
Claims and judgments	164,660	26,083	126,219	64,524	15,284
Obligation under capital					
leases	22,197	-	5,263	16,934	7,595
Christmas bonus	169,014	183,370	169,014	183,370	183,370
	<u>\$ 9,302,954</u>	<u>\$ 1,984,056</u>	<u>\$ 735,431</u>	<u>\$ 10,551,579</u>	<u>\$ 799,253</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, 2006 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% (6.00% at June 30, 2006) through July 1, 2009	\$ 180,000
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% (3.21% at June 30, 2006) through July 1, 2026	490,000
2005 serial bonds, original amount of \$1,310,000, due in annual principal installments ranging from \$35,000 to \$105,000; plus interest due in semiannual installments at variable rates from 4.23% to 5.33% (4.23% at June 30, 2006) through July 1, 2025	1,310,000
<u>Public Improvement Bonds:</u>	
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% (6.00% at June 30, 2006) through July 1, 2016	815,000
<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% (6.00% at June 30, 2006) through July 1, 2006	14,000
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% (6.00% at June 30, 2006) through July 1, 2009	65,000
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% (6.00% at June 30, 2006) through July 1, 2026	1,615,000
2005 original amount of \$145,000, 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 8.0 0% (6.25% at June 30, 2006) through July 1, 2014	135,000
	<u>\$ 4,624,000</u>

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

<u>June 30</u>	<u>Principal</u>	<u>Interest</u>
2007	\$ 224,000	\$ 260,008
2008	220,000	250,997
2009	235,000	227,117
2010	255,000	213,489
2011	190,000	201,094
2012-2016	1,165,000	824,501
2017-2021	990,000	507,385
2022-2026	1,175,000	222,964
2027	170,000	5,020
Totals	<u>\$ 4,624,000</u>	<u>\$ 2,712,575</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, 2006, the balance of this note, net of the unamortized discount of \$238,190 amounted to \$1,632,728 with an accrued interest of \$4,082. This amount will be repaid with unrestricted funds. The principal and discount amortization (recorded as interest expense) maturities are as follows:

<u>June 30</u>	<u>Principal</u>	<u>Interest</u>
2007	\$ 102,419	\$ 47,325
2008	105,534	44,202
2009	159,437	40,164
2010	164,287	35,303
2011	169,284	30,293
2012-2014	931,767	40,903
Totals	<u>\$ 1,632,728</u>	<u>\$ 238,190</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 \$475,973 and \$2,808, respectively, at June 30, 2006. This amount will be repaid with unrestricted funds. The principal and interest maturities are as follows:

<u>June 30</u>	<u>Principal</u>	<u>Interest</u>
2007	\$ 12,917	\$ 33,207
2008	13,862	32,256
2009	14,876	31,236
2010	15,964	30,142
2011	17,131	28,967
2012-2016	106,389	123,983
2017-2021	151,422	78,685
2022-2025	143,382	18,125
Totals	<u>\$ 475,943</u>	<u>\$ 376,601</u>

c) Note payable to Puerto Rico Department of Labor

On December 22, 2005, the Municipality entered into a financing agreement with the P.R. Department of Labor for a total amount of \$417,302 for unemployment benefits paid by the Commonwealth of Puerto Rico in behalf of the municipality. The agreement is payable in monthly installments of \$10,989, including interest of 11.08% and due in January 5, 2009. The outstanding principal balance of the note payable amounted to \$311,362 at June 30, 2006. The note is being paid from unrestricted funds. Debt service requirements in future years are as follows:

<u>June 30</u>	<u>Principal</u>	<u>Interest</u>
2007	\$ 120,668	\$ 26,538
2008	116,537	14,255
2009	74,157	2,080
Totals	<u>\$ 311,362</u>	<u>\$ 42,873</u>

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d) Notes Payable to Puerto Rico Land Authority

On October 22, 2003, the Municipality acquired a parcel of land from the Puerto Rico Land Authority in the amount of \$250,000 for which the Municipality issue a note payable. The note bears no interest and has an imputed interest rate of 6.00%. The note was originally recorded at its present value of \$135,020, net of an unamortized discount of \$114,980, at inception. At June 30, 2006, the balance of this note, net of the unamortized discount of \$95,442 amounted to \$118,064 with an accrued interest of \$6,494. This amount will be repaid with unrestricted funds. The principal and discount amortization (recorded as interest expense) maturities are as follows:

<u>June 30</u>	<u>Principal</u>	<u>Interest</u>
2007	\$ 2,916	\$ 6,923
2008	3,091	6,739
2009	3,277	6,543
2010	3,473	6,336
2011	3,682	6,116
2012-2016	21,999	26,791
2017-2021	17,529	21,507
2022-2026	35,367	12,687
2027-2029	26,730	1,800
Totals	<u>\$ 118,064</u>	<u>\$ 95,442</u>

e) 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.

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 \$1,013,131 and \$31,344 respectively, at June 30, 2006. This amount will be repaid with unrestricted funds. The principal and interest maturities are as follows:

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<u>June 30</u>	<u>Principal</u>	<u>Interest</u>
2007	\$ 15,807	\$ 61,958
2008	16,801	60,944
2009	17,856	59,845
2010	18,978	58,689
2011	20,171	57,459
2012-2016	121,533	265,978
2017-2021	164,823	221,349
2022-2026	223,532	160,822
2027-2031	303,155	78,737
2032-2033	110,475	10,995
Totals	\$ 1,013,131	\$ 1,036,776

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, 2006, the balance of this note, net of the unamortized discount of \$15,091, amounted to \$82,802. This amount will be repaid with unrestricted funds. The principal and discount amortization (recorded as interest expense) maturities are as follows:

<u>June 30</u>	<u>Principal</u>	<u>Interest</u>
2007	\$ 13,139	\$ 4,669
2008	13,933	3,872
2009	14,774	3,026
2010	15,666	2,130
2011	16,612	1,179
2012	8,678	215
Totals	\$ 82,802	\$ 15,091

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 \$12,242 to the principal on this agreement. At June 30, 2006, the outstanding principal amounted to \$126,600. The principal and interest maturities are as follows:

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<u>June 30</u>	<u>Principal</u>	<u>Interest</u>
2007	\$ -	\$ 8,229
2008	-	8,229
2009	2,177	8,153
2010	2,323	8,007
2011	2,478	7,850
2012-2016	15,114	36,513
2017-2021	20,900	37,381
2022-2026	28,901	22,651
2027-2031	39,965	11,528
2032-2033	14,742	689
Totals	<u>\$ 126,600</u>	<u>\$ 149,230</u>

- f) **Other payable to CRIM - Excess of property tax advances over actual collections** – The \$56,138 represents the balance owed as of June 30, 2006 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.
- g) **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, 2006, 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.
- h) **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, 2006 the outstanding balance amounts to \$1,095,516. This amount will be repaid with unrestricted funds.
- i) **Other claims and judgments** - Represent the final costs of legal cases paid subsequent to June 30, 2006 and other claims outstanding as of that date. The awarded amounts will be paid with unrestricted funds. As of June 30, 2006 the outstanding balance amounts to \$64,524.
- j) **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, 2006, the capitalized costs and the related accumulated amortization of the leased equipment amounted to \$43,572 and \$28,484, 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, 2006 reported in the accompanying government-wide statement of net assets is as follows:

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<u>Year ending</u> <u>June 30,</u>	<u>Amount</u>
2007	8,940
2008	6,756
2009	3,184
Total future minimum lease payments	18,880
Less: amount representing future interest cost at 8.00%	(1,946)
Present value of minimum lease payments	16,934
Less:	
Current portion of obligation under capital leases	7,595
Obligation under capital leases, excluding current portion	\$ 9,339

- k) **Christmas bonus** - Represent the accrued portion corresponding to fiscal year 2005-2006 of the Christmas bonus to be paid in December 2006.

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, 2006 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 6.78% for personal property (of which 6.58% 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.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Notes to Basic Financial Statements
June 30, 2006

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 receivable of 185,559 resulting from the final settlement for fiscal year 2005-2006 and a net payable to the CRIM of \$ 56,138 resulting from the final settlement for fiscal year 2004-2005. The net payable amount is recorded as a long term debt in the government-wide statement since will not be paid with expendable available resources.

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, 2006, the municipal tax rates imposed by the Municipality were 1.50% for financing institutions and 0.40% 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 \$232,426 at June 30, 2006, which represents municipal licenses collected in advance for the taxable year 2006-2007.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Notes to Basic Financial Statements
June 30, 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	\$ 4,358,155
Compensation in lieu of tax from the Puerto Rico Electric Power Authority (PREPA)	948,576
Reimbursement from Commonwealth Government - Christmas Bonus expenditures	144,337
P.R. Department of Health-reimbursement of costs	799,697
	\$ 6,250,765

11. FUND BALANCE RESTATEMENTS

a. Fund balances

The beginning fund balance of the EDA fund included in other governmental funds has been restated to recognize corrections of accounting errors. The corrections include an understatement of liabilities for \$25,120. The following schedule reconciles the fund balance at July 1, 2005 as previously reported to the beginning fund balance, as restated:

Fund	Prior period adjustments		Balance at beginning of year, as Restated
	Balance at beginning of year, as previously reported	Correction of errors	
Other governmental funds	\$ (50,295)	\$ (25,120)	\$ (75,415)

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:	\$ 6,847,477
Restatements:	
Understatement of accounts payable, EDA	(25,120)
Understatement of accounts receivable, P.R. Department of Health	564,492
Understatement of capital assets, EDA construction in progress	168,381
Net assets at beginning of year as restated:	\$ 7,555,230

COMMONWEALTH OF PUERTO RICO
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June 30, 2006

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 benefit 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 full time public employees working for the central government, the municipalities of Puerto Rico and certain public corporations not having their own retirement systems.

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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Notes to Basic Financial Statements
June 30, 2006

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 ended June 30,</u>	<u>Act No. 447</u>	<u>System 2000</u>
2006	\$ 60,926	\$ 140,455
2005	\$ 68,503	\$ 130,816
2004	\$ 74,224	\$ 74,481

13. POSTEMPLOYMENT BENEFITS

Pursuant to Law No. 157 of June 27, 2003, the Municipality is required to cover annually the 3% increase in the retirement plan of its retired employees. For the fiscal year ended the post employment benefits paid to retired employees under this requirement amounted to \$ 461.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Notes to Basic Financial Statements
June 30, 2006

14. COMMITMENTS AND CONTINGENCIES

a. Encumbrances and construction commitments

The Municipality has reported, outstanding encumbrances amounting to \$178,886 in the general fund at June 30, 2006. 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, 2006 of approximately \$814,546 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 \$ 7,126. 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. As of June 30, 2006 and as disclosed in Note 7(g) 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, 2006 the GAR informed the Municipality that additional funds in the amount of \$293,698 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.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Notes to Basic Financial Statements
June 30, 2006

With respects to pending or threatened litigation, the Municipality has reported liabilities of \$64,524 for awarded or anticipated unfavorable judgments as of June 30, 2006. Management believes that any unfavorable outcome in relation to pending or threatened litigation would not be significantly in excess of recorded amounts.

15. 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	\$ 93,821
P.R. Department of Labor – Law #52	\$ 296,271

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.

16. SPECIAL ITEM

On July 26, 2005 the Municipality agreed to sell a parcel of land and the appended buildings with a book value of \$78,797 for a total amount of \$612,265. 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.

17. SUBSEQUENT EVENTS

a. Sales Tax Implementation

Effective on August, 2006 the Municipality imposed a sales tax of 1% to be applicable over all direct sales to consumers, including certain services as approved by the Municipal Legislature. Subsequently on November 14, 2006 this tax was raised to 1.50% as amended by the Municipal Legislature to be in conformity with Commonwealth Government Sales Tax Law (Act No. 117 of July 4, 2006)

Section 6189 of the Puerto Rico Internal Revenue Code of 1994, as amended, authorizes the Municipalities in Puerto Rico to impose a sales and use tax to consumers. This tax must be imposed in conformity with the base, exemptions and limitations contained in Subtitle BB of the Code. The Municipal Sales Tax is specifically imposed over all sales transactions of taxable items and combined transactions (as defined by the municipal internal regulation) taken place within municipal limits. The Municipal Sales Tax is also specifically imposed over the purchase price for the use, storage or consumption of taxable transactions (as defined by the municipal internal regulation) taken place within Municipal limits.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Notes to Basic Financial Statements
June 30, 2006

b. Issuance of general obligation bonds

On November 27, 2006, the Governmental Development Bank of Puerto Rico (GDB) approved the issuance of a \$335,000 general obligation bond to the Municipality to finance the purchase of equipment for the new City Hall. Payments are due in annual installments through year 2011, bearing interest at a variable rate (LIBOR + 1.25%). Principal and interest payments will be financed through the Municipality's debt service fund.

REQUIRED SUPPLEMENTARY INFORMATION

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA
BUDGETARY COMPARISON SCHEDULE - GENERAL FUND
YEAR ENDED JUNE 30, 2006

	Budgeted Amounts		Actual Amounts (Budgetary Basis)	Variance with Final Budget Positive (Negative)
	Original	Final		
Revenues:				
Property taxes	\$ 1,000,607	\$ 1,000,607	\$ 1,000,607	\$ -
Municipal license tax	300,000	300,000	304,620	4,620
Licenses, permits and other local taxes	851,500	851,500	272,183	(579,317)
Fines and forfeitures	15,000	15,000	27,935	12,935
Interest	10,000	10,000	66,875	56,875
Intergovernmental:				
Other operating grants and contributions	5,297,079	5,297,079	5,157,566	(139,513)
Rent	100,000	100,000	81,481	(18,519)
Other	665,000	665,000	652,587	(12,413)
Total revenues	8,239,186	8,239,186	7,563,853	(675,332)
Expenditures:				
Current:				
General government	4,259,881	4,259,881	4,542,265	(282,384)
Public safety	1,091,056	1,091,056	1,094,947	(3,891)
Public works and sanitation	1,866,194	1,866,194	1,789,793	76,401
Culture and recreation	346,495	346,495	365,365	(18,870)
Health and welfare	483,171	483,171	480,517	2,653
Total expenditures	8,046,796	8,046,796	8,272,886	(226,091)
Excess (deficiency) of revenues over (under) expenditures	192,390	192,390	(709,033)	(901,423)
Other financing sources (uses):				
Transfers-out	(192,390)	(192,390)	(183,115)	9,275
Total other financing sources (uses)	(192,390)	(192,390)	(183,115)	9,275
Net change in fund balance	\$ -	\$ -	\$ (892,148)	\$ (892,148)

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, 2006

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, 2006

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, 2006. 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, 2006, 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 varies 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 30,2006

Excess of revenues and other financing sources over expenditures and other financing uses (budgetary basis):	\$	(892,148)
Budget to GAAP differences:		
Entity differences:		
Non budgeted funds recorded as revenues for financial reporting purposes:		838,954
Non budgeted funds recorded as expenditures for financial reporting:		(812,735)
Non budgeted transfers out:		(30,880)
Basis of accounting differences:		
Revenues recorded for financial reporting purposes but not in budgetary basis:		146,038
Expenditures recorded in budgetary basis but not for financial reporting purposes:		273,463
Expenditures recorded for financial reporting purposes but not in budgetary basis:		(362,073)
Other financing sources (uses):		417,302
Timing differences:		
Current year encumbrances recorded as expenditures for budgetary reporting purposes:		127,196
Prior year encumbrances recorded as expenditures for financial reporting purposes:		(295,861)
Net change in fund balance (GAAP basis):	\$	<u>(590,743)</u>

FEDERAL AWARDS AND SINGLE AUDIT SECTION

SUPPLEMENTARY INFORMATION

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA
SUPPLEMENTARY INFORMATION - FINANCIAL DATA SCHEDULE
BALANCE SHEET INFORMATION
JUNE 30, 2006

<u>Line Item Number</u>		Section 8 Housing Choice Vouchers 14,871
	ASSETS	
	Current Assets	
	Cash:	
111	Cash - unrestricted	\$ 179,579
100	Total cash	179,579
	Accounts and notes receivables:	
124	Accounts receivable - other government	99
120	Total receivables, net of allowance for doubtful accounts	99
150	Total Current Assets	179,678
190	TOTAL ASSETS	\$ 179,678
	LIABILITIES AND EQUITY	
	LIABILITIES	
	Current Liabilities	
342	Deferred revenues	167,550
347	Inter-program - due to	4,952
310	Total Current Liabilities	172,502
300	TOTAL LIABILITIES	172,502
	EQUITY	
511.1	Restricted Net Assets	7,176
513	TOTAL EQUITY/NET ASSETS	7,176
600	TOTAL LIABILITIES and EQUITY/NET ASSETS	\$ 179,678

The accompanying notes are an integral part of this schedule.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA
SUPPLEMENTARY INFORMATION - FINANCIAL DATA SCHEDULE
STATEMENT OF REVENUES AND EXPENSES INFORMATION
FISCAL YEAR ENDED JUNE 30, 2006

<u>Line Item Number</u>		Section 8 Housing Choice Vouchers 14.871
	REVENUES:	
706	HUD PHA operating grants	\$ 183,762
700	TOTAL REVENUES	183,762
	EXPENSES:	
	Administrative	
911	Administrative salaries	14,596
916	Other operating- administrative	3,492
	Subtotal	18,088
969	TOTAL OPERATING EXPENSES	18,088
970	EXCESS OPERATING REVENUE OVER OPERATING EXPENSES	165,674
	Other expenses	
973	Housing assistance payments	158,556
900	TOTAL EXPENSES	176,644
1000	EXCESS (DEFICIENCY) OF TOTAL REVENUE OVER (UNDER) TOTAL EXPENSES	\$ 7,118
MEMO account information		
1103	Beginning equity	58
1113	Maximum annual contributions commitment (per ACC)	198,492
1115	Contingency reserve, ACC program reserve	18,030
1116	Total annual contributions available	216,522
1120	Unit months available	648
1121	Number of unit months leased	618

The accompanying notes are an integral part of this schedule.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUÁNICA
Notes to Financial Data Schedule
June 30, 2006

NOTE A – BASIS OF PRESENTATION

The accompanying financial data schedule (FDS) is a trial balance of the Section 8 Housing Choice Voucher Program, administered by the Municipality. The FDS was created in order to standardize the financial information reported by Public Housing Authorities (PHA) to the Real Estate Assessment Center (REAC), as required by the Uniform Financial Reporting Standards (UFRS). REAC is the US Department of Housing and Urban Development (HUD) national management center created to assess the condition of HUD owned and assisted properties. The UFRS are rules to implement requirements of 24 CFR, Part 5, Subpart H, for the electronic filing of financial information to HUD.

In accordance with the guidelines for reporting and attestation requirements of UFRS, the accompanying FDS is included as information supplementary to the financial statements. It was prepared using the accrual basis of accounting, as required by REAC regulations.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
YEAR ENDED JUNE 30, 2006

Federal Grantor/Pass-Through Grantor/Program Title	Federal CFDA Number (note B)	Pass-Through Entity Identifying Number (note C)	Federal Expenditures (note A)
<u>U.S. Department of Agriculture</u>			
Passed through the P.R. Department of Education: Child and Adult Care Food Program	10.558	N/AV	\$ 2,604
<u>U.S. Department of Commerce</u>			
Grant for Public Works and Economic Development	11.300	N/A	144,210
<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	AB - 25 FD - 25	1,016,893
Section 8 Housing Choice Vouchers Program	14.871	N/A	176,644
Subtotal U.S. Department of Housing and Urban Development			<u>1,193,538</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	101,917
<u>U.S. Department of Homeland Security-Federal Emergency Management Agency (FEMA)</u>			
Passed through the Puerto Rico Governor's Office - (Governor's Authorized Representative-GAR): Disaster Grants - Public Assistance	97.036	N/AV	24,046
Hazard Mitigation Grant Program	97.039	DR-1501-PR-0001	352,736
Passed through the P.R. Department of Justice: Citizen Corps Program	97.053	N/AV	1,211
Subtotal U.S. Department of Homeland Security			<u>377,993</u>
Total Expenditures of Federal Awards			<u>\$ 1,820,261</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
Year ended June 30, 2006

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	\$ -	\$ 2,604
11.300	-	144,210
14.228	-	1,016,893
14.871	-	176,644
93.575	-	101,917
97.036	-	24,046
97.039	352,736	-
97.053	-	1,211
Total federal awards expenditures:	352,736	1,467,525
Total non-federal awards expenditures:	-	1,158,860
Total expenditures, fund statements:	\$ 352,736	\$ 2,626,385

**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, 2006, and have issued our report thereon dated December 22, 2006 which is qualified since we were unable to obtain sufficient and competent evidence to support the allocation of pool cash balances and their corresponding interfund receivables balances as of June 30, 2006 recorded in the General Fund, Commonwealth Legislature Resolutions Fund and Other Governmental Funds, 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 **2006 II-1** and **2006 II-4**.

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 **2006 II-1** and **2006 II-4** 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 **2006 II-2** and **2006 II-3**.

We also noted certain additional matters that we reported to management of the Municipality in a separate letter dated December 22, 2006.

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, 2006. 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 2006 III-1, 2006 III-2 and 2006 III-4 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, 2006.

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 2006 III-1 to 2006 III-4.

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 2006 III-1, 2006 III-2 and 2006 III-4 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, 2006

Section I - Summary of Auditor's Results:

Part I - Financial Statements

- | | | |
|---|--|---|
| Type of auditor's report issued: | <input type="checkbox"/> Unqualified opinion | <input checked="" type="checkbox"/> Qualified opinion |
| | <input type="checkbox"/> Adverse opinion | <input type="checkbox"/> Disclaimer of opinion |
| Internal control over financial reporting: | | |
| ▪ Material weaknesses identified? | <input checked="" type="checkbox"/> Yes | <input type="checkbox"/> No |
| ▪ Reportable conditions identified that are not considered to be material weaknesses? | <input type="checkbox"/> Yes | <input checked="" type="checkbox"/> None reported |
| Noncompliance material to financial statements noted? | <input checked="" type="checkbox"/> Yes | <input type="checkbox"/> No |

Part II - Federal Awards

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

Identification of major programs:	CFDA Number	Name of Federal Program or Cluster
	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: | <input checked="" type="checkbox"/> \$300,000 | |
| Auditee qualified as low-risk auditee: | <input type="checkbox"/> Yes | <input checked="" type="checkbox"/> No |

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS-Continued

For the year ended June 30, 2006

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

Reference Number: 2006 II-1
Area: Accounting records and reports
Type: Material weakness

①

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) The Municipality has not established a complete set of accounting records properly balanced and reconciled with subsidiary records. Management has established the uniform computerized accounting system as required by the Office of Commissioner of Municipal Affairs (OCAM), as well as a parallel set of manual and electronic records. None of them are completely and fully established.
- (2) 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, 2006, as disclosed in the bank reconciliation of the general bank account, did not agree by a significant amount with the pooled cash balance disclosed in the Form 4(a) Monthly Cash Report maintained by the Finance Department. For other bank accounts, the differences between the bank reconciliations and the Form 4(a) were identified but still not adjusted in the Form 4(a) or in the accounting records.

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.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS-Continued

For the year ended June 30, 2006

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

Area: Accounting records and reports (continued):

Reference number 2006 II-1 - continued

Cause (cont.): Deficiencies related to Form 4(a) Monthly Cash Report are caused by accounting errors and interfund loans or advance payments not adjusted or reimbursed.

Effect: As a result of the inadequacy of accounting records the financial statements have been prepared by external consultants from alternative sources, including computerized and manual records and reports. In addition, we could not conclude about the allocation of pooled cash transactions recorded in the General Fund.

Recommendation: The Municipality should start an implementation process of a complete set of accounting records and reports properly reconciled. This process should include applicable training to accounting personnel on accounting principles related to governmental financial reporting and properly supervise them to assure achievement of financial reporting objectives. A review of Form 4(a) Cash Report pooled cash balance related to the General Fund is recommended to correct and report appropriate revenues, expenditures and cash cumulative balances.

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, 2006

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

Reference Number: 2006 II-2
Area: **Compliance with Municipal Laws and Regulations**
Type: **Material instance of noncompliance**

Criteria: As required by the Autonomous Municipal Law of 1981, as amended, the Municipality should properly administer the general fund operating budget to avoid deficits and negative results and provide adequate resources to amortize the general fund deficit, if any.

Condition: The June 30, 2006 financial statements disclosed that the General Fund ended with a cumulative fund balance deficit of \$1,354,452. For the fiscal year ended, the Municipality reported a net change in fund balance of (\$590,743) and an operational budgetary deficit of (\$892,148). In addition, the Municipality did not budgeted resources to amortize the prior year's operational deficit as required by Law.

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 presents a significant amount of deficit which is currently causing severe cash flows problems. The General Fund has overdrawn its share of the pool cash funds to finance its own operations.

Recommendation: Procedures should be established to assure compliance with requirements of the Municipal Law. The Municipality should establish a deficit reduction plan, should assign the necessary budgetary credits in the annual budget as required by law and should control and collect interfund loans and 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, 2006

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

Reference Number: 2006 II-3
Area: **Interfund transactions – inappropriate 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.
Condition:	During our audit we became aware that Commonwealth's Legislature Resolution funds were used to finance, through temporary interfund loans, the operations of the general fund and a federal program.
Cause:	This practice arises because of cash flow problems of the General Fund are caused by operational deficits.
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 discontinue this practice in order to be in compliance with the established local law and regulation.
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, 2006

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

Reference Number: 2006 II-4
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:	Certain temporarily advances are not been collected by the Municipality or not collected on a timely basis.
Cause:	The Municipality has not established adequate controls and procedures over billing and collection of advances.
Effect:	Amounts are not being timely reimbursed by the applicable agencies. In the past the Municipality has suffered significant losses for uncollectible amounts which severely affected its cash flow and general fund's operational results. At June 30, 2006 the general fund still have significant uncollected amounts of interfund loans receivable of \$197,536.
Recommendation:	The Municipality should establish the referred controls and procedures including assigning responsible personnel of billings and collection process. A complete review of uncollected balances should be performed on a monthly basis to develop timely billing and collection of unclaimed funds from Commonwealth and Federal agencies and therefore, timely reimbursement of funds to the general fund.
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, 2006

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

<i>Reference Number:</i>	<u>2006 III-1</u>
<i>Agency:</i>	U. S. Department of Housing and Urban Development
<i>Pass-through Entity:</i>	Office of Commissioner of Municipal Affairs (OCAM)
<i>Program:</i>	Community Development Block Grant – State’s Program
<i>CFDA Number:</i>	14.228
<i>Regulation/Requirement:</i>	Cash management, 24 CFR 85.20(b)
<i>Type:</i>	Material weakness\material instance of noncompliance
<i>Questioned Costs:</i>	\$ -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.
Context:	There is an excess of cash in the program bank account which comes from previous years. The Municipality maintained an average monthly excess of cash of \$35,582 during the fiscal year 2005-2006. Program personnel informed OCAM that they intent to use excess funds to acquire materials and a vehicle, but at June 30 funds has still not been used for that purposes.
Cause:	Program accounting controls were not adequate and there were no proper procedures established to determine excess cash available. 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.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS-Continued

For the year ended June 30, 2006

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

Reference Number: 2006 III-1 - continued

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, 2006

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

<i>Reference Number:</i>	<u>2006 III-2</u>
<i>Agency:</i>	U. S. Department of Housing and Urban Development
<i>Pass-through Entity:</i>	Office of Commissioner of Municipal Affairs (OCAM)
<i>Program:</i>	Community Development Block Grant – State’s Program
<i>CFDA Number:</i>	14.228
<i>Regulation/Requirement:</i>	Davis-Bacon Act
<i>Type:</i>	Material weakness\material instance of noncompliance
<i>Questioned Costs:</i>	\$ -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) Payrolls obtained from contractors were received by program personnel weeks or months after the wages have been paid.
- (2) In one of the cases payrolls interviews were dated before the starting date of the construction activity. No reasonable explanation was obtained from program personnel.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS-Continued

For the year ended June 30, 2006

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

Reference Number: 2006 III-2 - 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 timely reviews made to payrolls submitted by contractors paid with this federal fund. Program should also document timely interviews made to contractor's personnel. The improvements of both procedures are necessary to fully document the monitoring procedures performed to determine municipal and 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, 2006

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

<i>Reference Number:</i>	<u>2006 III-3</u>
<i>Agency:</i>	U. S. Department of Housing and Urban Development
<i>Pass-through Entity:</i>	Office of Commissioner of Municipal Affairs (OCAM)
<i>Program:</i>	Community Development Block Grant – State’s Program
<i>CFDA Number:</i>	14.228
<i>Regulation/Requirement:</i>	Special tests and provisions - tests to accounting records for compliance with 24 CFR 85.20(b)
<i>Type:</i>	Reportable condition
<i>Questioned Costs:</i>	\$ -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 Program Year 2005. Record does not include significant receivables and payables accounts.
Cause:	General ledger is maintained on cash basis and not on modified accrual basis. Most expenditures are accounted in program general ledger when they are paid to suppliers or when they are reimbursed to the general fund instead of when they are incurred. No interfund loans payables or amounts receivables from grantor are accounted in program general ledger.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS-Continued

For the year ended June 30, 2006

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

Reference Number: 2006 III-3 - continued

Effect:	General ledger is not complete and do not include significant transactions at year end. Expenditures are usually accounted in program general ledger in a subsequent month or even, in a subsequent fiscal year. The same situation occurs for revenues. Program amounts included in the basic financial statements and the accompanying schedule of expenditures of federal awards were obtained from other alternative sources.
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, 2006

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

Reference Number: 2006 III-4
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 10th 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 10th 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:

- (1) The quarterly progress reports were submitted after the prescribed period of time – 2 of 4 reports.
- (2) The monthly progress reports were submitted after the prescribed period of time – 10 of 12 reports.
- (3) There is no evidence supporting the preparation and submission of the 4 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, 2006

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

Reference Number: 2006 III-4 - 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, 2006

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

Fiscal year ended June 30,	Finding No.	Condition	Status
2005	2005 II-1	<p>a. 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, did not agreed by a significant amount with the balance disclosed in the Form 4(a).</p> <p>b. 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.</p>	<p>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. <u>2006 II-1</u> in the accompanying schedule of findings and questioned costs.</p>
2005	2005 II-2	<p>At June 30, 2005 financial statements disclosed that the General Fund ended with a cumulative fund balance deficit of \$763,710.</p>	<p>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. <u>2006 II-2</u> in the accompanying schedule of findings and questioned costs.</p>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA**

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS - Continued

For the year ended June 30, 2006

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

Fiscal year ended June 30,	Finding No.	Condition	Status
2005	2005 II-3	The Municipality has not 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. <u>2006 II-4</u> in the accompanying schedule of findings and questioned costs.
2005	2005 II-4	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.	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. <u>2006 II-3</u> in the accompanying schedule of findings and questioned costs.
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. <u>2006 II-4</u> 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, 2006

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

Fiscal year ended June 30,	Program	No.	Condition	Status
2005	US Department of Commerce: Grants for Public Works and Economic Development - CFDA No. 11.300	2005 III-1	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.	Finding remains not cleared by grantor agency.
2005	US Department of Commerce: Grants for Public Works and Economic Development - CFDA No. 11.300	2005 III-2	Our tests over procedures related to the construction activity financed with EDA funds disclosed that: 1) There is no evidence supporting the dates 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.	Finding remains not cleared by grantor agency.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA**

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS - Continued

For the year ended June 30, 2006

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

Fiscal year ended June 30,	Program	No.	Condition	Status
2005	US Department of Commerce: Grants for Public Works and Economic Development - CFDA No. 11.300	2005 III-3	A complete general ledger has not been maintained by the Municipality. Grant receivables and payables are not recognized.	Finding remains not cleared by grantor agency.
2005	US Department of HUD: Community Development Block Grant State's Program - CFDA No. 14.228	2005 III-4	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 the 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. <u>2006 III-1</u> 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, 2006

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

Fiscal year ended June 30,	Program	No.	Condition	Status
2005	US Department of HUD: Community Development Block Grant State's Program - CFDA No. 14.228	2005 III-5	<p>Our tests over monitoring made by the Municipality over two construction activities financed with CDBG funds disclosed the following:</p> <ol style="list-style-type: none"> 1) In one of the activities we did not found evidence of payroll reviews. From a total of 11 payrolls submitted by contractor in 5 cases we did not found evidence documenting submission date. 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. 	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. <u>2006 III-2</u> in the accompanying schedule of findings and questioned costs.
2005	US Department of HUD: Community Development Block Grant State's Program - CFDA No. 14.228	2005 III-6	A complete general ledger has not been maintained by the Municipality. Grant receivables and payables are not recognized.	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. <u>2006 III-3</u> 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, 2006

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

Fiscal year ended June 30,	Program	No.	Condition	Status
2005	US Department of Homeland Security, Federal Emergency Management Agency: Hazard Mitigation Grant - CFDA No. 97.039	2005 III-7	The Municipality did not comply with requirements applicable to progress and financial reports.	Audit report and related findings have not been cleared by grantor agency. See related finding No. <u>2006 III-4</u> 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-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.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA**

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS - Continued

For the year ended June 30, 2006

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-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.
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 sent 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. 2006 III-1 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-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. 2006 III-3 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, 2006

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-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).



**ESTADO LIBRE ASOCIADO DE PUERTO RICO
MUNICIPIO DE GUANICA**

COMMENTS TO SCHEDULE OF FINDINGS AND QUESTIONED COSTS

For the year ended June 30, 2006

**FINDING 2006 II-1 Accounting records and reports
Material Weakness**

The Municipality is in process to schedule trainings to accounting personnel on accounting principles related to governmental financial matters. The Finance Director will be working to review the form 4(a) to correct and report appropriate revenues, expenditures and cash cumulative balances. The Administration and Internal Auditor Office will be monitoring the procedures to maintain a complete and reconciled set of accounting records.

**FINDING 2006 II-2 Compliance with Municipality Laws and Regulations
Material instance of noncompliance**

The Municipality will establish a deficit reduction plan in the annual budget as required by law and enforce the Finance Director to collect interfund loans and advances to decrease severe cash flows problems.

**FINDING 2006 II-3 Interfund transactions-inappropriate use of restricted funds
Material instance of noncompliance**

The Finance Director has been instructed to discontinue this practice.

FINDING 2006 II-4 Interfund transactions-due from/to other funds

The Finance Director has been instructed to review uncollected balances on a monthly basis to develop timely billing and collection of unclaimed funds from Commonwealth and Federal Agencies.

FINDING 2006 III-1 Cash Management/Material Weakness

The Finance Director has been instructed to establish specific procedures to assure that disbursements are issued soon after the related deposits are made.

FINDING 2006 III-2 Davids- Bacon Act

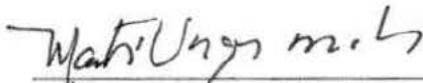
The Federal Program Director has been instructed to establish adequate procedures to review certified payroll paid by contractors. The Federal Program Director was instructed to conduct on-site inspections regularly after reviewing the payroll.

FINDING 2006 III-3 Special Tests and provisions – test to accounting records for compliance with 24 CFR 85.20 (b)

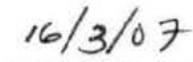
The Finance Director has been instructed to maintain on accrual basis the general ledger on which grant receivables and payables are recognized. Responsible Personnel will be properly trained. Reviews will be conducted a monthly basis to ensure this situation was corrected.

FINDING 2006 III-4 Acquisition and Demolition of 19 Housing Units

The Federal Program personnel have been instructed to establish and follow adequate procedures to assure full compliance with the reporting requirements of the grant agreement.



Martín Vargas Morales, Mayor



Date

December 22, 2006

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

In connection with our audit of the basic financial statements of the Municipality of Guanica (the Municipality) as of and for the year ended June 30, 2006, we considered its internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements that collectively comprise the Municipality's basic financial statements and not to provide an opinion on the internal control over financial reporting. Also, as part of obtaining reasonable assurance about whether the basic financial statements are free of material misstatements, we performed tests of the Municipality's compliance with certain provisions of laws, regulations, contracts and grants agreements. However, the objective of our audit of the basic financial statements was not to provide an opinion or overall compliance with such provisions.

In addition, as part of our audit of the Municipality's compliance with requirements applicable to major federal award programs, we considered its internal controls in order to determine our auditing procedures for the purpose of expressing our opinion on the Municipality's compliance with requirements applicable to major federal award programs and to report on internal control in accordance with U. S. Office of Management and Budget (OMB) Circular A-133 and not to provide assurance on internal control.

As a result of our audit, we noted certain financial, internal control and compliance matters that are presented for your consideration in the accompanying "*Memorandum of Management Letter Comments*". These matters are not significant enough to be considered reportable conditions as defined by SAS 60 *Communication of Internal Control Structure Related Matter Noted in an Audit*. A separate report dated December 22, 2006 contains our report 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. This letter does not affect our report dated December 22, 2006 on the basic financial statements of June 30, 2006. In addition, a separate report dated December 22, 2006 contains our report on compliance with requirements applicable to each major program and on internal control over compliance in accordance with OMB Circular A-133.

We will review the status of these comments during our next audit engagement. We have already discussed many of these comments and suggestions with Mrs. Luis A. Pacheco-Santiago, Finance Director, and we will be pleased to discuss them in further detail at your convenience, to perform any additional study of these matters, or to provide advisory or technical assistance to you in implementing the recommendations.

Very truly yours,



José A. Toro-Mercado, CPA
Managing Partner

COMMONWEALTH OF PUERTO RICO
Municipality of Guánica

MEMORANDUM OF MANAGEMENT LETTER COMMENTS

Year ended June 30, 2006

<u>Number</u>	<u>Area/ program</u>	<u>Description</u>
1	Revenues and cash receipts	Our tests to a sample of 25 official collector receipts disclosed one case on which the corresponding source documents were not available for examination. We recommend the Municipality to review the procedures established for cash receipts documentation.
2	Payroll and related liabilities	<p>Our tests to a sample of 25 employees files disclosed the following exceptions:</p> <ul style="list-style-type: none">• In 3 cases, the gross pay for the payroll period verified did no agreed with the applicable salary authorization found within the employees file. The Personnel Director provided us an alternate source document containing the pay rate used to compute the gross amount, which is not the official salary change notification document that should have been included in the employee file.• In 2 cases, no copy of a valid ID was found in the employee personnel file.

We recommend the Municipality to review the procedures established for employee's files documentation and for the posting of payroll expense in the accounting records. The Municipality's Internal Auditor should perform tests to verify the posting of salary expense in the accounting records and a review of salary authorizations with emphasis on documentation of salary revisions to employees.

COMMONWEALTH OF PUERTO RICO
Municipality of Guánica

MEMORANDUM OF MANAGEMENT LETTER COMMENTS - continued

Year ended June 30, 2006

<u>Number</u>	<u>Area/ program</u>	<u>Description</u>
3	Expenditures and cash disbursements	<p>Our tests to a sample of 25 cash disbursements disclosed the following:</p> <ul style="list-style-type: none">• In 11 cases the cash disbursement was not posted in the manual encumbrance and disbursement registers. We noted that Manual registers are not being properly maintained and updated. In addition to this manual system the Municipality maintains a computerized system and electronic records and reports which are the primary source for the preparation of the financial statements.• In 1 case the disbursement made through a manual check was not accounted in the general ledger.• In 1 case the cancelled check was not provided for our examination. We could not ascertain total correctness and full compliance in this payment.• In 1 case the Municipality contracted a maintenance service for a total amount of \$1,160 and did not registered the obligation in the "Orders and Contracts Register". Obligation is being registered as partial invoices are received and paid.• In 1 case the corresponding invoice was not provided for our examination. We could not ascertain total correctness and full compliance in this payment. <p>We recommend the Municipality to analyze the costs and benefits of maintaining manual registers in addition to computerized systems which are not properly completed. In addition, we recommend the review and improvement of pre-audit and filing procedures to locate Missing documents should be located and provided for examination.</p>
4	Capital assets	<p>Our audit of the fixed assets area revealed that physical inventory records maintained by the Property Custodian are incomplete and do not reconcile with amounts included in Finance Department records, which are used to prepare the basic financial statements.</p> <p>We recommend the Municipality to improve the recordkeeping of assets made by the Property Custodian.</p>

COMMONWEALTH OF PUERTO RICO
Municipality of Guánica

MEMORANDUM OF MANAGEMENT LETTER COMMENTS - continued

Year ended June 30, 2006

<u>Number</u>	<u>Area/ program</u>	<u>Description</u>
5	Encumbrances	The Finance Department has not adequate controls over recording and documentation of transactions related to prior years encumbrances. Management did not provide us a detail of individual prior years orders paid during current year as well as a detail of prior year encumbrances outstanding at year end. Management provided only summarized details of these transactions by expenditure accounts. We recommend the Municipality to improve its accounting with respect to encumbrances.
6	Health Services and operating costs	The Municipality administers the Municipal Health Center for the purpose of providing health services to low income families. As part of this service the Municipality entered into an agreement with the Puerto Rico Department of Health (PRDH) by which this agency reimburses a portion of the operating costs of the Center. The portion of the operating funds not reimbursed to the Municipality results in a significant outflow of funds, which are covered by the General Fund. Based on the effect of this matter over the Municipality's operations and financial condition, we recommend to Management an analysis of costs and administration of this Center, search for additional funding, review billings and collection procedures and make further negotiations with the PRDH related to the current agreement.
7	CDBG Program	A portion of the housing rehabilitation program of the Municipality is financed with CDBG funds. Our verification of 6 files of the participants of the program revealed 1 case on which there is no certification from the Puerto Rico Department of Labor (PRDL) indicating unemployed status for one of the family members over 18 years old. We recommend the administration of the federal programs office to perform periodic reviews of the files in order to assure that all required documentation is included in participant files. The missing evidence should also be obtained and included in the file corresponding file.

COMMONWEALTH OF PUERTO RICO
Municipality of Guánica

MEMORANDUM OF MANAGEMENT LETTER COMMENTS - continued

Year ended June 30, 2005

Number	Area/ Program	Description
8	CDBG Program	Our tests over disbursements financed with federal funds disclosed two construction contracts which did not include the 10% retention clause as required by Municipal Regulations. We recommend the Municipality to include all clauses required by Municipal regulations.
9	Hazard Mitigation Grant Program / Capital Assets	During fiscal year 2005-2006 the Municipality acquired certain land and property as part of a grant agreement with FEMA. Funds financed the acquisition of property from owners due to a natural disaster. Due to the nature of this property, it lacks of value but, in order to comply with Municipality's internal controls, property should be included at a nominal value in the detailed fixed assets records. Although the property lack of any value at the moment (no resale value) we became aware that it was not included within the property custodian records. We recommend the property custodian to register this property and document the specific reasons of the nominal value.