

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

MUNICIPIO DE GUAYAMA
AUDITORIA 2005-2006
30 DE JUNIO DE 2006

Cantón
OFICINA DEL COMISIONADO
DE ASESORES MUNICIPALES

2007 MAR 30 AM 11:11

RECIBIDO
UNIDAD DE CORREO

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUAYAMA
BASIC FINANCIAL STATEMENTS
WITH THE ADDITIONAL REPORTS AND INFORMATION
REQUIRED BY THE SINGLE AUDIT ACT
YEAR ENDED JUNE 30, 2006

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUAYAMA

BASIC FINANCIAL STATEMENTS
WITH THE ADDITIONAL REPORTS AND INFORMATION
REQUIRED BY THE SINGLE AUDIT ACT

YEAR ENDED JUNE 30, 2006

CONTENTS

	Page
<u>BASIC FINANCIAL STATEMENTS</u>	
Independent Auditors' Report	1-2
Required Supplementary Information (Part 1) Management's Discussion and Analysis	3-11
Government-Wide Financial Statements:	
Statement of Net Assets	12
Statement of Activities	13
Fund Financial Statements:	
Governmental Funds:	
Balance Sheet	14
Statement of Revenues, Expenditures and Changes in Fund Balances	15
Reconciliation of the Statement of Revenues, Expenditures, and Changes in Fund Balances to the Statement of Activities	16
Notes to Basic Financial Statements	17-38
<u>SUPPLEMENTARY INFORMATION</u>	
Required Supplemental Information (Part II):	
Budgetary Comparison Schedule-General Fund	39
Notes to Budgetary Comparison Schedule-General Fund	40
Schedule of expenditures of federal awards	41-42
Notes to the schedule of federal awards	43

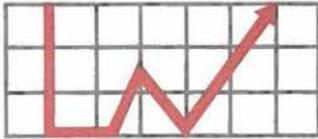
COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUAYAMA

BASIC FINANCIAL STATEMENTS
WITH THE ADDITIONAL REPORTS AND INFORMATION
REQUIRED BY THE SINGLE AUDIT ACT

YEAR ENDED JUNE 30, 2006

CONTENTS - (CONTINUED)

	Page
<u>INTERNAL CONTROL AND COMPLIANCE WITH LAWS AND REGULATIONS</u>	
Report on internal control over financial reporting and on compliance and on compliance and other matters based on an audit of Financial Statements performed in accordance with Governmental Auditing Standards	44-45
<u>INTERNAL CONTROL AND COMPLIANCE WITH LAWS AND REGULATIONS (CONTINUED)</u>	
Report on compliance with requirements applicable to each major program and on internal control over compliance required by OMB Circular A-133	46-48
<u>FINDINGS AND QUESTIONED COSTS</u>	
Schedule of findings and questioned costs	49-66
Summary schedule of prior year audit findings	67-70



López-Vega, CPA, PSC

Certified Public Accountants / Management Advisors

INDEPENDENT AUDITORS' REPORT

Member of:

- American Institute of Certified Public Accountants
- Puerto Rico Society of Certified Public Accountants

**To the Honorable Mayor and
the Municipal Legislature
Municipality of Guayama
Guayama, 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 Guayama, 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.

We conducted our audit 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 the provisions of the Office of Management and Budget 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 the respective financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the respective financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statements presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the governmental activities, each major fund, and the aggregate remaining fund information of the **Municipality of Guayama, 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 11 and the Budgetary Comparison Schedule-General Fund on page 39 are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. 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.

INDEPENDENT AUDITORS' REPORT (CONTINUED)

In accordance with *Government Auditing Standards*, we have also issued our report dated December 20, 2006 on our consideration of the Municipality's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grants.

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

López Vega, CPA, PSC.

LOPEZ-VEGA, CPA, PSC

San Juan, Puerto Rico
December 20, 2006

Stamp No. 2195987 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.



López-Vega, CPA, PSC

Certified Public Accountants / Management Advisors

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUAYAMA**

MANAGEMENT'S DISCUSSION AND ANALYSIS

YEAR ENDED JUNE 30, 2006

Management's Discussion and Analysis

As management of the Municipality of Guayama, we offer readers of the Municipality's basic financial statements this narrative overview and analysis of the financial activities of the Municipality as of and for the fiscal year ended June 30, 2006. This Management's Discussion and Analysis (MD&A) include comparative data, and it has been designed accordingly with the following goals:

- a) Assist the reader in focusing on significant financial issues,
- b) Provide an overview of the Municipality's financial activity,
- c) Identify changes in the Municipality's financial position (its ability to address the next and subsequent year challenges),
- d) Identify any material deviations from the financial plan (the approved budget,) and;
- e) Identify individual fund issues or concerns.

Since the MD&A is designed to focus on the current year activities, resulting changes and currently known facts, please read it in conjunction with the Municipality's financial statements.

FINANCIAL HIGHLIGHTS

- The Municipality net assets increase by \$ 4,124,620.
- In the fund financial statements, the governmental activities revenue decrease \$ 3,428,208 (or 10%) while governmental activities expenditures decrease \$ 2,924,941 (or 7%).
- The General Fund (the primary operating fund) reflected, on a current financial resource basis, a decrease of \$ 982,080.
- On a budgetary basis, actual revenues exceeded actual expenditures by \$ 2,041,149.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUAYAMA**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2006

Using This Annual Report

This annual report consists of a series of new financial statements with a change in the focus from previous financial statements. The new focus is on both the Municipality as a whole (government-wide) and the major individual funds. Both perspectives (government-wide and major fund) allow the user to address relevant questions, broaden a basis for comparison (year to year or government to government) and enhance the Municipality's accountability.

Government-Wide Financial Statements

The Government-Wide Financial Statements are designed to provide users of the financial statements with a broad overview of the Municipality's finances in a manner similar to private-sector companies.

The Statement of Net Asset presents information on all of the Municipality's assets and liabilities, with the difference between both reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the Municipality is improving or deteriorating.

The Statement of Activities presents information showing how the Municipality's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the related cash flows. Thus, revenues and expenses are reported in the Statement of Activities that will only result in cash flows in future fiscal periods. The Statement of Activities is focused on both the gross and net cost of various activities, which are provided by the government's general tax and other revenues. This is intended to summarize and simplify the user's analysis of cost of various governmental services.

Fund Financial Statements

The Fund Financial Statements provide detailed information about the Municipality's most significant funds, not the Municipality as a whole. The Municipality has only one kind of fund which is the governmental fund.

Governmental funds are used to account for essentially the same functions reported as governmental activities in the Government Wide Financial Statements. However, unlike the Government Wide Financial Statements, Government Fund Financial Statements, focus on near term inflows and outflows of spendable resources, as well as on balances of spendable resources available at the end of the fiscal year. Such information is useful in evaluating the Municipality's near term financial requirements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUAYAMA**

MANAGEMENT'S DISCUSSION AND ANALYSIS – (CONTINUED)

YEAR ENDED JUNE 30, 2006

Fund Financial Statements (Continued)

Because the focus of governmental funds is narrower than that of the government wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government wide financial statements. By doing so, users of the basic financial statements may better understand the long-term impact of the Municipality's near term financial decisions. Both of the Governmental Fund Balance Sheet and the Governmental Fund Statement of Revenues, Expenditures and Changes in Fund Balances provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

Infrastructure Assets

Historically, a government's largest group of assets (infrastructure-roads, bridges, underground pipes [unless associated with a utility], etc.) have not been reported nor depreciated in government financial statements. GASB 34 requires that these assets be valued and reported within the Governmental column of the Government-Wide Statements. Additionally, the government must elect to either (a) depreciate these assets over their estimated useful life or (b) develop a system of asset management designed to maintain the service delivery potential to near perpetuity. If the government develops the asset management system (the modified approach) which periodically (at least every third year), by category, measures and demonstrated its maintenance of locally established levels of service standards, the government may record its cost of maintenance in lieu of depreciation. The information about the condition and maintenance of condition of the government infrastructure assets should assist financial statement users in evaluating a local government and its performance over time.

The Municipality elected to depreciate infrastructure assets instead of using the modified approach.

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE

Net Assets

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. The Municipality's combined net assets (excess of assets over liabilities) totaled \$ 33,984,951 at the end of 2006, compared to \$ 29,860,331 at the end of the previous year.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUAYAMA**

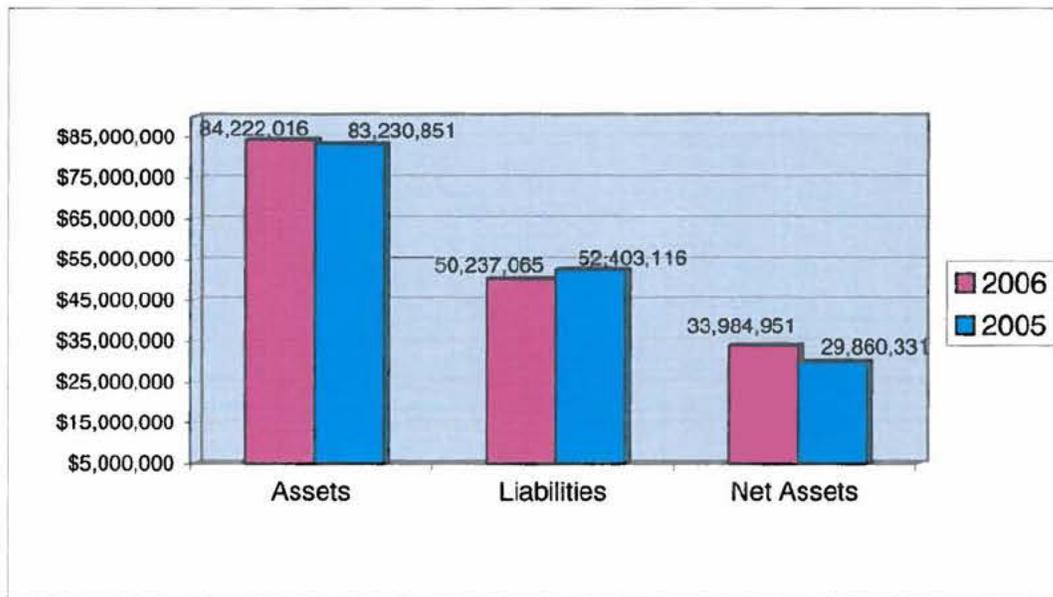
MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2006

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE

Net Assets (Continued)

Condensed Statement of Net Assets	2006	2005	Change	%
Current assets	\$30,567,512	\$38,659,454	(\$8,091,942)	(21%)
Capital assets	27,088,663	23,359,068	3,729,595	16%
Other capital assets	26,565,841	21,212,329	5,353,512	25%
Total assets	84,222,016	83,230,851	991,165	1%
Current liabilities	10,685,960	10,772,609	(86,649)	(1%)
Noncurrent liabilities	39,551,105	41,630,507	(2,079,402)	(5%)
Total liabilities	50,237,065	52,403,116	(2,166,051)	(4%)
Invested in capital assets, net of related debt	27,930,399	17,644,292	10,286,107	58%
Restricted	16,033,669	22,098,478	(6,064,809)	(27%)
Unrestricted	(9,979,117)	(9,882,439)	(96,678)	1%
Total net assets	\$33,984,951	\$29,860,331	\$4,124,620	14%



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUAYAMA**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2006

Changes in Net Assets

The Municipality's net assets increase by \$4,124,620. Approximately 45 percent of the Municipality's total revenue came from taxes, while 50 percent resulted from grants and contributions, including federal aid. Charges for Services provided 3 percent and Interest revenue and miscellaneous 2 percent of the total revenues. The Municipality's expenses cover a range of services. The largest expenses were for health and welfare services, general government, public works, and public safety. As follow, is presented a comparative analysis of governmental-wide data. With this analysis, the readers have comparative information with the percentage of change in revenues and expenses from prior year to current year.

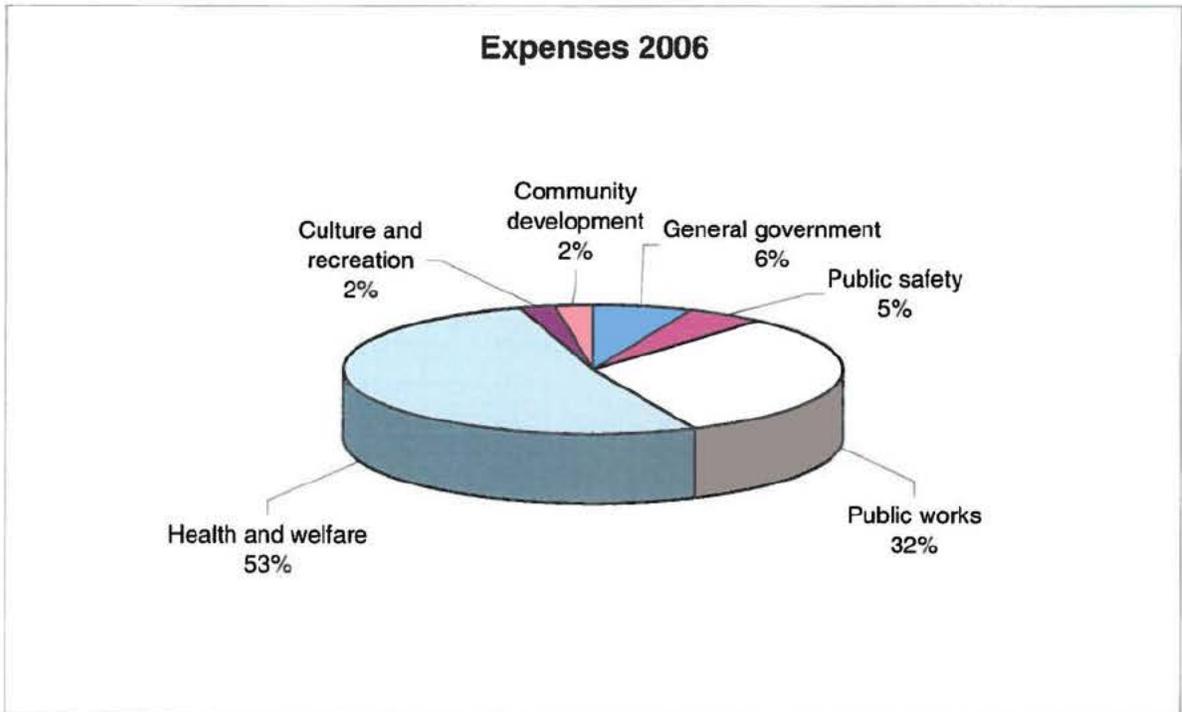
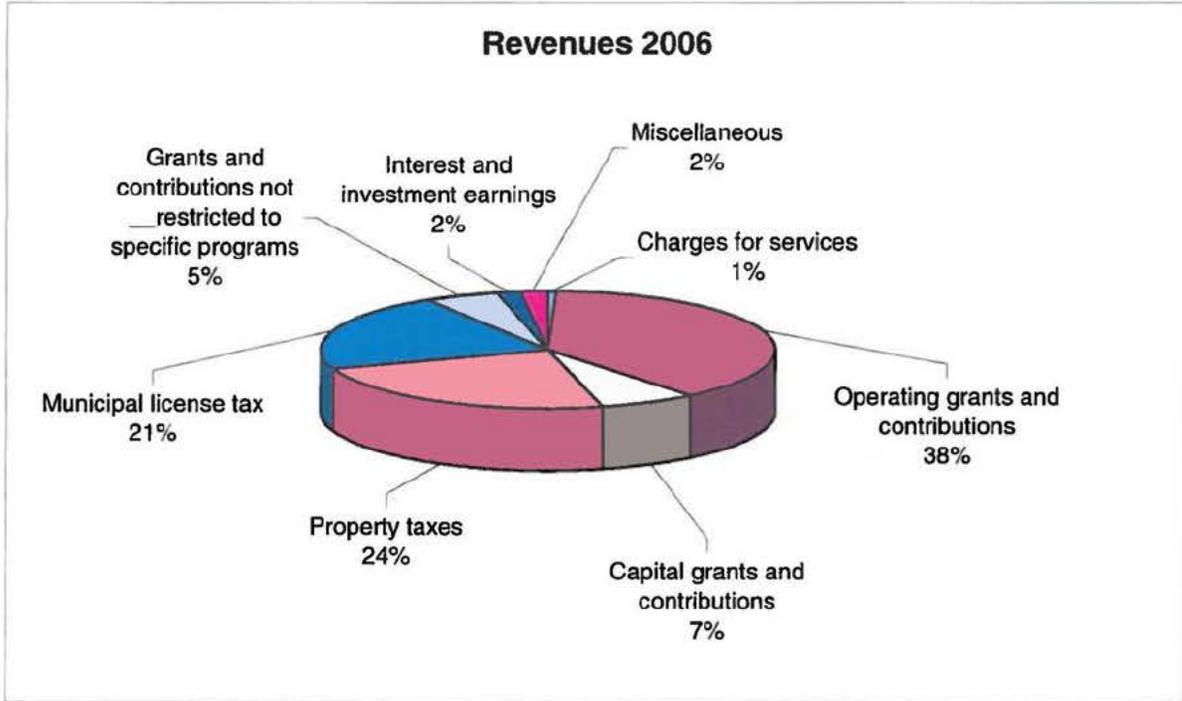
Condensed Statement of Activities	2006	2005	Change	%
Program revenues:				
Charges for services	\$187,774	\$409,272	(\$221,498)	(54%)
Operating grants and contributions	14,432,933	16,565,337	(2,132,404)	(13%)
Capital grants and contributions	2,619,516	2,499,327	120,189	5%
General revenues:				
Property taxes	8,767,895	8,613,358	154,537	2%
Municipal license tax	8,000,287	8,244,120	(243,833)	(3%)
Grants and contributions not restricted to specific programs	1,969,288	3,960,204	(1,990,916)	(50%)
Interest and investment earnings	603,031	131,565	471,466	358%
Miscellaneous	709,574	292,311	417,263	143%
Total revenues	37,290,298	40,715,494	(3,425,196)	(8%)
Expenses:				
General government	2,082,791	3,291,509	(1,208,718)	(37%)
Public safety	1,614,950	1,771,890	(156,940)	(9%)
Public works	10,247,681	8,811,118	1,436,563	16%
Health and welfare	16,651,454	16,013,020	638,434	4%
Culture and recreation	697,179	378,054	319,125	84%
Community development	802,211	1,287,329	(485,118)	(38%)
Urban development	32,712		32,712	100%
Education	4,082		4,082	100%
Interest on long-term debt	1,032,618	1,072,580	(39,962)	(4%)
Total expenses	33,165,678	32,625,500	540,178	2%
Change in net assets	4,124,620	8,089,994	(3,965,374)	(49%)
Net assets, beginning of year	29,860,331	22,737,741	7,122,590	31%
Net assets, end of year	\$33,984,951	\$30,827,735	\$3,157,216	10%

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUAYAMA

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2006

Changes in Net Assets (Continued)



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUAYAMA**

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2006

FINANCIAL ANALYSIS OF THE MUNICIPALITY'S INDIVIDUAL FUNDS

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

Governmental Funds

The focus of the Municipality's governmental funds is to provide information on near-term inflows, outflows, and balances of spend able resources. Such information is useful in assessing the Municipality's financing requirements. In particular, unreserved fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year.

As of the end of the current fiscal year, the Municipality's governmental funds reported combined ending fund balances of \$19,881,552 a decrease of \$8,005,293 in comparison with the prior year. There are reservations of fund balance amounting to \$17,117,185. This is the fund balance that it is not available for new spending because it has already been committed 1) to liquidate contracts and purchase orders of the prior fiscal year (\$1,074,516), 2) to pay debt service (\$ 4,464,356), 3) to pay for capital projects (\$8,734,459) and 4) for other purposes (\$ 2,843,854).

Within the governmental funds, it is included the general fund which is the chief operating fund of the Municipality. As of June 30, 2006, the general fund has a fund balance of \$ 3,838,883.

GENERAL FUND BUDGETARY HIGHLIGHTS

Over the course of the year, the Municipality Council revised the Municipality's budget in order to include increases in revenues that were identified during the course of the fiscal year based on current developments that positively affected the Municipality's finances. Increases in budgeted expenditures were also made since the law mandates a balanced budget.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

The Municipality's investment in capital assets as of June 30, 2006, amounts to \$ 58,132,167, net of accumulated depreciation of \$ 4,477,663, leaving a net book value of \$ 53,654,504. This investment in capital assets includes land, buildings, improvements, equipment, infrastructure and construction in progress.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUAYAMA**

MANAGEMENT AND DISCUSSION ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2006

CAPITAL ASSETS AND DEBT ADMINISTRATION- (CONTINUED)

Infrastructure assets are items that are normally immovable and of value only to the state, such as roads, bridges, streets and sidewalks, drainage systems, lighting systems, and similar items.

The total increase in the Municipality's investment in capital assets for the current fiscal year was about 21% in terms of net book value. Depreciation charges for the year totaled \$ 868,518.

The Municipality finances a significant portion of its construction activities through bond issuances. The proceeds from bond issuances designated for construction activities are committed in its entirety for such purposes and cannot be used for any other purposes. As of June 30, 2006, the Municipality has \$8,734,459 of unexpended proceeds mainly from bond issuances that are committed to future construction activities.

Debt Administration

The Puerto Rico Legislature has established a limitation for the issuance of general obligation municipal bonds and notes for the payment of which the good faith, credit and taxing power of each municipality may be pledged. See "Limitations on Ability of Municipalities to Issue General Obligation Debt-The Municipal Bonds" for a general description of such limitations.

The applicable law also requires that in order for a Municipality to be able to issue additional general obligation bonds and notes such Municipality must have sufficient "payment capacity". Act No. 64 provides that a municipality has sufficient "payment capacity" to incur additional general obligation debt if the deposits in such municipality's Redemption Fund and the annual amounts collected with respect to such Municipality's Special Additional Tax (as defined below), as projected by GDB, will be sufficient to service to maturity the Municipality's outstanding general obligation debt and the additional proposed general obligation debt ("Payment Capacity").

The Municipality is required under applicable law to levy the Special Additional Tax in such amounts as shall be required for the payment of its general obligation municipal bonds and notes. In addition, principal of and interest on all general obligation municipal bonds and notes and on all municipal notes issued in anticipation of the issuance of general obligation bonds issued by the Municipality constitute a first lien on the Municipality's Basic Tax revenues. Accordingly, the Municipality's Basic Tax revenues would be available to make debt service payments on general obligation,

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUAYAMA

MANAGEMENT'S DISCUSSION AND ANALYSIS - (CONTINUED)

YEAR ENDED JUNE 30, 2006

CAPITAL ASSETS AND DEBT ADMINISTRATION- (CONTINUED)

municipal bonds and notes to the extent that the Special Additional Tax levied by the Municipality, together with moneys on deposit in the Municipality's Redemption Fund, are not sufficient to cover such debt service. It has never been necessary to apply Basic Taxes to pay debt service on general obligation debt of the Municipality.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

The Municipality relies primarily on property and municipal taxes as well as federal grants to carry out the governmental activities. Historically, property and municipal taxes have been very predictable with increases of approximately five percent. Federal grant revenues may vary if new grants are available but the revenue also is very predictable.

Those factors were considered when preparing the Municipality's budget for the 2006-2007 fiscal year.

FINANCIAL CONTACT

The Municipality's financial statements are designed to present users (citizens, taxpayer, customers, investors and creditors) with a general overview of the Municipality's finances and to demonstrate the Municipality's accountability. If you have questions about the report or need additional financial information, contact the Municipality's Chief Financial Officer.

Commonwealth of Puerto Rico
Municipality of Guayama
Statement of Net Assets
June 30, 2006

	Governmental Activities
Assets	
Cash and cash equivalents	\$ 16,239,192
Cash with fiscal agent	11,645,021
Accounts receivable:	
Intergovernmental	2,148,306
Federal grants	413,470
Other	121,523
Capital assets	
Land, improvements, and construction in progress	27,088,663
Other capital assets, net of depreciation	26,565,841
Total capital assets	<u>53,654,504</u>
Total assets	<u>84,222,016</u>
Liabilities	
Accounts payable and accrued liabilities	1,508,568
Due to other governmental entities	2,433,059
Deferred revenues:	
Municipal license tax	5,991,653
Federal grant revenues	752,680
Noncurrent liabilities:	
Due within one year	37,157,610
Due in more than one year	<u>2,393,495</u>
Total liabilities	<u>50,237,065</u>
Net Assets	
Invested in capital assets, net of related debt	27,930,399
Restricted for:	
Capital projects	8,734,459
Debt service	4,464,356
Federal and state grant funds	2,834,854
Unrestricted (deficit)	<u>(9,979,117)</u>
Total net assets	<u>\$ 33,984,951</u>

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

Commonwealth of Puerto Rico
Municipality of Guayama
Statement of Activities
For the Year Ended June 30, 2006

Functions/Programs	Expenses	Program Revenues			Net (Expense) Revenue and Changes in Net Assets
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Governmental Activities
General government	\$ 2,082,791	\$ 114,695	\$ 228,514	\$ -	\$ (1,739,582)
Public safety	1,614,950	23,725	111,831		(1,479,394)
Public works	10,247,681	49,354		1,031,077	(9,167,250)
Health and welfare	16,651,454		12,757,969		(3,893,485)
Culture and recreation	697,179				(697,179)
Community development	802,211		1,276,932	1,588,439	2,063,160
Urban development	32,712		53,525		20,813
Education	4,082		4,162		80
Interest on long-term debt	1,032,618				(1,032,618)
Total governmental activities	\$ 33,165,678	\$ 187,774	\$ 14,432,933	\$ 2,619,516	(15,925,455)
General revenues:					
Property taxes					8,767,895
Municipal license tax					8,000,287
Grants and contributions not restricted to specific programs					1,969,288
Interest and investment earnings					603,031
Miscellaneous					709,574
Total general revenues					20,050,075
Change in net assets					4,124,620
Net assets - beginning as restated					29,860,331
Net assets - ending					\$ 33,984,951

Commonwealth of Puerto Rico
Municipality of Guayama
Balance Sheet
Governmental Funds
June 30, 2006

	General Fund	Special Revenue Fund State & Federal Grants	Capital Projects Fund State & Federal Grants	Debt Service Fund	Total Governmental Funds
Assets					
Cash and cash equivalents	\$ 10,229,192	\$ 3,776,716	\$ 2,233,284	\$ -	\$ 16,239,192
Cash with fiscal agent		566,440	6,710,451	4,368,130	11,645,021
Accounts receivable:					
Municipal license tax	121,523				121,523
Intergovernmental			72,672	96,226	168,898
Federal grants		153,852	259,618		413,470
Due from other funds	1,465,313	624,029			2,089,342
Total assets	\$ 11,816,028	\$ 5,121,037	\$ 9,276,025	\$ 4,464,356	\$ 30,677,446
Liabilities and Fund Balances					
Liabilities :					
Accounts payable and accrued liabilities	\$ 923,812	\$ 381,749	\$ 203,007	\$ -	\$ 1,508,568
Due to other governmental entities	453,651				453,651
Due to other funds	608,029	1,462,313	19,000		2,089,342
Deferred revenues:					
Municipal license tax	5,991,653				5,991,653
Federal grant revenues		433,121	319,559		752,680
Total liabilities	7,977,145	2,277,183	541,566	-	10,795,894
Fund balances:					
Reserved for:					
Encumbrances	1,074,516				1,074,516
Capital projects			8,734,459		8,734,459
Other purposes		2,843,854			2,843,854
Debt service fund				4,464,356	4,464,356
Unreserved:					
Undesigned	2,764,367				2,764,367
Total fund balances	3,838,883	2,843,854	8,734,459	4,464,356	19,881,552
Total liabilities and fund balances	\$ 11,816,028	\$ 5,121,037	\$ 9,276,025	\$ 4,464,356	

Amounts reported for governmental activities in the statement of net assets are different because:

Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds	53,654,504
Long-term liabilities are not due and payable in the current period, and therefore, are not reported in the funds	(39,551,105)
Net assets of governmental activities	\$ 33,984,951

Commonwealth of Puerto Rico
Municipality of Guayama
Statement of Revenues, Expenditures and Changes in Fund Balances
Governmental Funds
For the Year Ended June 30, 2006

	General Fund	Special Revenue Fund State & Federal Grants	Capital Projects Fund State & Federal Grants	Debt Service Fund	Total Governmental Funds
Revenues					
Property taxes	\$ 6,544,569	\$ -	\$ -	\$ 2,223,326	\$ 8,767,895
Municipal license taxes	8,000,287				8,000,287
Licenses, permits and other local taxes	630,004				630,004
Intergovernmental	1,567,797	321,650	1,028,067		2,917,514
Charges for services	49,353				49,353
Rent of property	114,695				114,695
Fines and forfeitures	23,725				23,725
Interest	603,031				603,031
Federal grants		13,882,769	1,588,439		15,471,208
Miscellaneous	143,390	566,184			709,574
Total revenues	17,676,851.00	14,770,603.00	2,616,506.00	2,223,326.00	37,287,286.00
Expenditures					
Current:					
General government	6,845,368	840,537			7,685,906
Public safety	1,682,888	37,448			1,720,336
Public works	3,854,748	168,515	8,668,400		12,691,663
Health and welfare	4,282,432	12,762,760			17,045,192
Culture and recreation	1,123,782	200,577			1,324,359
Community development		1,276,987			1,276,987
Urban development		34,770			34,770
Education		4,161			4,161
Debt service:					
Principal				1,509,184	1,509,184
Interest				1,032,618	1,032,618
Total expenditures	17,789,218	15,325,755	8,668,400	2,541,802	44,325,176
Excess (deficiency) of revenues over (under) expenditures	(112,367)	(555,152)	(6,051,894)	(318,476)	(7,037,890)
Other financing sources (uses)					
Transfers in		833,931		35,782	869,713
Transfers out	(869,713)				(869,713)
Total other financing sources (uses)	(869,713)	833,931	-	35,782	-
Net change in fund balances	(982,080)	278,779	(6,051,894)	(282,694)	(7,037,890)
Fund balance, beginning as restated	4,820,963	2,565,075	14,786,353	4,747,050	26,919,441
Fund balance, ending	\$ 3,838,883	\$ 2,843,854	\$ 8,734,459	\$ 4,464,356	\$ 19,881,551

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

Commonwealth of Puerto Rico
Municipality of Guayama
Reconciliation of the Statement of Revenues,
Expenditures, and Changes in Fund Balances of
Governmental Funds to the Statement of Activities
For the Year Ended June 30, 2006

Net Change In Fund Balances - Total Governmental Funds

Amounts reported for governmental activities in the Statement of Activities are different because:	\$ (7,037,890)
Governmental Funds report capital outlays as expenditures. However, in the Government-Wide Statement of Activities and Changes in Net Assets, the cost of those assets is allocated over their estimated useful lives as depreciation expense. This is the amount of capital assets recorded in the current period.	14,037,537
Capital assets received as a donation are not recorded in the Governmental Funds, because current financial resources are not involved; however, the transaction must be reflected in the Government-Wide Financial Statements based on the fair value of the donated property. This is the amount of donated capital assets recorded in the current period.	3,010
Depreciation expense on capital assets is reported in the Government-Wide Statements of Activities and Change in Net Assets, but they do not require the use of current financial resources. Therefore, depreciation expense is not reported as expenditures in Governmental Funds.	(868,518)
Disposal of capital assets require removal of cost of the capital assets from the capital asset account on the Government-Wide Statement of Net Assets, resulting in a loss on disposal of capital assets on the Government-Wide Statement of Activities and Change in Net Assets.	(4,088,922)
Some revenues reported in the Statement of Activities do not provide current financial resources in Governmental Funds.	2,003,289
Some expenses reported in the Statement of Activities do not require the use of current financial resources and, therefore, are not reported as expenditures in Governmental Funds.	(1,111,886)
Bonds and notes proceeds provide current financial resources to Governmental Funds. Repayment of bonds and notes principal is an expenditure in Governmental Funds, but the repayment reduces long -term liabilities in the Government-Wide Statement of Net Assets. This is the amount by which the debt proceeds exceed debt service principal payments.	1,188,000
Change in Net Assets of Governmental Activities	<u>\$ 4,124,620</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUAYAMA

NOTES TO BASIC FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2006

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The **Municipality of Guayama** (the Municipality) was founded on the year 1736. The Municipality's governmental system consists of an executive and legislature body. It is governed by a Mayor and a sixteen-member Municipal Legislature who are elected for a four-year term.

The Municipality provides public safety, public works, culture and recreation, health and welfare, urban development, education, economic development, and other miscellaneous services.

The accounting policies and financial reporting practices of the Municipality conform to accounting principles generally accepted in the United States of America ("GAAP") as applicable to governmental units.

In June 1999, the Governmental Accounting Standards Board (GASB) issued Statement No. 34, "Basic Financial Statements and Management's and Discussion and Analysis for State and Local Governments." This Statement, known as the Reporting Model, provides for the most significant change in financial reporting for state and local governments in over 20 years and affects the way the Municipality prepares and presents financial information. The Statement was adopted as of July 1, 2002. In addition to this Statement, GASB Statement No. 37, "Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments: Omnibus" and GASB Statement No. 38, "Certain Financial Statement Note Disclosures" have been adopted and are reflected in these financial statements.

As part of this Statement, there is a new reporting requirement regarding the capitalization of local government infrastructure (roads, bridges, traffic signals, etc.). This requirement permits an optional four-year delay for implementation to fiscal year 2007. The Municipality has elected to delay the capitalization of infrastructure.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUAYAMA**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The following is a summary of the significant accounting policies of the Municipality:

A. Component Units

In evaluating how to define the Municipality for financial reporting purposes, management has considered all potential component units. The decision to include a potential component unit in the reporting entity was made by applying the provisions of Statement No. 14, The Financial Reporting Entity, of the GASB as amended by the GASB Statement No. 39, "Determining Whether Certain Organizations Are Component Units an amendment of GASB Statement 14". The basic, but not the only criterion for including a potential component unit within the reporting entity is if elected officials of a primary government are financially accountable for the entity. Financial accountability exists if the primary governmental appoints a voting majority of the entity's governing body, and if either one of the following conditions exist: the primary government can impose its will on the other entity or the potential exists for the other entity to (1) provide specific financial benefits to or (2) impose specific financial burdens on the primary government. A second criterion used in evaluating potential component units is if the nature and significance of the relationship between the entity and a primary government are such that to exclude the entity from the financial reporting entity would render the financial statements misleading or incomplete. GAAP details two methods of presentation: blending the financial data of the component unit's balances and transactions in a manner similar to the presentation of the Municipality's balances and transactions or discrete presentation of the component unit's financial data in columns separate from the Municipality's balances and transactions.

B. Government-wide and fund financial statements

Financial information of the Municipality is presented in this report as follow:

1. Management's discussion and analysis introduces the basic financial statements and provides an analytical overview of the Municipality's financial activities.
2. The government-wide financial statements (i.e. the statement of net assets and the statement of activities) report information on all the activities of the Municipality and its component unit. Governmental activities, which normally are supported by taxes and intergovernmental revenues, are reported separately from business-type activities, if any, which rely to a significant extent on fees and charges for support. Interfund activity has been removed from these statements to minimize the duplicating effect on assets and liabilities within the governmental activities.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUAYAMA

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

B. Government-wide and fund financial statements

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment is offset by program revenue. Direct expenses are those that are charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items not properly included among program revenues are reported instead as general revenues.

3. Fund financial statements focus on information about the Municipality's major governmental funds. Major individual governmental funds are reported as separate columns in the fund financial statements. The Municipality reports the following major governmental funds:

General Fund - is the accounting entity in which all governmental activity, except that which is required to be accounted for in another fund, is accounted for. Its revenues consist mainly of taxes, licenses and permits, intergovernmental revenue, charges for services and other.

Special Revenue Fund- State and Federal Grants - is the accounting entity in which revenues derived from federal and state grants, is accounted for. The uses and limitations of each special revenue fund are specified by Municipality ordinances or federal and state statutes.

Capital Projects Fund -Local, State and Federal Grants - is the accounting entity in which revenues derived from local funds, state and federal grants or other restricted revenue sources related to capital projects, is accounted for. The uses and limitations of each capital project fund are specified by Municipality ordinances or federal and state statutes.

Debt Service Funds- Debt Service Funds are used to account for the accumulation of resources for and the payment of, general long-term debt principal, interest, and related costs.

4. The notes to the financial statements provide information that is essential to a user's understanding of the basic financial statements.
5. Required supplementary information such as the budgetary comparison schedule-general fund and other types of data required by GASB.
6. Notes to the budgetary comparison schedule-general fund.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUAYAMA

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

C. Financial reporting presentation

The accounts of the Municipality are organized on the basis of funds, each of which is considered a separate accounting entity. The operations of each fund are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues, and expenditures. Fund types are as follows:

General Fund- General Fund is the general operating fund of the Municipality. It is used to account for all governmental activity, except those required to be accounted for in another fund.

Special Revenue Funds- Special Revenue Funds are used to account for revenues derived from grants or other restricted revenue sources. The uses and limitations of each special revenue fund are specified by Municipality ordinances or federal and state statutes.

Debt Service Funds- Debt Service Funds are used to account for the accumulation of resources for and the payment of, general long-term debt principal, interest, and related costs.

Capital Projects Funds- Capital Project Funds are used to account for financial resources used for the acquisition or construction of major capital facilities.

D. Measurement focus, basis of accounting and financial presentation

Except for budgetary purposes, the basis of accounting used by the Municipality conform to accounting principles generally accepted in the United States of America ("GAAP") as applicable to governmental units. The accounting and financial reporting treatment applied to a fund is determined by its measurement focus.

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenues in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

The Municipality has elected not to apply all Statements and Interpretations issued by the Financial Accounting Standard Board after November 30, 1989, in accordance with GASB Statement No.20.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUAYAMA

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

D. Measurement focus, basis of accounting and financial presentation

Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the government considers revenues to be available if they are collected within the current period or soon enough thereafter. Expenditures are recorded when the related fund liability is incurred, except for principal and interest on general long-term debt, claims and judgments, and compensated absences, which are recognized as expenditures when payment is due. General capital asset acquisitions are reported as expenditure in governmental funds. Proceeds from issuance of general long-term debt reported as other financing sources.

Property taxes, franchise taxes, licenses, and interest associated with the current fiscal period are all considered to be susceptible to accrual and so have been recognized as revenues of the current fiscal period. All other revenue items are considered to be measurable and available only when the government receives cash.

Private-sector standards of accounting and financial reporting issue 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. Governments also have the option of following subsequent private-sector guidance for their business-type activities and enterprise funds, subject to this same limitation. The Municipality has elected not to follow subsequent private-sector guidance.

Amounts reported as program revenues include 1) charges to customers or applicants for goods, services, or privileges provided, 2) operating grants, and contributions, and 3) capital grants and contributions, including special assessments, if any. Internally dedicated resources are reported as general revenues rather than as program revenues. Likewise, general revenues include all taxes.

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

The preparation of the financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUAYAMA

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

E. Assets, liabilities and net assets

1. **Cash, cash equivalents, and cash with fiscal agent-** The Municipality's cash and cash equivalents are considered to be cash on hand, demand deposits, and short-term investments with original maturities of three months or less from the date of acquisition.

Cash with fiscal agent in the debt services fund represents special additional property tax collections retained by the Commonwealth of Puerto Rico and restricted for the payment of the Municipality's debt service, as established by law.

2. **Receivables and payables-** Activity between funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as either "due to/from other funds" (i.e., the current portion of interfund loans) or "advances to/from other funds" (i.e., the non-current portion of interfund loans). All other outstanding balances between funds are reported as "due to/from other funds."

Advances between funds, as reported in the fund financial statements, if any, 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.

Receivables are stated net of estimated allowances for uncollectible accounts, which are determined, based upon past collection experience and current economic conditions. Intergovernmental receivables in the general fund represent mostly contributions from the Puerto Rico Electric Power Authority, which contribute a specific percentage of their revenues as payment in lieu of taxes. Intergovernmental receivable in the special revenue fund represent amounts owed to the Municipality for reimbursement of expenditures incurred pursuant to federally funded programs and the amount in the debt service fund represent the distribution of property tax collected by the Municipal Revenue Collection Center (CRIM), which is restricted for the debt service.

3. **Inventories-** Inventories in the general fund is recorded as expenditure and, consequently, the inventory is not recorded in the statement of net assets.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUAYAMA

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

E. Assets, liabilities and net assets

4. **Capital assets-** Capital assets, which include property, equipment and infrastructure assets (e.g., roads, bridges, sidewalks and similar items), are reported in the governmental activities column in the governmental-wide financial statements. The Municipality defines capital asset as assets with an initial, individual cost of more than \$25 and an estimated useful life in excess of one year. Such assets are reported at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation.

The cost of normal maintenance and repairs that do not add to the value of the asset or materially extend assets lives are not capitalized.

Major outlays for capital assets and improvements are capitalized as projects are constructed.

Capital assets of the Municipality, as well as the component unit, are depreciated using the straight-line method over the following estimated useful lives:

Description	Useful Life	Capitalization threshold
Buildings and site improvements	40 years	\$ 1
Infrastructure	40 years	\$ 1
Works of art	10 years	\$ 1
Vehicles	5 years	\$ 1
Furniture and fixtures	5 years	\$ 25
Machinery and equipment	3 to 5 years	\$ 25

5. **Long-term obligations-** The liabilities reported in the government-wide financial statements included general and special obligation bonds, bank and long-term notes, other long-term liabilities, such as vacation, sick leave, litigation, long-term liabilities to other governmental entities and landfill closure and post closure care costs.

In the fund financial statements, governmental fund types recognize bond issuances cost, during the current period. The face amount of debt issued is reported as other financing sources, while bond issuance costs, whether or not withheld from the actual debt proceeds received, are reported as expenditures in the general fund.

6. **Compensated absences-** Employees accumulate vacation leave at a rate of 2.5 days per month up to a maximum of 60 days. Unpaid vacation time accumulated is fully vested to the employees from the first day of work. All vacation pay is accrued when incurred in the government-wide financial statements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUAYAMA

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

E. Assets, liabilities and net assets

Employees accumulate sick leave at a rate of 1.5 days per month up to a maximum of 90 days. Upon retirement, an employee receives compensation for all accumulated and unpaid sick leave at the current rate, if the employee has at least 10 years of service with the Municipality.

7. **Claims and judgments-** The estimated amount of the liability for claims and judgments, which is due on demand, such as from adjudicated or settled claims, is recorded in the general fund.
8. **Reservation of fund balance-** Reservations of fund balance in the fund financial statements, represent portions of fund balances that are legally segregated for specific future use or are not appropriated for expenditure. The Municipality has the following reservations of fund balance:
 - a. **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.
 - b. **Encumbrances-** Represent future expenditures under purchase orders, contracts and other commitments. These committed amounts generally will become liabilities in future periods as the goods or services are received.
 - c. **Debt Service Fund-** Represents net assets available to finance future debt service payments.
 - d. **Other Purposes-** Represents net assets available for specific use and/or legally segregated for other specific future use.
9. **Interfund and intra-entity transactions-** The Municipality has the following types of transactions among funds:
 - a. **Operating Transfers-** Legally required transfers that are reported when incurred as "Operating transfer-in" by the recipient fund and as "Operating transfers-out" by the disbursing fund.
 - b. **Intra-Entity Transactions-** Transfers between the funds of the primary government are reported as interfund transfers with receivables and payables presented as amounts due to and due from other funds.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUAYAMA**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

E. Assets, liabilities and net assets

10. Risk financing- The Municipality carries commercial insurance to cover casualty, theft, tort claims and other losses. Insurance policies are negotiated by the Puerto Rico Treasury Department and costs are allocated among all the Municipalities of Puerto Rico. Cost of insurance allocated to the Municipality and deducted from the gross property tax collections by the CRIM for the year ended June 30, 2006 amounted to approximately \$ 193,000. The current insurance policies have not been cancelled or terminated. The CRIM also deducted approximately \$561,000 for workers compensation insurance covering all municipal employees.

11. Reconciliation of Government-Wide and Fund Financial Statements- The governmental fund balance sheet includes reconciliation between fund balance-total governmental funds and net assets-governmental activities as reported in the government-wide statement of net assets. The two elements of that reconciliation explains that "long term liabilities, including compensated absences, bonds and notes payable, are not due and payable in the current period and therefore are not reported in the funds.", and that 'capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds. The detail of this reconciliation is as follows:

		<u>Total Net Assets - Governmental Activities</u>
<u>Net assets invested in capital assets, net of related debt</u>		
Capital assets, net of depreciation	\$ 53,654,504	
Deduct:		
Bonds and Notes Payable	<u>(25,724,105)</u>	\$ 27,930,399
<u>Net assets restricted for capital projects</u>		
Fund balance restricted for capital projects		8,734,459
<u>Net assets restricted for debt service</u>		
Fund balance restricted for debt service		4,464,356
<u>Net assets restricted for other purposes</u>		
Fund balance restricted for other purposes		2,843,854
<u>Net assets unrestricted (deficit)</u>		
General fund - total fund balance:	\$ 3,838,883	
Deduct:		
Compensated absences	(2,762,575)	
Landfill obligation	(7,341,321)	
Advances from CRIM	(2,079,526)	
Claims and judgments	(155,120)	
Due to other governmental entities	<u>(1,488,458)</u>	<u>(9,988,117)</u>
Total net assets - governmental activities		<u>\$ 33,984,951</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUAYAMA

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

2. DEPOSITS

Under Puerto Rico statutes public funds deposited in commercial banks must be fully collateralized for the amount deposited in excess of federal depository insurance. All securities pledged as collateral are held by the Secretary of the Treasury of Puerto Rico. In addition, the Municipality maintains deposits with the Government Development Bank for Puerto Rico (GDB).

The Municipality's bank balances in commercial banks of approximately \$10,200,000 in the general fund were fully collateralized at June 30, 2006. In the other major governmental funds there were deposits with commercial banks of approximately \$8,800,000 that were fully collateralized.

The deposits at GDB of approximately \$6,700,000 those are restricted principally for capital projects, and the \$4,368,000 in the debt service fund are unsecured and uncollateralized, as no collateral is required to be carried by governmental banks.

3. RECEIVABLES

a. **Municipal License Tax-** The Municipality imposes a municipal license tax on all businesses that operate within the Municipality, which are not totally or partially exempt from the tax pursuant to the Industrial Incentives Acts of the Commonwealth of Puerto Rico. This is a self-assessed tax based on the business volume in gross sales as shown in the tax return that is due on April 15 of each year. Entities with sales volume of \$1,000,000 or more must include audited financial statements together with the tax return. During the fiscal year ended June 30, 2006, the tax rates were as follows:

1. Financial business- 1.50% of gross revenues
2. Other organizations within municipal area - 0.30% of gross revenues
3. Other organizations 0.50% of gross revenues

This tax is due in two equal installments on July 1 and January 1 of each fiscal year. A discount of 5% is allowed when full payment is made on or before April 15. Municipal license tax receivable represents filed municipal license tax returns that were uncollected as of June 30, 2006, net of allowance for uncollectibles. Municipal license taxes collected prior to June 30 but pertaining to the next fiscal year are recorded as deferred revenues.

b. **Intergovernmental Receivables-** Intergovernmental receivables in the Capital Projects Fund consist of amounts due from the Governmental Development Bank of Puerto Rico.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUAYAMA**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

3. RECEIVABLES (CONTINUED)

c. **Federal Grants-** Federal Grants receivable in the Special Revenue and Capital Projects Funds mainly consist in expenditures incurred not yet reimbursed by the CDBG and FEMA Programs.

4. INTERFUND TRANSACTIONS

a. **Due from/to other fund:**

Interfund receivables and payables at June 30, 2006 are summarized as follows:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
General	Special Revenue Fund	\$ 1,446,313
	Capital Projects Fund	19,000
Special Revenue	Special Revenue Fund (02)	16,000
	General Fund	608,029
Total		<u>\$ 2,089,342</u>

b. **Transfer in/out to other fund**

Following is a summary of interfund transfers for the year:

<u>Transfer out</u>	<u>Transfer in</u>	<u>Purpose</u>	<u>Amount</u>
General Fund	Debt Service Fund	Debt Retirement	\$ 35,782
Total			<u>\$ 35,782</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUAYAMA**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

5. CAPITAL ASSETS

Capital assets; those with an estimated useful live of one year or more from the time of acquisition by the Municipality and a cost of \$25 or more, are primarily funded through the issuance of long-term bonds and loans. A summary of capital assets and changes occurring in 2006, including those changes pursuant to the implementation of GASB Statement No. 34, follows. Land and construction in progress are not subject to depreciation:

Governmental Activities:	Balance July 1, 2005	Additions	Retirements	Balance June 30, 2006
Capital asset, not being depreciated:				
Construction in Progress	\$14,421,182	\$7,432,516	(\$ 4,088,922)	\$17,764,776
Land	8,937,886	386,000		9,323,886
Total capital assets not being depreciated	23,359,068	7,818,516	(4,088,922)	27,088,662
Capital assets, being depreciated:				
Buildings and building improvements	17,825,417	4,942,817		22,768,234
Infrastructure and infrastructure improvements	3,959,059	1,120,952		5,080,011
Equipment	809,261	55,403		864,664
Computers	155,858	27,008		182,866
Works of art	4,500	2,900		7,400
Furnishing	811,785	14,547		826,332
Vehicles	1,255,594	58,404		1,313,998
Total capital assets being depreciated	\$24,821,474	\$6,222,031		\$31,043,505

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUAYAMA**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

Less accumulated depreciation for:

Buildings and building improvements	(\$1,238,510)	(\$520,566)	(\$1,759,076)
Infrastructure and infrastructure improvements	(111,494)	(117,570)	(229,064)
Equipment	(657,456)	(60,316)	(717,772)
Computers	(137,631)	(14,266)	(151,897)
Works of art	(150)	(612)	(762)
Furnishing	(777,868)	(16,009)	(793,877)
Vehicles	(686,036)	(139,179)	(825,215)
Total accumulated depreciation	<u>(3,609,145)</u>	<u>(868,518)</u>	<u>(4,477,663)</u>
Total capital assets being depreciated, net	<u>21,212,329</u>	<u>5,353,513</u>	<u>26,565,842</u>
Governmental activities capital assets, net	<u>\$44,571,397</u>	<u>\$13,172,029</u>	<u>(\$4,088,922)</u> <u>\$ 53,654,504</u>

Depreciation expense was charged to functions/programs of the Municipality as follows:

Governmental activities:

General government	\$590,893
Public safety	12,984
Health and Welfare	4,327
Public works	46,212
Culture and recreation	60,477
Urban Development	11,835
Community development	141,368
Education	<u>422</u>
Total depreciation expense-governmental activities	<u>\$868,518</u>

6. PROPERTY TAXES

The personal property tax is self assessed by the taxpayer on a return which is to be filed by May 15 of each year with the CRIM, a governmental entity created by the government of Puerto Rico as part of the Municipal Governmental Autonomous Law of August 1991. Real property tax is assessed by the CRIM on each piece of real estate and on each building.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUAYAMA**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

6. PROPERTY TAXES (CONTINUED)

The assessment is made as of January 1 of each year and is based on current values for personal property and on estimated values as of 1957 for real property tax. The tax on personal property must be paid in full together with the return by May 15. The tax on real property may be paid in two installments by July 1 and January 1. The CRIM is responsible for the billing and collections of real and personal property taxes on behalf of all the municipalities of Puerto Rico. Prior to the beginning of each fiscal year, the CRIM informs the Municipality of the estimated amount of property tax expected to be collect for the ensuing fiscal year. Throughout the year, the CRIM advances funds to the Municipality based on the initial estimated collections. 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. This settlement has to be completed on a preliminary basis not later than three months after fiscal year-end, and a final settlement made not later than six months after year-end. If the CRIM remits to the Municipality property tax advances, which are less than the tax actually collected, a receivable from the CRIM is recorded at June 30.

Residential real property occupied by its owner is exempt by law from the payment of property taxes on the first \$15,000 of the assessed value. For such exempted amounts, the Puerto Rico Treasury Department assumes payment of the basic tax to the Municipalities, except for property assessed at less than \$ 3,500 for which no payment is made. As part of the Municipal Autonomous Law of 1991, the exempt amount to be paid by the Puerto Rico Treasury department to the Municipalities was frozen as of January 1, 1992. In addition, the law grants a tax exemption from the payment of personal property taxes of up to \$50,000 of the assessed value to retailers having annual net sales of less than \$150,000.

On January 26, 2000, Public Law 42 was enacted which authorized the CRIM to obtain a loan up to \$200,000,000, and for a term not to exceeding 10 years, to allow for the financing of the debt that the Municipalities of Puerto Rico have with the CRIM arising from final settlements of property tax advances versus actual collections through fiscal year ended June 30, 2000. The amounts that the Municipalities will collect from additional property taxes resulting from increases in the subsidy from the Commonwealth of Puerto Rico to the Municipalities are assigned through this law to repay such loan. The increase in this subsidy was the result of the Public Law 238, enacted on August 15, 1999. On October 11, 2001, Public Law 146 was enacted to amend Public Law 42, to extend the loan amortization period up to 30 years.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUAYAMA**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

6. PROPERTY TAXES (CONTINUED)

Also, on October 11, 2002, Public Law 172 was enacted, to provide as an option for the Municipalities to include the debt that the Municipalities of Puerto Rico have with the CRIM arising from final settlements of property tax advances versus actual collections for the fiscal year ended June 30, 2001 with the loan authorized through Public Law 42 enacted on January 26, 2000.

On June 26, 1997, Public Law 21 was enacted which authorized the CRIM to sell property tax receivables related to taxpayers who owned property taxes from 1974 to 1996. The property tax receivables were purchased by Public Financing Corporation, a subsidiary of the Government Development Bank (GDB), with proceeds of a bonds issuance. This Law imposes to the CRIM the obligation to replace any uncollectible property tax receivable with any valid property tax receivables or equivalent in money.

A high percentage of receivables were determined to be uncollectible receivables, and therefore, on October 11, 2001, Public Law 146 was enacted which authorized the CRIM to obtain a loan to pay in advance the bonds issued by the Public Financing Corporation (a GDB subsidiary), and any costs related to the transaction. Also, a term not to exceeding 30 years was authorized to the financing of the debt that the Municipalities of Puerto Rico have with the CRIM arising from the sale of property tax receivables to the Public Financing Corporation (a GDB Subsidiary).

The annual tax rate is 8.33% for real property and 6.33% for personal property of which 1.03% of both tax rates are for the redemption of public debt issued by the Commonwealth of Puerto Rico. The remaining percentage is distributed as follows: (a) 5.8% and 3.8%, respectively, represents the Municipality's basic property tax rate which is appropriated for basics and accounted for in the general fund. A portion of such amount is deposited in an equalization fund together with a percentage of the net revenues of the Puerto Rico electronic lottery and a subsidy from the Commonwealth of Puerto Rico. From such fund, a distribution is made to all municipalities; (b) 1.50% represents the ad valorem tax restricted for debt service and accounted for in the debt service fund. The Commonwealth also contributes an annual tax rate of 0.2% of the property tax collected and such amount is accounted for similar to item (a) above.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUAYAMA

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

7. DUE TO OTHER GOVERNMENTAL ENTITIES

The amounts due to other governmental entities in the General Fund include the following:

General Services Administration	\$ 50
Puerto Rico Aqueduct and Sewer Authority	19,542
Puerto Rico Telephone	19,728
Retirement System Administration	110,675
Commonwealth of Puerto Rico Employees Association	43,697
Department of Labor and Human Resources	<u>259,959</u>
Total	<u>\$453,651</u>

The Municipality reached agreements with the Department of Labor and the Municipal Revenue Collection Center for the payment of debts on a long-term basis. These liabilities are presented in the Statement of Net Assets as non-current liabilities.

8. DEFERRED REVENUES

- a. **Municipal License Tax-** The deferred revenues of approximately \$6,000,000 in the general fund relates to municipal license tax collected in fiscal year 2005-06 that will be earned in fiscal year 2006-07.
- b. **Federal Government-** The deferred revenues presented in major governmental funds represents the portion of federal grants received for which qualifying expenditures have not been incurred. Deferred revenues from the federal government are as follows:

<u>Program Description</u>	<u>Amount</u>
Section 8 Housing Choice Vouchers	\$216,920
FEMA	461,022
Other Programs	<u>74,738</u>
Total	<u>\$752,680</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUAYAMA**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

9. LONG-TERM LIABILITIES

Long-term liability activity for the year ended June 30, 2006, was as follows:

	Beginning Balance	Borrowings or Additions	Payments or Deductions	Ending Balance	Due Within One Year
Bonds Payable	\$26,642,105	\$	(\$1,143,000)	\$25,499,105	\$1,248,000
Note Payable	270,000		(45,000)	225,000	50,000
Property Tax Debt-Law 42	108,114	23,631	(1,934)	129,811	2,056
Property Tax Debt-Law 146	1,173,826	41,224		1,215,050	
Property Tax Advances	174,207	734,665	(174,207)	734,665	480,225
Department of Labor	394,665		(259,063)	135,602	
Treasury Department	1,691,070		(338,214)	1,352,856	338,214
Compensated Absences	2,605,329	157,246		2,762,575	275,000
Landfill Obligation	8,571,191		(1,229,870)	7,341,321	
Claims and Judgments		155,120		155,120	
Total	\$41,630,507	\$1,111,976	(\$3,191,288)	\$39,551,105	\$2,393,495

- a. **Legal debt margin-** The Municipality is subject to a legal debt margin requirement, which is equal to 10% of the total assessment if property located within the Municipality plus 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 are issued, the revenues if the debt service fund should be sufficient to cover the projected debt service requirement. Long-term debt, except for the bonds payable, is paid with unrestricted funds.
- b. **Bonds payable-** The Municipality issues general and special obligation bonds to provide funds for the construction of major capital facilities. Bonds payable outstanding at June 30, 2006 are as follows:

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUAYAMA**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

9. LONG-TERM LIABILITIES (CONTINUED)

Type of bonds	Maturity date	Original amount	Range of Interest rates	Balance at June 30, 2006
1995 Series	7-1-10	4,765,000	6.11% to 7.71%	\$ 1,840,000
1996 Series	7-1-21	5,105,000	4.70% to 6.63%	4,160,000
1996 Series	1-1-20	27,000	4.50%	18,000
1996 Series	1-1-20	550,000	4.50%	446,105
1997 Series	7-1-17	400,000	3.28% to 5.00%	285,000
1998 Series	7-1-13	825,000	2.70% to 4.50%	525,000
2000 Series	7-1-25	4,590,000	2.70% to 5.60%	4,100,000
2000 Series	7-1-18	3,840,000	2.70% to 5.01%	3,055,000
2003 Series	7-1-28	705,000	5.00% to 6.00%	665,000
2003 Series	7-1-28	2,450,000	5.00% to 6.00%	2,320,000
2004 Series	7-1-24	1,810,000	2.36% to 6.00%	1,715,000
2005 Series	7-1-20	1,810,000	3.28% to 5.00%	1,725,000
2005 Series	7-1-29	4,645,000	4.37% to 5.00%	4,645,000
Total general obligation bonds				<u>\$25,499,105</u>

These bonds are payable from the ad valorem property tax of 1.50% which is restricted for debt service and retained by the Government Development Bank for Puerto Rico for such purposes.

Annual debt service requirements to maturity for note payable is as follow:

Year Ending June 30,	Principal	Interest
2007	\$ 1,254,000	\$ 1,300,430
2008	1,335,000	1,231,327
2009	1,421,000	1,153,169
2010	1,527,000	1,070,671
2011	1,088,000	1,001,695
2012-2016	6,340,000	4,122,300
2017-2021	6,914,105	2,349,566
2022-2026	3,945,000	917,298
2027-2031	1,675,000	150,120
Total	<u>\$25,499,105</u>	<u>\$13,296,576</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUAYAMA**

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

- c. **Note Payable-** The proceeds of the issuance of notes payables were used principally to pay debt incurred in prior years and to cover the expenditures of special event. The note is payable as follow:

Type of note	Maturity date	Original amount	Range of Interest rates	Balance at June 30, 2006
2003 Series	7-1-10	355,000	4.17% to 5.00%	225,000
Total general obligation note				<u>\$225,000</u>

This note are payable from the ad valorem property tax of 1.50% which is restricted for debt service and retained by the Government Development Bank for Puerto Rico for such purposes.

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

Year Ending June 30,	Principal	Interest
2007	\$ 50,000	\$10,596
2008	55,000	6,426
2009	55,000	3,613
2010	65,000	1,423
Total	<u>\$225,000</u>	<u>\$22,058</u>

- d. **Advances from CRIM-** This amount represents the balance owed to CRIM at June 30, 2006 will be repaid mainly through a financing obtained by the CRIM with GDB. During the fiscal years 2004-05 and 2005-06, the advances from CRIM exceeded the actual collections by \$734,665.
- e. **Department of Labor-** These amounts represent the balance owed to the Department of Labor at June 30, 2006 from unemployment benefits paid. The Municipality agreed with the Department of Labor to pay this debt in monthly installments on a long term basis.
- f. **Property Taxes Debts-** These amounts represents the balance owned to the Treasury Department and to the Municipal Revenue Collection Center ("CRIM") at June 30, 2006 as described in Note 6.
- g. **Compensated absences-** The government-wide statement of net assets includes approximately \$2,762,575 of accrued vacation and sick leave benefits, representing the Municipality's commitment to fund such costs from future operations.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUAYAMA

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

9. LONG-TERM LIABILITIES (CONTINUED)

h. Landfill obligation- State and federal laws and regulations require the Municipality to place a final cover on its landfill site, when it stopped accepting waste, and perform certain maintenance and monitoring functions at the site for 30 years after closure. In accordance with Statement No. 18 of the GASB, "Accounting for Municipal Solid Waste Landfill Closure and Post-closure Care Costs", the Municipality has performed a study of the activities that need to be implemented at the Municipality's landfill to guarantee the maximum yield of available space and to comply with applicable state and federal regulations. Based on this study, the Municipality has recognized \$7,341,321 as the Municipality's estimated current cost for landfill closure and post-closure costs as of June 30, 2006. The annual estimate of post closure costs has been assessed approximately to be \$ 70,000 for a period of approximately 30 years. Actual costs may be different due to inflation, changes in technology, or changes in laws and regulations. The balance of closure and post-closure costs are reported in the government-wide statement of net assets.

10. PENSION PLAN

The Employee's Retirement System of the Commonwealth and its Instrumentalities (the Retirement System) is a cost-sharing multiple defined benefit pension plans sponsored by, and reported as a component unit of the Commonwealth of Puerto Rico. All regular employees of the Municipality under 55 years of age at the date of employment become members of the Retirement System as a condition to their employment.

The Retirement System provides retirement, death and disability benefits pursuant to legislation enacted by the Commonwealth's legislature. Disability retirement benefits are available to members for occupational and non-occupational disabilities. Retirement benefits depend upon age at retirement and the number of years of creditable service. Benefits vest after ten years of plan participation.

Members who have attained 55 years of age and have completed at least 25 years of creditable service or members who have attained 58 years of age and have completed ten years of creditable service are entitle to an annual benefit payable monthly for life.

The amount of the annuity shall be one and one-half percent of the average compensation, as defined, multiplied by the number of years of creditable service up to twenty years, plus two percent of the average compensation, as defined, multiplied by the number of years of creditable service in excess of 20 years. In no case will the annuity be less than \$200 per month.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUAYAMA

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

10. PENSION PLAN (CONTINUED)

Participants who have completed at least 30 years of creditable service are entitled to receive the Merit Annuity. Participants who have not attained 55 years of age will receive 65 percent of the average compensation, as defined; otherwise they will receive 75 percent of the average compensation, as defined. No benefits are payable if the participant receives a refund of his/her accumulated contributions.

Commonwealth legislation requires employees to contribute 5.775% for the first \$550 of their monthly gross salary and 8.275% for the excess over \$550 of monthly gross salary. The Municipality is required by the same statute to contribute 9.275% of the participant's gross salary. Total Municipality contributions to the above-mentioned plans during the year ended June 30, 2006 recorded as pension expenditures were approximately \$563,000. This amount represents 100% of the required contribution for the fiscal year ended June 30, 2006

On September 24, 1999, an amendment to Act No. 447 of May 15, 1951, which created the Retirement System, was enacted with the purpose of establishing a new pension program (System 2000). Employee's participation in the current system as of December 31, 1999, may elect to stay in the defined benefit plan or transfer to the new program. Persons joining the Municipality on or after January 1, 2000, will only be allowed to become members of System 2000. System 2000 will reduce the retirement age from 65 years to 60 for those employees who joined the current plan on or after April 1, 1990.

System 2000 is a hybrid defined contribution plan, also known as a cash balance plan. Under this new plan, there will be a pool of pension assets, which will be invested by ERS together with those of the current defined benefit plan. The Commonwealth of Puerto Rico will not guarantee benefits at retirement age. The annuity will be based on a formula which assumes that each year the employee's contribution (with a minimum of 8.275% to the employee's salary up to a maximum of 10%) will be invested in an account which will either: (1) earn a fixed rate based on the two-year Constant Maturity Treasury Note or, (2) earn a rate equal to 75% of the return of the ERS's investment portfolio (net of management fees), or (3) earn a combination of both alternatives. Participants will receive periodic account statements similar to those of defined contribution plans showing their accrued balances. Disability pensions will not be granted under System 2000. The employer's contribution (9.275% of the employee's salary) will be used to fund the current plan. Additional information on the Retirement System is provided in its financial statements for the year ended June 30, 2006, a copy of which can be obtained from the Retirement System, Minillas Station, P.O. Box 42004, San Juan, PR 00940.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUAYAMA

NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

11. COMMITMENTS AND CONTINGENCIES

A. Federal grants:

The Municipality participates in a number of Federal Financial Assistance Programs. Although the Municipality's grant programs have been audited in accordance with the provisions of the Single Audit Act of 1996, through June 30, 2006, these programs are still subject to financial and compliance audits by the granting agencies and the resolution of previously identified questioned costs. The amount, if any, of expenditures which may be disallowed by the granting agencies cannot be determined at this time, although the Municipality expects such amounts, if any, not to be material.

B. Claims and lawsuits:

The Municipality is a defendant in a number of lawsuits arising principally from claims against the Municipality for alleged improper actions, and other legal matters that arise in the ordinary course of the Municipality's activities.

With respect to pending and threatened litigation, the Municipality has reported liabilities of approximately \$ 155,120 for awarded and anticipated unfavorable judgments. This amount was included in the financial statements and represents the amount estimated as probable liability or a liability with a fixed or expected due date, which will require future available financial resources for its payment.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUAYAMA**

BUDGETARY COMPARISON SCHEDULE - GENERAL FUND

YEAR ENDED JUNE 30, 2006

	<u>Budgeted Amounts</u>		<u>Actual Amounts (Budgetary Basis) (See Note 1)</u>	<u>Variance with Final Budget Positive (Negative)</u>
	<u>Original</u>	<u>Final</u>		
Revenues and budget carryover:				
Property taxes	\$6,544,569	\$ 6,544,569	\$ 6,544,569	\$ -
Municipal license tax	8,510,000	8,510,000	8,000,287	(509,713)
Licenses, permits and other local taxes	1,076,500	1,076,500	630,004	(446,496)
Intergovernmental	3,294,821	3,294,821	1,567,797	(1,727,024)
Rent of property	16,980	16,980	114,695	97,715
Fines and forfeitures	1,000	1,000	23,725	22,725
Interest	90,000	90,000	603,031	513,031
Miscellaneous	230,000	230,000	143,390	(86,610)
Charge for Services	98,000	98,000	49,353	(48,647)
Budgeted carryover		<u>2,589,608</u>	<u>2,589,608</u>	<u>-</u>
Total revenues and budget carryover	<u>19,861,870</u>	<u>22,451,478</u>	<u>20,266,459</u>	<u>(2,185,019)</u>
Expenditures and other financing uses:				
Current:				
General government	8,199,530	9,790,967	7,453,991	2,336,976
Public safety	1,717,665	2,022,908	1,681,509	341,399
Public works	4,210,561	4,787,648	3,929,394	858,254
Health and welfare	4,409,519	4,482,958	4,143,299	339,659
Culture and recreation	1,290,342	1,329,683	981,335	348,348
Transfer to other fund	<u>34,250</u>	<u>37,314</u>	<u>35,782</u>	<u>1,532</u>
Total expenditures and other financing uses	<u>19,861,867</u>	<u>22,451,478</u>	<u>18,225,310</u>	<u>4,226,168</u>
Excess of revenues and other financing sources over (under) expenditures and other financing uses			<u>\$ 2,041,149</u>	<u>\$ 2,041,149</u>
Explanation of Differences:				
Sources/inflows of resources:				
Actual amounts (budgetary basis) "available for appropriation" from the budgetary comparison schedule				\$20,266,459
Differences-budget to GAAP:				
Budgeted carryover				(2,589,608)
Total revenues as reported on the statement of revenues, expenditures, and changes in fund balances				<u>\$17,676,851</u>
Uses/outflows of resources:				
Actual amounts (budgetary basis) "total charges to appropriations" from the budgetary comparison schedule				\$ 18,225,310
Differences-budget to GAAP:				
Non budgeted -Transfer to other funds				833,931
Prior year encumbrances recorded as current year expenditures for GAAP basis				410,634
Current year encumbrances recorded as expenditures for budgetary purposes				<u>(810,944)</u>
Total expenditures and other financing uses as reported on the statement of revenues, expenditures, and changes in fund balances				<u>\$ 18,658,931</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUAYAMA

NOTES OF BUDGETARY COMPARISON SCHEDULE - GENERAL FUND

YEAR ENDED JUNE 30, 2006

1. STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY

a. Budgetary Control

The Municipality's annual budget is prepared on the budgetary basis of accounting, which is not in accordance with GAAP, and represents departmental appropriations recommended by the Mayor and approved by the Municipal Legislature prior to the beginning of the fiscal year. Amendments to the budget require the approval of the Municipal Legislature. Transfers of appropriations within the budget, known as Mayor's Resolutions, do not require the approval of the Municipal Legislature.

The Municipality prepares its annual budget including the operations of the general fund.

For budgetary purposes, encumbrance accounting is used. The encumbrances (i.e., purchase orders, contracts) are considered expenditures when incurred. For GAAP reporting purposes, encumbrances outstanding at year-end are reported as reservations of fund balances and do not constitute expenditures or liabilities because the commitments will be honored during the subsequent year.

The unencumbered balance of any appropriation at the end of the fiscal year will lapse at the end of such fiscal year. Other appropriations, mainly capital project 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 annual budget as presented in the Budgetary Comparison Schedule-General Fund is the budget ordinance at June 30, 2006 representing the original budget. There were no supplemental appropriations for the year ended June 30, 2006.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUAYAMA**

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

YEAR ENDED JUNE 30, 2006

<u>Federal Grantor/Pass-through Grantor/Program or Cluster Title</u>	<u>Federal CFDA Number</u>	<u>Pass-through Entity Identifying Number</u>	<u>Federal Expenditures</u>
U.S DEPARTMENT OF AGRICULTURE			
Pass-through Commonwealth of Puerto Rico Department of Education:			
Child Care and Adult Food Program	10.558	Not Available	\$ 813,486
Total U.S. Department of Agriculture			813,486
U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT:			
Direct Programs:			
Community Development Block Grant – Entitlement Grants	14.218		657,687
Direct Programs:			
Section 8 – Housing Choice Voucher	14.871		1,043,344
Pass-through Office of the Commissioner Of Municipal Affairs:			
Community Development Block Grant – State Program	14.228	98-DR-26	619,300
Total U.S. Department of Housing and Urban Development			2,320,331
U.S. DEPARTMENT OF HOMELAND SECURITY			
Pass-through the Commonwealth of Puerto Rico Governor Authorized Representative (GAR):			
Public Assistance Grants	83.544	1247-DRPR 1501-DRPR	32,297
Total U.S. Department of Homeland Security			32,297

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUAYAMA

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS - (CONTINUED)

YEAR ENDED JUNE 30, 2006

Federal Grantor/Pass-through Grantor/Program or Cluster Title	Federal CFDA Number	Pass-through Entity Identifying Number	Federal Expenditures
U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES			
Pass-through the Commonwealth of Puerto Rico - Administration for Children and Families:			
Head Start Program	93.600	Not Available	11,578,909
Total U.S. Department of Health and Human Services			<u>11,578,909</u>
TOTAL EXPENDITURES OF FEDERAL AWARDS			<u>\$14,745,023</u>

The accompanying notes are an integral part of this schedule.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUAYAMA**

NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

YEAR ENDED JUNE 30, 2006

1. BASIS OF PRESENTATION:

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of the **Municipality of Guayama** and is presented on the modified accrual basis of accounting. The basis of accounting is the same used to prepare the basic financial statements. The information in this Schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

2. RELATIONSHIP TO FEDERAL FINANCIAL REPORTS:

Amounts reported in the accompanying Schedule are included in the Special Revenue Fund State & Federal Grants and Capital Projects Fund State & Federal Grants in the Municipality's basic financial statements. The reconciliation between the expenditures in the basic financial statements and the disbursements in the Schedule of Expenditures of Federal Awards is as follows:

Description	Special Revenue Fund State & Federal Grants	Capital Projects Fund State & Federal Grants	Total
Per Schedule of Expenditures of Federal Awards	\$ 14,701,089	\$ 43,934	\$ 14,745,023
Non federal programs Expenditures	<u>624,666</u>	<u>8,624,466</u>	<u>9,249,132</u>
Total expenditures in the basic financial statements	<u>\$ 15,325,755</u>	<u>\$ 8,668,400</u>	<u>\$ 23,994,155</u>



López-Vega, CPA, PSC

Certified Public Accountants / Management Advisors

Member of:

- American Institute of Certified Public Accountants
- Puerto Rico Society of Certified Public Accountants

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

**To the Honorable Mayor
and the Municipal Legislature
Municipality of Guayama
Guayama, 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 Guayama, Puerto Rico**, as of and for the year ended June 30, 2006, which collectively comprise the Municipality's basic financial statements and have issued our report thereon dated December 20, 2006, which was unqualified. 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 of Guayama's** internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted certain matter involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect **Municipality of Guayama's** ability to initiate record, process 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 item **06-01**.

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 in the accompanying Schedule of Findings and Questioned Costs are not material weaknesses.

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 (CONTINUED)

Compliance

As part of obtaining reasonable assurance about whether the **Municipality of Guayama's** financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain other matters that we reported to management of the **Municipality of Guayama** in a separate letter dated December 20, 2006.

This report is intended solely for the information and use of the management and federal awarding agencies and pass-through entities. However, this report is matter of public record and its distribution is not limited.

López Vega, CPA, PSC.

LOPEZ-VEGA, CPA, PSC

San Juan, Puerto Rico
December 20, 2006

Stamp No. 2195988 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.



López-Vega, CPA, PSC

Certified Public Accountants / Management Advisors



López-Vega, CPA, PSC

Certified Public Accountants / Management Advisors

Member of:

- American Institute of Certified Public Accountants
- Puerto Rico Society of Certified Public Accountants

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

**To the Honorable Mayor
and the Municipal Legislature
Municipality of Guayama
Guayama, Puerto Rico**

Compliance

We have audited the compliance of the **Municipality of Guayama** 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 of Guayama's** major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the **Municipality of Guayama's** management. Our responsibility is to express an opinion on the **Municipality of Guayama'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 the *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB 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 of Guayama'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 of Guayama's** compliance with those requirements.

In our opinion, the **Municipality of Guayama** 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. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements that is required to be reported in accordance with OMB Circular A-133 and which is described in the accompanying schedule of findings and questioned costs as items **06-02** through **06-08**.

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

Internal Control Over Compliance

The management of the **Municipality of Guayama** is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered the **Municipality of Guayama'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 matter involving the internal control over compliance and its operation that we consider to be reportable condition. 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 of Guayama's** ability to administer a major federal program in accordance with applicable requirements of laws, regulations, contracts and grants. Reportable condition is described in the accompanying Schedule of Findings and Questioned Costs as items **06-02**, and **06-04** through **06-08**.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants caused by error of 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 weakness. However, of the reportable conditions described above, we consider none of them to be material weakness.

We also noted other matters involving the internal control over compliance and certain immaterial instance of noncompliance, which we have reported to management of the **Municipality of Guayama** in a separate letter dated March 23, 2007.



López-Vega, CPA, PSC

Certified Public Accountants / Management Advisors

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

This report is intended for the information of the management and federal awarding agencies and pass-through entities. However, this report is a matter of public record and its distribution is not limited.

López Vega, CPA, PSC

LOPEZ-VEGA, CPA, PSC

San Juan, Puerto Rico

March 23, 2007

Stamp No. 2195989 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.



López-Vega, CPA, PSC

Certified Public Accountants / Management Advisors

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUAYAMA**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

YEAR ENDED JUNE 30, 2006

Section I – Summary of Auditor’s Results

Financial Statements

Type of auditor’s report issued:	Unqualified		
Internal control over financial reporting:			
Material weakness identified?	Yes	No	X
Reportable conditions identified not considered to be material weaknesses?	Yes	X	None reported
Noncompliance material to financial statements noted?	Yes	No	X

Federal awards

Internal Control over major programs:			
Material weakness identified?	Yes	X	No
Reportable conditions identified not considered to be material weaknesses?	Yes	X	None reported
Type of auditor’s report issued on compliance for major programs:	Unqualified		
Any audit findings disclosed that are required to be reported in accordance with Circular A-133, Section .510(a)?	Yes	X	No

Identification of major programs:

CFDA Number	Name of Federal Program or Cluster
10.558	Child and Adult Care Food Program
14.218	Community Development Block Grant – Entitlement’s Program
14.228	Community Development Block Grant – State’s Program
93.600	Head Start Program

Dollar threshold used to distinguish Between Type A and Type B programs	\$442,351
Auditee qualified as low-risk auditee?	Yes No X

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUAYAMA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

Section II – Financial Statements Findings

Finding Reference	06-01
Requirement	Financial Reporting – Accounting Records
Statement of Condition	During our examination of the Municipality's accounting system we noted that it does not summarize the transactions in a formal General Ledger in order to properly record and account for the transactions of all of its Governmental Funds (Local, State and Federal funds) and Account Groups.
Criteria	Chapter VII Article 8.010 of State Act Number 81 of August 30, 1991 states that the Municipality should maintain an effective and updated accounting system.
Cause of Condition	The Municipality did not establish effective internal control over the transactions recorded on its accounting records. Also, the accounting data is not summarized in the form of a double-entry general ledger record.
Effect of Condition	The Municipality accounting system did not provide updated and complete financial information that present the financial position and the result of operations and the change in fund balances. Such information is necessary to take management decisions.
Recommendation	We recommend that the Municipality should implement internal control and procedures in order to maintain an accounting system that contains information pertaining to authorizations, obligations, unobligated balances, assets, liabilities, outlays or expenditures, interfund transactions, etc.
Questioned Costs	None
Management Response and Corrective Action	The Municipality maintains two sets of accounting records; a manual system and a computerized system provided in the past by the Office of the Commissioner of Municipal Affairs (OCAM). Actually, all of the transactions were recorded in both systems, but the manual system is the primary financial record for financial statements preparation purposes at the end of each fiscal year, due to the fact that the computerized system real accounts balances carried forward from prior years were affected by accounting errors in the firsts' years of the system operation.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUAYAMA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

Section II - Financial Statements Findings

Finding Reference **06-01 (Continued)**

Nevertheless, as part of our corrective action plan, the management is considering alternatives to improve the accounting system, including the acquisition of new accounting software, and therefore, hope to solve the accounting system condition in a near future.

Implementation Date: June, 2007

Responsible Person: Carmen L. Anaya
Finance Department Director

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUAYAMA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference 06-02

Program Community Development Block Grant – Entitlement Grant (CFDA. No. 14.218); U.S. Department of Housing and Urban Development

Community Development Block Grants – State’s Program (CFDA No. 14.228); U.S. Department of Housing and Urban Development; Pass through the Commonwealth of Puerto Rico – Office of Commissioner of Municipal Affairs (OCAM)

Requirement Allowable Activities-Housing Rehabilitation Activities

Statement of Condition We performed a housing rehabilitation activities test of fifteen (15) participant’s files and found the following exceptions:

- a. In seven (7) participant’s files, we noted that the program did not establish adequate internal control procedures to assure that the work was properly completed on time. At the time of our examination, a period from four (4) to sixteen (16) months has elapsed from purchase order date.

Purchase Order Date	Case Number	Time Elapsed (In Month)
24-Mar-06	2003-0442	12
26-May-06	2004-0149	10
8-Jun-06	2004-0150	9
16-Oct-06	2004-0144	5
16-Nov-06	2004-0133	4
15-Nov-05	2004-0161	16
25-Jan-06	2004-0434	14

- b. In fifteen (15) participant’s files, we noted that the eligibility applications were not properly completed. The files did not include a form where staff program can calculate the eligibility using the Poverty Guideline;
- c. In nine (9) participant’s file, the eligibility determination was not properly documented. The rehabilitation contracts were not signed by mayor or representation person.

Criteria Code of Federal Regulations 24, Section 570.506 (b) state that at a minimum, the grantee should maintain records demonstrating that each activity undertaken meets one of the three national objectives of

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUAYAMA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference 06-02 (Continued)

the CDBG Program, i.e., benefit low- and moderate-income persons, prevent or eliminate slums or blight, or meet community development needs having a particular urgency. Also, Code of Federal Regulations 24, Section 570.506 (b) (9) states that when CDBG-State Program funds are used for residential rehabilitation activity to aid in the prevention or elimination of slums or blight in a slum or blighted area, the grantee must maintain records to support the local definition of "substandard", documents like pre-rehabilitation inspection report describing the deficiencies in each structure to be rehabilitated, second inspection to review the works and final inspections when the works are finished. Also, the eligibility determination of participants must be documented.

Cause of Condition The Municipality's controls and procedures failed to assure that the participant's files include all the required documents to comply with the program requirements and to assure that inspections to monitor the rehabilitation activities were conducted, as established in the program's operational guide.

Effect of Condition The Municipality is not in compliance with Code of Federal Regulations 24, Section 570.506 (b) and 570.506 (b) (9).

Recommendation We recommend the Program to establish the following procedures: (a) assign a staff to inspect the rehabilitation work upon completion to assure that is carried out in accordance with contracts specifications; (b) assure that all participant files include all required documentation and; (c) ascertain eligibility determination and adequate evidence of family income.

Questioned Cost None.

Management Response and Corrective Action As part of our corrective action plan, management gave instructions to the program staff to follow the written instructions and procedures adopted in the Housing Rehabilitation Manual.

Implementation Date: April, 2007

Responsible Person: Mr. Jorge Correa Bernier
Federal Department Director

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUAYAMA**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	06-03
Program	Community Development Block Grants – State’s Program (CFDA. No. 14.228); U.S. Department of Housing and Urban Development; Pass through the Commonwealth of Puerto Rico – Office of Commissioner of Municipal Affairs (OCAM)
Requirement	Cash Management
Statement of Condition	During our cash management test, we noted that the program’s Bank cash account maintained a monthly average cash balance of \$37,222.04 in books.
Criteria	Code of Federal Regulations 24, Subpart I, Sec.570.489 (c) requires a cash management system in order to minimize the time elapsed between the transfer of funds from the pass-through grantor and disbursements made by the grantee.
Cause of Condition	The Municipality’s disbursements procedures failed to assure that funds requested and received from the pass-through grantor be disbursed in compliance with the Code of Federal Regulations Requirements.
Effect of Condition	The Municipality is not in compliance with Code of Federal Regulations 24, Subpart I, Sec.570.489 (c).
Recommendation	We recommend management to strengthen its disbursement procedures to minimize the time elapsed between the transfer of funds from the pass-through grantor and the disbursements made by the Municipality.
Questioned Costs	None
Management Response and Corrective Action	The situation commented by the auditors in the statement of condition is related to an amount received by the program for the payment of construction project, which was inactive during fiscal year 2004-2005. Nevertheless, the Program will disburse this amount shortly, because the construction work resumed during the current fiscal year.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUAYAMA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference 06-03 (Continued)

Implementation Date: During the fiscal year 2006-2007

Responsible Person: Mr. Jorge Correa Bernier
Federal Department Director

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUAYAMA**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	06-04
Program	Community Development Block Grants – State’s Program (CFDA. No. 14.228); U.S. Department of Housing and Urban Development; Pass through the Commonwealth of Puerto Rico – Office of Commissioner of Municipal Affairs (OCAM)
Requirement	Procurement and Suspension and Debarment
Statement of Condition	During our contract provision test, we noted the following situations: <ul style="list-style-type: none">a. Four (4) contracts did not include a provision for retention of all required records for three (3) years;b. Four (4) contracts did not include a provision for compliance with Energy Policy and Conservation Act;c. Four (4) contracts did not include a provision for compliance with the Copeland “Anti-Kickback Act”;d. Four (4) contracts did not include provision for compliance with sections 103 and 107 of the Contract Work Hours & Safety Standards Act.e. One (1) contract did not include provision for compliance with Davis Bacon Act.f. One (1) contract did not include provision for granting access to GAO or other Federally Agency, to books, documents, etc.
Criteria	Code of Federal Regulations 24, Subpart I, Section 570.489 (g) requires that all purchase orders and contracts include all clauses required by Federal Statutes, executive orders and implementing regulations.
Cause of Condition	The Municipality’s internal control and procedures failed to detect the exclusion of certain contract clauses in the procurement process.
Effect of Condition	The Municipality is not in compliance with Code of Federal Regulation 24, Subpart I, Section 570.489 (g).

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUAYAMA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference 06-04 (Continued)

Recommendation We recommend that the Municipality should strengthen its procedures in order to assure that the contracts contain all provisions requested by federal agencies.

Questioned Costs None

Management Response and Corrective Action As part of the corrective action plan, management is going to prepare a uniform Federal required contract clauses attachment, in order to attach it to each contract granted and related to federal grants.

Implementation Date: April, 2007

Responsible Person: Mrs. Carmen Escobar
Municipal Secretary Office Director

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUAYAMA**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference **06-05**

Program **Head Start Program (CFDA. No. 93.600); U.S. Department of Health and Human Services; Pass through State – Commonwealth of Puerto Rico Administration for Children and Families (ACUDEN)**

Requirement **Cash Management**

Statement of Condition During our Cash Management test, we noted that the Program requested funds that were not disbursed on a reasonable lapse of time. Also, a monthly average cash balance of \$506,526.92 was maintained during the fiscal year ended June 30, 2006. The following table illustrates the monthly cash balance for Bank Statements and Municipality Bank Conciliation.

Bank Account: 078-831008		
Months	Adjusted Bank Cash Balance per Conciliation	Cash Balance per Bank Statement
Jul-05	\$ 245,860.79	\$ 581,578.66
Aug-05	656,690.29	810,391.24
Sep-05	108,769.27	273,270.01
Oct-05	1,012,752.33	1,207,317.81
Nov-05	(87,854.61)	830,171.52
Dec-05	428,879.79	799,255.14
Jan-06	450,907.76	600,348.00
Feb-06	1,217,313.13	1,362,063.64
Mar-06	749,306.22	825,530.74
Apr-06	960,531.75	1,068,881.45
May-06	404,589.65	867,165.27
Jun-06	(69,423.30)	719,567.45

Criteria Code of Federal Regulations 45, Subpart C, Section 92.20 (b) (7) states that the Municipality must maintain procedures for minimizing the time elapsed between the transfer of funds from the U.S. Treasury and disbursement by grantees and sub grantees whenever advance payment procedures are used.

Cause of Condition The program did not maintain appropriate cash management procedures in order to request funds to federal agencies only for immediate needs.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUAYAMA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference 06-05 (Continued)

Effect of Condition The program requested funds in excess of immediate needs and for that reason is not in compliance with Code of Federal Regulations 45, Subpart C, Section 92.20 (b) (7).

Recommendation We recommend management to continue strengthen it's procedures to minimize the time elapsed between the transfer of funds from the Administration for Children and Families and the disbursements made by the Municipality.

Questioned Costs None

**Management Response
and Corrective Action**

Management will give instructions to the program staff in order to strengthen cash management procedures to minimize the time elapsed between the transfer of funds from the Commonwealth of Puerto Rico Administration for Children and Families (ACUDEN), and the disbursements made by the Municipality. But, the Program believes that the cash advance procedures as per grant agreement provisions put obstacles to comply with the cash management requirement.

Also, an expenditures plan was established, which will allow us to request for advance payment just to fulfill the programs' actual commitments.

Implementation Date: April, 2007

Responsible Person: Mrs. Maria de Los Ángeles Torres
Head Start Program Director

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUAYAMA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	06-06
Program	Head Start (CFDA. No. 93.600); U.S. Department of Health and Human Services; Pass through State – Commonwealth of Puerto Rico Administration for Children and Families (ACUDEN)
Requirement	Matching, Level of Effort, Earmarking-Matching
Statement of Condition	During our matching requirement test, we noted the followings exceptions: <ul style="list-style-type: none">a. The “Rent” in Local In-Kind contribution for fiscal year 2005-2006, we noted that the Program did not include sufficient evidential matter to support the like in-kind rent contribution. Also, these rent contributions did not agree with the amounts recorded in the general ledger. In accordance with the supporting documents the In-kind rent contributions were \$698,112.00. However, the amounts recorded in the general ledger were \$924,554.00; a difference of (\$226,442).b. For the “Municipal employees” in local in-kind contribution for fiscal year 2005-2006, we noted that the supporting documents did not agree with the amounts recorded in the general ledger. In accordance with the supporting documents the in-kind contributions for “Municipal employees” were \$388,516.72. However, the amounts recorded in the general ledger were \$295,611.00; a difference of \$92,905.72.c. For the “Volunteers” local in-kind contribution for fiscal year 2005-2006, we noted that the Program did not include sufficient evidential matter to support the \$57,458.70 to “Volunteers Labor” in-kind contribution. In accordance with the supporting documents the in-kind contributions for “Volunteers” were \$1,308,001.30. However, the amounts recorded in the general ledger were \$1,365,460.00; a difference of (\$57,458.70).d. We noted that the Program did not include \$259,477.48 of local in-kind contribution for fiscal year 2005-2006 in the “Others” account.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUAYAMA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	06-06 (Continued)
Criteria	<p>Code of Federal Regulations 45, Subpart C, Section 13.01.20 states that the Municipality is required to contribute at least twenty (20%) of cost of the program through cash or in kind contribution. The grant agreement provisions has established that any deficiency in matching share contribution at the end of the program year will be remitted in cash to the grantee in the next ninety (90) days after year-end closeout.</p> <p>Also, OMB Common Rules, Subpart C 45 CFR 92.20 (b)(1), requires that accurate, current, and complete disclosure of financial results of financially assisted activities must be made in accordance with the financial reporting requirement of the grant or sub-grant.</p>
Cause of Condition	<p>The Municipality did not maintain adequate procedures to monitor compliance with matching share contribution requirement.</p>
Effect of Condition	<p>The Municipality did not comply with the matching share requirement imposed through grant agreement and program regulations.</p>
Recommendation	<p>We recommend to the Municipality management to monitor continuously the level of matching share contribution in order to take appropriate actions if anticipated unfavorable outcome will be expected.</p>
Questioned Costs	<p>None</p>
Management Response and Corrective Action	<p>To reduce significantly the probability that a similar situation occurs in the future, management's going to instruct the program accountant to adjust the amounts in the next year. Also, the following procedures will be implemented:</p> <ol style="list-style-type: none">a. In order to report the actual rent in kind, a professional consultant will be contracted by the Municipality to appraise the donated buildings.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUAYAMA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

Section III - Major Federal Award Program Findings and Questioned Costs

Finding Reference 06-06 (Continued)

- b. Monthly certifications of salaries and marginal benefits will be obtained from the Municipalities who provide in kind personnel.
- c. Each month, a program office clerk will account, receive, and verify the voluntary works' schedules, per center.
- d. The program will monitor and make monthly entries of the actual local contributions.

Implementation Date: April, 2007

Responsible Person: Mrs. Maria de Los Angeles Torres
Head Start Program Director

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUAYAMA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference	06-07
Program	Head Start (CFDA. No. 93.600); U.S. Department of Health and Human Services; Pass through State – Commonwealth of Puerto Rico Administration for Children and Families (ACUDEN)
Requirement	Matching, Level of Effort, Earmarking – Administrative Cost Limits
Statement of Condition	The Accounting System maintained by Head Start Program financial activities did not provide for the classification of financial transactions between administrative and programmatic costs. Alternate procedures were used by the Program staff to compute compliance with the fifteen percent (15%) administrative costs limit.
Criteria	Code of Federal Regulations 45, Subpart C, Section 92.20 (a) (2) states that the sub grantees must maintain fiscal controls and accounting procedures sufficient to permit the tracing of funds to a level of expenditures adequate to establish that such funds have not been used in violation of the restriction and prohibitions of applicable statutes.
Cause of Condition	The program accounting records did not provide a chart of accounts to account by separate, programmatic and administrative expenditures.
Effect of Condition	Such condition may cause program's non-compliance with certain compliance requirements like: allowable costs, activities allowed and unallowed; and earmarking.
Recommendation	We recommend management to modify the Accounting System chart of accounts to create separate accounts for administrative and programmatic expenditures. Also, cost with dual benefits (administrative and programmatic) should be identified and allocated appropriately using a cost-benefit proportion.
Questioned Costs	None
Management Response and Corrective Action	As part of the corrective action plan, management will modify the accounting system chart of accounts, to create separate accounts for administrative and programmatic expenditures.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUAYAMA**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference **06-08**

Program **Head Start (CFDA. No. 93.600); U.S. Department of Health and Human Services; Pass through State – Commonwealth of Puerto Rico Administration for Children and Families (ACUDEN)**

Requirement **Reporting - Financial Reporting**

Statement of Condition During our Reporting Test, we found differences between the amounts reported as federal expenditures in the monthly financial reports submitted to the pass-through agency and the amounts detailed in the trial balance and the general ledger. In our sample test of three (3) months, we identified the following exceptions:

Months	Accumulated Expenditures per Accounting Records	Accumulated Expenditures per Financial Report	Differences
May-05	\$2,157,397.34	\$2,321,045.00	(\$163,647.66)
Aug-05	4,658,201.00	4,948,766.00	(290,565.00)
Jan-06	9,256,961.00	9,482,832.00	(225,871.00)

As result, the financial reports do not agree with the program accounting records. In addition, we noted that the program staff did not have adequate accounting records, and sufficient evidential matter to support their accounting records.

Criteria The grant agreement between the Administration for Children and Families states that final year reports should be submitted within the first twenty days after the ending of the program year. In addition, OMB Common Rules, Subpart C, Section 92.20 (b) (1), states that the grantee must maintain internal control procedures that permits proper tracing of funds to the accounting records. Also, it requires accurate, current and complete disclosure of financial results.

Cause of Condition No adequate internal controls exist to assure the timely submission of closing reports to agencies as required by grant agreements. Also, the Municipality has not established adequate internal control procedures to assure the correctness of the reports.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUAYAMA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2006

Section III – Major Federal Award Program Findings and Questioned Costs

Finding Reference

06-08 (continued)

Effect of Condition

The program did not comply with the grant agreement which require the timely submission of reports to the Administration for Children and Families. Also, the Municipality did not comply with 24 CFR Section 92.20 (b) (1).

Recommendation

We recommend that the required reports be prepared including all the required information and submitted in a timely manner. If the deadline is not achievable, a request for an extension should be obtained from the federal agency. Also, we recommend that the Municipality establish monitoring procedures to assure the accuracy of accounting records and a correct completion of the closing reports. The program accountant must establish adequate communication channels with the Finance Department in order to obtain documental evidence related to cash receipt and disbursements in a daily manner, in order to be posted in the cash register maintained by the program. The program accountant assures that accounting records are updated at the end of each month in order to prepare accurate monthly reports to the pass-through agency. In addition, the accountant must assure that the cash register and the general ledger are duly reconciled and journal entries posted in the general ledger are duly documented and explained. We consider that the Program Director must evaluate the implementation of a computer accounting software to maintain the program books. Due to the large volume of transactions manual books are considered inefficient.

Questioned Costs

None.

**Management Response
and Corrective Action**

As part of the corrective action plan, management gave instructions to the accountant staff to complete the adjustment, in order to avoid errors in the accounting process.

The new electronic system accounting system established by the Grantee assures the issuance of the reports at the required dates, avoiding mistakes and differences.

Implementation Date: June, 2007

Responsible Person: Mrs. Maria de Los Angeles
Head Start Program Director

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUAYAMA**

NOTES TO BUDGETARY COMPARISON SCHEDULE - GENERAL FUND

YEAR ENDED JUNE 30, 2006

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
05-05	14.228	<p><u>During the Cash Management test, the auditors noted that the Municipality requested funds that were not disbursed on a reasonable lapse of time. Also, a monthly average cash balance of \$64,640 was maintained during the fiscal year ended June 30, 2005.</u></p> <p>No corrective action has been taken. The auditors reissued the finding in the current year. See Finding Reference 06-03.</p>
04-03	14.228	<p><u>In twenty (20) disbursement vouchers related to CDBG Program, the auditors noted that the purchase order was issued after the receipt of the goods and services.</u></p> <p>This finding was corrected substantially; the few instances for corrective action were included in the Management Letter.</p>
04-04	14.228	<p><u>During the examination of eight (8) participant files maintained by the Municipality, related to assistance for housing rehabilitation, the auditors noted that the written policies and procedures adopted by the Municipality for Housing Rehabilitation Activities were not followed by the Program Staff as established in the Manual.</u></p> <p>No corrective action has been taken. The auditors reissued the finding in the current year. See Finding Reference 06-02.</p>
04-05	14.228	<p><u>During the contract provision test, the auditors noted the following situations: (a) Two (2) contracts did not include a provision for compliance with executive order "Equal Employment opportunity"; (b) two (2) contracts did not include a provision for granting accesses to GAO or other federally agency, to books and other documents; (c) two (2) contracts did not include a provision for compliance with Energy Policy and Conservation Act; (d) two (2) contracts did not include a provision for compliance with the Copeland "Anti-Kickback"; (e) two (2) contracts did not include provision for compliance with EO-1991-55.</u></p> <p>No corrective action has been taken. The auditors reissued the finding in the current year. See Finding Reference 06-04.</p>
04-06	14.228	<p><u>The Municipality disbursed CDBG funds to a sub-recipient and did not perform the necessary monitoring procedures to obtain a reasonable assurance that the sub-recipient administers program funds in compliance</u></p>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUAYAMA

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS (CONTINUED)

YEAR ENDED JUNE 30, 2006

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
		<p><u>with Federal requirements.</u></p> <p>No corrective action has been taken.</p>
04-07	93.600	<p><u>During the Cash Management test, the auditors noted that the Municipality requested funds that were not disbursed on a reasonable lapse of time. Also, a monthly average cash balance of \$42,257 was maintained during the fiscal year ended June 30, 2004.</u></p> <p>No corrective action has been taken. The auditors reissued the finding in the current year. See Finding Reference 06-05.</p>
04-08	93.600	<p><u>In a sample of fifteen (15) Participants Files, constituted by 90 percent of low income participants and which was realized to support our Earmarking Test, the auditors noted the following exceptions: (a) The program did not request to the applicants household a copy of the Social Security Card and Birth Certificate of all family members to assure participant family composition and; (b) In one (1) file, the participant was not correctly classified as a participant whose income family was above poverty guideline.</u></p> <p>This finding was corrected substantially; the few instances for corrective action were included in the Management Letter.</p>
04-09	93.600	<p><u>The program did not comply with enrollment levels established by Head Start program. The participants enrolled with income above the official Federal Poverty Guidelines were exceeding the 12 percent.</u></p> <p>This finding was corrected substantially; the few instances for corrective action were included in the Management Letter.</p>
04-10	93.600	<p><u>The Accounting System maintained by the Head Start Program financial activities did not provide for the classification of financial transactions between administration and programmatic costs. Alternate procedures were used by the Program staff to compute compliance with the fifteen percent (15%) administrative costs limit.</u></p> <p>No corrective action has been taken. The auditors reissued the finding in the current year. See Finding Reference 06-08.</p>
04-11	93.600	<p><u>During the reporting test, whose samples were four (4) monthly reports, the</u></p>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUAYAMA

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS (CONTINUED)

YEAR ENDED JUNE 30, 2006

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
		<p><u>auditors noted the following exceptions: (a) Two (2) monthly reports were not available for the examination; (b) two (2) monthly reports had no evidence that the report was submitted on time; (c) one (1) monthly report was submitted subsequent to the deadline and; (d) four (4) monthly reports did not agree with the amounts per accounting records.</u></p> <p>Full corrective action has been taken.</p>
03-03	14.228	<p><u>Seven (7) CDBG Program disbursement vouchers did not have all supporting documents stamped as paid. Two (2) CDBG Program disbursement vouchers were not pre-numbered. One (1) CDBG Program disbursement voucher did not include the invoice. In one (1) CDBG Program disbursement voucher there was no evidence of receiving report or the certification of the Municipality's employee who received the goods or services. In nine (9) CDBG Program disbursement vouchers the purchase order were dated after the receiving report and invoice date.</u></p> <p>The audit finding does not warrant further action because two years have passed since the audit report in which the finding occurred was submitted to the Federal clearinghouse.</p>
03-04	14.228	<p><u>Three (3) housing rehabilitation participant files did not include the pre-rehabilitation inspection specifying which were the participant housing unit deficiencies to be corrected. Two (2) files did not include the birth certificate neither copy of the social security for the family members. Two (2) files did not include the residence deed neither utilities invoices as evidence of residence existence. In three (3) cases the eligibility determination was not properly documented.</u></p> <p>The audit finding does not warrant further action because two years have passed since the audit report in which the finding occurred was submitted to the Federal clearinghouse.</p>
03-05	14.228	<p><u>Three (3) contracts did not include a provision for granting access to GAO or other federally agency, to books and other documents. Three (3) contracts did not include a provision for compliance with the Clean Air Act and Water Act. Three (3) contracts did not include a provision for compliance with Energy Policy and Conservation Act. Three (3) contracts did not include a provision for compliance with the Copeland "Anti-Kickback". Three (3) contracts did not include a provision for retention of</u></p>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUAYAMA**

SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS (CONTINUED)

YEAR ENDED JUNE 30, 2006

Original Finding Number	CFDA No.	Current Status of Prior Year Audit Federal Award Findings - Part III Findings (As required by OMB Circular A-133)
		<p><u>all required records for three years.</u></p> <p>The audit finding does not warrant further action because two years have passed since the audit report in which the finding occurred was submitted to the Federal clearinghouse.</p>
03-06	14.228	<p><u>The Municipality pass-through program funds to another entity and did not perform the necessary monitoring procedures to obtain a reasonable assurance that the sub recipient administers program funds in compliance with Federal requirements.</u></p> <p>The audit finding does not warrant further action because two years have passed since the audit report in which the finding occurred was submitted to the Federal clearinghouse.</p>
03-14	93.600	<p><u>The Municipality requested funds that were not disbursed on a reasonable lapse of time. Also, a monthly average cash balance of \$88,191 was maintained during the fiscal year ended June 30, 2003.</u></p> <p>The audit finding does not warrant further action because two years have passed since the audit report in which the finding occurred was submitted to the Federal clearinghouse.</p>
03-15	93.600	<p><u>The Accounting System kept by the Head Start Program did not provide for the classification of financial transactions between administration and programmatic costs. Alternate procedures were used by the Program staff to compute compliance with the fifteen percentage (15%) administrative costs limit.</u></p> <p>The audit finding does not warrant further action because two years have passed since the audit report in which the finding occurred was submitted to the Federal clearinghouse.</p>