

**OFICINA DEL COMISIONADO DE ASUNTOS MUNICIPALES  
ÁREA DE ASESORAMIENTO, REGLAMENTACIÓN E INTERVENCIÓN FISCAL  
ÁREA DE ARCHIVO DIGITAL**

**MUNICIPIO DE GUAYAMA  
AUDITORÍA 2010-2011  
30 DE JUNIO DE 2011**

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF GUAYAMA**

**SINGLE AUDIT REPORT**

For the Fiscal Year Ended June 30, 2011

**Honorable Glorimari Jaime Rodríguez, Mayor**

Prepared by the Finance Department  
Amílcar Ayala Acevedo  
Finance Director



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**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF GUAYAMA**  
**Single Audit Report**  
For the Fiscal Year Ended June 30, 2011

Table of Contents

<b>Independent Auditors' Report</b> .....	1-2
<b>Management's Discussion and Analysis</b> .....	3-13
<b>Basic Financial Statements:</b>	
Government-wide Financial Statements:	
Statement of Net Assets.....	14-15
Statement of Activities .....	16
Governmental Fund Financial Statements:	
Balance Sheet – Governmental Funds.....	17
Reconciliation of the Balance Sheet – Governmental Funds to the Statement of Net Assets .....	18
Statement of Revenues, Expenditures and Changes in Fund Balances – Governmental Funds.....	19
Reconciliation of the Statement of Revenues, Expenditures and Changes in Fund Balances – Governmental funds to the Statement of Activities .....	20
Notes to Basic Financial Statements.....	21-57
<b>Required Supplementary Information:</b>	
Budgetary Comparison Schedule - General Fund .....	58
Notes to Budgetary Comparison Schedule - General Fund .....	59
Budgetary Comparison Schedule - Debt Service Fund .....	60
Notes to Budgetary Comparison Schedule - Debt Service Fund .....	61
Schedule of Expenditures of Federal Awards and Reports Required by Government Auditing Standards and OMB Circular A-133:	
Schedule of Expenditures of Federal Awards.....	62-63
Notes to the Schedule of Expenditures of Federal Awards .....	64
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 .....	65-66
Report on compliance with the requirements that could have a direct and material effect on each major program and on internal control over compliance in accordance with OMB Circular A-133 .....	67-69
Schedule of Findings and Questioned Costs.....	70-99
Summary Schedule of Prior Year Audit Findings .....	100-104

*Pedro C. Ortíz Ledée*

**Certified Public Accountant**

**INDEPENDENT AUDITOR'S REPORT**

**To the Honorable Mayor and  
Members of the Municipal Legislature  
Municipality of 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 (Municipality), as of and for the fiscal year ended June 30, 2011, 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 and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

As discussed in Note 6 to the financial statements, the Municipality has not recorded certain capital assets including the infrastructure in the governmental activities and accordingly, has not recorded depreciation expense on those assets. Accounting principles generally accepted in the United States of America require that those capital assets including infrastructure be capitalized and depreciated, which would increase the assets, net assets and expenses of the governmental activities. The amount by which this departure would affect the assets, net assets and expenses of the governmental activities is not reasonably determinable.

As discussed in Note 8 (e) to the financial statements, the Municipality did not comply with the requirements established by Statement No. 18, *Accounting for Municipal Solid Waste Landfill Closure and Post Closure Care Costs*, issued by the Governmental Accounting Standards Board and the regulations set forth by the U.S. Environment Protection Agency. At June 30, 2011, the accompanying statement of net assets present a liability for closure and post closure care costs of the Municipality's solid waste landfill using an estimate made by the management of the Municipality and not based on a study of the actual landfill capacity used. The amount by which this departure would affect the liabilities, net assets and expenses of the governmental activities is not reasonably determinable.

In our opinion, because of the effects of the matter discussed in the preceding paragraphs, the financial statements referred to previously do not present fairly, in conformity with accounting principles generally accepted in the United States of America, the financial position of the governmental activities of the Municipality as of June 30, 2011, or the changes in financial position, thereof for the year then ended.

## INDEPENDENT AUDITOR'S REPORT (CONTINUED)

In addition, in our opinion, the financial statements referred to previously present fairly, in all material respects, the respective financial position of each major fund, and the aggregate remaining fund information of the Municipality, as of June 30, 2011, and the respective changes in financial position, for the fiscal year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 31, 2012, 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 grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and the budgetary comparison information on pages 3 through 13 and 58 through 61 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Municipality's financial statements as a 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 also not a required part of the financial statements. The schedule of expenditures of federal awards is the responsibility of management and was derived from and relate directly to underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

  
Pedro C. Ortiz Ledee, CPA  
License Number 5200

Guayama, Puerto Rico  
March 31, 2012



**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF GUAYAMA**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**FOR THE YEAR ENDED JUNE 30, 2011**

Management of the Municipality of Guayama of the Commonwealth of Puerto Rico (the Municipality) provides this *Management's Discussion and Analysis* (MD&A) for the readers of the Municipality's basic financial statements. This narrative represents an overview and analysis of the financial activities of the Municipality for the fiscal year ended June 30, 2011.

Because this MD&A is designed to focus on the current year activities, resulting changes and currently known facts, we encourage readers to consider the information presented in this MD&A in conjunction with the additional information furnished in the accompanying basic financial statements.

In this statement the condensed Statements of Activities, Balance Sheet, and Statement of Operations for the fiscal year ended June 30, 2011 are presented in a comparative approach to financial statements of fiscal year ended June 30, 2010.

**FINANCIAL HIGHLIGHTS**

**a) Government-Wide Highlights**

- **Assets** – The Municipality has reported assets amounting to \$157.2 millions in the accompanying statement of net assets, of which the most significant are capital assets and cash, amounting to \$106.4 millions, and \$47.5 millions, respectively.
- **Liabilities** – The Municipality has reported liabilities amounting to \$64.0 millions in the accompanying statement of net assets, of which the most significant are bonds payable, commitments and contingencies, estimated liability for municipal solid waste landfill closure and postclosure care costs and unearned revenues amounting to \$23.3 millions, \$16.0 millions, \$9.3 millions and \$8.2 millions, respectively.
- **Net assets** – The assets of the Municipality exceeded its liabilities by \$93.1 millions at June 30, 2011, which is presented as “net assets” in the accompanying statement of net assets. Restricted net assets and unrestricted deficit amounted to \$5.1 millions and \$5.6 millions, respectively. Net assets invested in capital assets amounted to \$93.7 millions.
- **Net change in net assets** – The Municipality's net assets increased by \$6.1 millions during fiscal year ended June 30, 2011.
- **Revenues** – The Municipality has reported total revenues amounting to \$50.9 millions in the accompanying statement of activities, of which the most significant are taxes, and operating grants and contributions, amounting to \$22.7 millions and \$18.3 millions, respectively.
- **Expenses** – The Municipality has reported total expenses amounting to \$44.8 millions in the accompanying statement of activities.

**b) Governmental Funds Highlights**

- **Assets** – The Municipality's governmental funds have reported combined assets amounting to \$56.9 millions in the accompanying balance sheet – governmental funds, of which the most significant are cash, due from other funds and grants and contributions accounts receivable amounting to \$47.5 millions, \$6.8 millions and \$1.7 millions, respectively.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF GUAYAMA**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**FOR THE YEAR ENDED JUNE 30, 2011**

- **Liabilities** – The Municipality's governmental funds have reported combined liabilities amounting to \$36.9 millions in the accompanying balance sheet – governmental funds, of which the most significant are commitment and contingencies, deferred revenues, due to other funds and accounts payable and accrued liabilities amounting to \$16 millions, \$8.3 millions, \$6.8 millions and \$3.3 millions, respectively.
- **Governmental fund balances** – The Municipality's governmental funds reported combined fund balances amounting to \$20.0 millions.
- **Net change in governmental fund balances** – The Municipality's governmental fund balances increased by \$1.1 millions during fiscal year ended June 30, 2011.
- **Revenues** – The Municipality's governmental funds have reported combined revenues amounting to \$51.8 millions in the accompanying statement of revenues, expenditures and changes in fund balances – governmental funds, of which the most significant are grants and contributions, property taxes, intergovernmental revenues, municipal license taxes and sales tax amounting to \$18.5 millions, \$12.2 millions, 8.2 millions, \$7.6 millions and \$3.1 millions, respectively.
- **Expenditures** – The Municipality's governmental funds have reported combined expenditures amounting to \$51.4 millions in the accompanying statement of revenues, expenditures and changes in fund balances – governmental funds, of which the most significant are categorized as education, general government, health, sanitation and welfare, public works and capital outlays amounting to \$13.0 millions, \$11.0 millions, \$5.1 millions, \$6.7 millions and \$6.8 millions respectively.

#### **USING THIS ANNUAL REPORT**

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

#### **OVERVIEW OF THE BASIC FINANCIAL STATEMENTS**

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

##### **Government-Wide Financial Statements**

The *government-wide financial statements* are designed to provide readers with a broad overview of the Municipality's operations and finance as a whole in a manner similar to private-sector business. These statements provide short-term and long-term information about the Municipality's financial position, which assist the Municipality's management to determine the economic condition at the end of the fiscal year. These financial statements are prepared using the flow of economic resources measurement focus

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF GUAYAMA**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**FOR THE YEAR ENDED JUNE 30, 2011**

and the accrual basis of accounting. This basically means that these financial statements follow methods that are similar to those used by most businesses. They take into account all revenues and expenses connected with the fiscal year ended June 30, 2011 even if cash involved has not been received or paid. The government-wide financial statements include: (1) the statements of net assets and (2) the statement of activities.

**Statement of Net Assets**

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

**Statement of Activities**

The statement of activities presents information showing how the Municipality's net assets changed during the fiscal year ended June 30, 2011. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will not result in cash flows until future fiscal periods (such as uncollected taxes and earned but unused vacation leave). This statement also presents a comparison between direct expenses and program revenues for each function of the Municipality.

Both of the abovementioned financial statements present all the governmental activities of the Municipality, which consist mostly of taxes and intergovernmental revenues (such as federal grants). Most services provided by the Municipality fall into this category, including, general government, public works, health, sanitation and welfare, and education, etc.

**Fund Financial Statements**

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

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The Municipality, like most other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. Each fund is considered an independent fiscal entity accounted for within a set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenue, and expenditures. Fund accounting segregates funds according to their intended purpose and is used to aid management in demonstrating compliance with legal, financial and contractual provisions.

The fund financial statements focus on: (1) individual parts of the Municipality's government and (2) reporting the Municipality's operations in more detail than the government-wide financial statements. For financial reporting purposes, the Municipality classifies its funds within the following fund categories: (1) general fund, (2) debt service fund, (3) special revenue funds and (4) capital projects funds (collectively known as the "governmental funds").

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF GUAYAMA**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**FOR THE YEAR ENDED JUNE 30, 2011**

Governmental funds are used to account for all of the services provided by the Municipality. Governmental funds are used to account for essentially the same functions reported as governmental activities in the governmental-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on near-term inflows and outflows of spendable resources. They also focus on the balances of spendable resources available at the end of the fiscal year. This approach is known as using the flow of current financial resources measurement focus and the modified accrual basis of accounting. These statements provide a detailed short-term view of the Municipality's finances that assist in determining whether there will be adequate financial resources available to meet the current needs of the Municipality, which is, evaluating the Municipality's near-term financing requirements.

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

For financial reporting purposes, the Municipality has three major funds: (1) General fund, (2) Head Start fund and (3) Debt service fund.

**Notes to the Basic Financial Statements**

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

**Required Supplementary Information**

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

**INFRASTRUCTURE ASSETS**

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

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF GUAYAMA  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
FOR THE YEAR ENDED JUNE 30, 2011**

**FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE**

**Net Assets**

As noted earlier, net assets may serve over time as a useful indicator of the Municipality's financial position. In the case of the Municipality, net assets (excess of assets over liabilities) amounted to \$93.1 millions at June 30, 2011 compared to \$87.1 millions at the end of the previous year.

The largest portion of the Municipality's net assets is invested in capital assets, net of their related debt (\$93.7 millions). The Municipality's net assets is also composed of net assets amounting to \$5.1 millions that are restricted for (1) future debt service payments, (2) the future acquisition or construction of capital assets and (3) other purposes, mainly the financing of federal and state assisted programs. In addition, the Municipality's net assets are reported net of unrestricted deficit of \$5.6 millions.

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

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

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**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF GUAYAMA**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**FOR THE YEAR ENDED JUNE 30, 2011**

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

**Comparative Condensed Statement of Net Assets**  
**Governmental Activities**  
**June 30,**

	<b>2011</b>	<b>2010</b>
<b>Assets:</b>		
Current assets	\$ 50,795,944	\$ 33,930,198
Noncurrent assets:		
Capital assets, net	106,426,146	102,297,910
Total assets	\$ 157,222,090	\$ 136,228,108
<b>Liabilities:</b>		
Current liabilities	28,877,798	12,828,454
Long-term liabilities due within one year	2,918,277	3,030,610
Long-term liabilities due after one year	32,277,492	33,305,749
Total liabilities	64,073,567	49,164,813
<b>Net assets (liabilities):</b>		
Invested in capital assets, net of related debt	\$ 93,684,851	\$ 85,580,099
Restricted	5,061,283	9,157,951
Unrestricted	(5,597,611)	(7,674,755)
Total net assets (as restated)	\$ 93,148,523	\$ 87,063,295

**Changes in Net Assets**

The Municipality's net assets increased by \$6.1 millions. Approximately 44 percent of the Municipality's total revenues came from taxes, while 52 percent resulted from grants and contributions including federal financial assistance. The Municipality's expenses cover a range of services. The largest expenses were for education (29 percent), general government (24 percent), public works (17 percent) and health, sanitation and welfare (15 percent).

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF GUAYAMA  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
FOR THE YEAR ENDED JUNE 30, 2011**

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

**Statement of Activities  
Governmental Activities  
Fiscal Years Ended June 30,**

	2011	2010
<b>Program revenues:</b>		
Program-specific operating grants and contributions	\$ 18,289,118	\$ 12,960,904
Program-specific capital grants and contributions	453,145	498,625
Charges for services	343,667	359,019
Total programs revenues	19,085,930	13,818,548
<b>General revenues:</b>		
Property taxes	11,261,119	11,809,808
Municipal license taxes	7,631,074	7,633,804
Construction excise taxes	684,181	277,540
Sales tax	3,076,027	3,364,415
Grants and contributions, not restricted to specified programs	7,884,292	7,817,476
Unrestricted interest on deposits	160,416	106,677
Miscellaneous	1,142,340	801,309
Total revenues	50,925,379	45,629,577
<b>Program expenses:</b>		
General government	10,845,007	8,324,235
Public safety	2,657,302	2,724,194
Public works	7,472,608	5,624,760
Culture and recreation	2,821,144	2,762,906
Health, sanitation and welfare	6,806,062	6,506,026
Education	13,131,874	12,293,919
Interest on long-term obligations	1,106,154	1,180,484
Total expenses	44,840,151	39,416,524
<b>Net increase in assets</b>	6,085,228	6,213,053
<b>Net assets, at beginning of fiscal year, as restated</b>	87,063,295	80,850,242
<b>Net assets, at end of fiscal year</b>	\$ 93,148,523	\$ 87,063,295

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF GUAYAMA  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
FOR THE YEAR ENDED JUNE 30, 2011**

**FINANCIAL ANALYSIS OF THE MUNICIPALITY'S GOVERNMENTAL FUNDS**

**Comparative Condensed Balance Sheet - Governmental Funds  
Major and other governmental funds  
June 30,**

	<b>2011</b>	<b>2010</b>
<b>Assets:</b>		
Total assets	\$ 56,936,671	\$ 35,617,330
Combined total assets	56,936,671	35,617,330
<b>Liabilities:</b>		
Total liabilities - major and other governmental funds	36,931,403	16,672,721
Combined total liabilities	36,931,403	16,672,721
<b>Fund balances:</b>		
Restricted, committed and assigned - major and other governmental funds	18,157,140	15,227,657
Unassigned - major and other governmental funds	1,848,128	3,716,952
Combined total fund balances	20,005,268	18,944,609
<b>Total liabilities and fund balances</b>	<b>\$ 56,936,671</b>	<b>\$ 35,617,330</b>

***Analysis of Financial Position of Governmental Funds***

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

At June 30, 2011, the total assets of governmental funds increased by \$21.3 millions (60 percent). Total liabilities of governmental funds increased by \$20.3 millions (122 percent).

For a detailed explanation of the individual fluctuations of total assets and total liabilities of governmental funds, please refer to the previous financial analysis of the government-wide financial statements included in this management's discussion and analysis, where a detailed discussion of most of these fluctuations has been made.

The total fund balances increased by \$1.1 millions during the current fiscal year.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF GUAYAMA**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**FOR THE YEAR ENDED JUNE 30, 2011**

The following is a detailed financial analysis of the Municipality's governmental funds:

**Major Governmental Funds**

**General fund** – The General fund (GF) is the principal operating fund of the Municipality. The GF's total assets amounted to \$30,413,196 at June 30, 2011. Such assets consist mainly of unrestricted cash and cash equivalents (\$27,719,545).

The GF's total liabilities amounted to \$27,158,343. Such liabilities are composed mainly of commitment and contingencies (\$15,984,516) and deferred revenues (\$7,842,778).

At the end of the current fiscal year, the fund balance of the GF's amounted to \$3,254,853.

**Head Start fund** – The Head Start special revenue fund (HSSRF) total assets amounted to \$754,159, which consist mainly of cash in commercial banks (\$535,977). The HSSRF's total liabilities amounted to \$754,159.

**Debt service fund** – The debt service fund (DSF) total assets amounted to \$5,219,251, which consist of restricted cash in fiscal agent (\$5,138,000) and property taxes receivable (\$81,251). The DSF's total liabilities amounted to \$2,047,264, which composed of: (1) matured bonds due and payable (\$1,515,000), (2) matured interest due and payable (\$532,264). At the end of the current fiscal year, DSF's total and restricted fund balance reached \$3,171,987.

**Other governmental funds** – The other governmental funds (OGF) total assets amounted to \$20,550,065, which consist mainly of restricted cash in fiscal agent and commercial banks (\$8,347,148). The OGF's total liabilities amounted to \$6,971,637, which are composed mainly of due to other funds (\$4,242,237), and accounts payable and accrued liabilities (\$2,218,408). At the end of the current fiscal year, OGF's total fund balance reached \$13,578,428.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF GUAYAMA  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
FOR THE YEAR ENDED JUNE 30, 2011**

**Condensed Statement of Revenues, Expenditures and Changes  
in Fund Balances - Governmental Funds  
Fiscal Year Ended June 30,**

	<b>2011</b>	<b>2010</b>
<b>Revenues:</b>		
Total revenues - major and other governmental funds	\$ 51,815,809	\$ 45,194,033
Combined total revenues	51,815,809	45,194,033
<b>Expenditures:</b>		
Total expenditures - major and other governmental funds	51,383,150	42,960,326
Combined total expenditures	51,383,150	42,960,326
<b>Excess of expenditures over revenues</b>	<b>432,659</b>	<b>2,233,707</b>
<b>Other financing sources (uses), net:</b>		
Other financing sources, net - major and other governmental funds	628,000	755,000
Combined other financing sources (uses), net	628,000	755,000
<b>Net change in fund balance</b>	<b>1,060,659</b>	<b>2,988,707</b>
<b>Fund balance, at beginning of fiscal year</b>	<b>18,944,609</b>	<b>15,955,902</b>
<b>Fund balance, at end of fiscal year</b>	<b>\$ 20,005,268</b>	<b>\$ 18,944,609</b>

**CAPITAL ASSETS AND DEBT ADMINISTRATION**

**Capital Assets**

The accompanying statement of net assets reported total gross capital assets, at cost, amounting to \$125.6 millions. The related accumulated depreciation and amortization of capital assets amounted to \$19.1 millions. This investment in capital assets includes land, buildings, improvements, equipment, infrastructure and construction in progress. Infrastructure assets are items that are normally immovable and of value only to the municipal government, such as roads, bridges, streets and sidewalks, drainage systems, lighting systems, and similar items.

Actual costs incurred to purchase or construct capital assets were \$6.3 millions for the year ended June 30, 2011. Depreciation and amortization charges for the year totaled \$2.1 millions.

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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF GUAYAMA**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**FOR THE YEAR ENDED JUNE 30, 2011**

**Debt Administration**

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

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

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

**ECONOMIC FACTORS AND NEXT BUDGETS AND RATES**

The Municipality relies primarily on property and municipal license taxes, as well as, federal and state grants to carry out the governmental activities. Historically, property and municipal license taxes have been very predictable with increases not generally exceeding ten percent. Federal grant revenues may vary if new grants are available but the revenue is also very predictable.

Those factors were considered when preparing the Municipality's budget for the 2010-2011 fiscal year. There were no significant changes between the budget for fiscal year 2009-2010 and the one for fiscal year 2010-2011.

**REQUEST FOR INFORMATION**

This financial report is designed to provide a general overview of the Municipality's finances for all of the Municipality's citizens, taxpayers, customers, investors and creditors. This financial report seeks to demonstrate the Municipality's accountability for the money it receives. Questions concerning any of the information provided in this report or requests for additional information should be addressed to: Municipality's Director of Finance, Mr. Amílcar Ayala Acevedo, at PO Box 360, Guayama, Puerto Rico, 00785.

**BASIC FINANCIAL STATEMENTS**

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF GUAYAMA**  
**STATEMENT OF NET ASSETS**  
**JUNE 30, 2011**

<b>Assets</b>	<b>Governmental activities</b>
<b>Current assets:</b>	
Cash in commercial banks	\$ 33,099,262
Account receivables:	
Taxes:	
Property taxes	81,251
Sales tax	155,592
Intergovernmental	916,452
Grants and contributions	1,665,137
Real estate held for sale	514,800
 Restricted assets:	
Cash in commercial banks	2,668,311
Cash in fiscal agent	11,695,139
 Total current assets	50,795,944
 <b>Noncurrent assets:</b>	
Capital assets:	
Depreciable capital assets	72,895,333
Nondepreciable capital assets	52,663,980
Accumulated depreciation and amortization	(19,133,167)
Capital assets, net of accumulated depreciation	106,426,146
Total noncurrent assets	106,426,146
 Total assets	\$ 157,222,090

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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF GUAYAMA**  
**STATEMENT OF NET ASSETS**  
**JUNE 30, 2011**

**Liabilities and net assets**

	<u>Governmental activities</u>
<b>Current liabilities (due within one year):</b>	
Accounts payable	\$ 3,290,178
Intergovernmental payables	448,358
Accrued employees' christmas bonus	457,507
Accrued interest payable on long-term debt	532,264
Unearned revenues	8,164,975
Commitments and contingencies	15,984,516
Current portion of long-term obligations:	
Bonds payable	\$ 1,545,000
Notes payable	60,727
Compensated absences	1,312,550
Total current portion of long-term obligations	<u>2,918,277</u>
Total current liabilities	<u>31,796,075</u>
<b>Noncurrent liabilities, excluding current portion (due in more than one year):</b>	
Bonds payable	21,712,105
Notes payable	117,304
Landfill closure and postclosure costs	9,332,770
Compensated absences	1,115,313
Total noncurrent liabilities	<u>32,277,492</u>
Total liabilities	<u>64,073,567</u>
<b>Net assets (deficit):</b>	
Invested in capital assets, net of related debt	93,684,851
Restricted for:	
Debt service	\$ 3,171,987
Capital projects	530,846
Other specified purposes	1,358,450
Total restricted net assets	<u>5,061,283</u>
Unrestricted	<u>(5,597,611)</u>
Total net assets	<u>\$ 93,148,523</u>

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

Commonwealth of Puerto Rico  
Municipality of Guayama  
Statement of Activities  
Fiscal Year Ended June 30, 2011

Function/programs	Expenses including depreciation and amortization of \$2,145,021	Charges for services	Program revenues		Net (expenses) and changes in net assets
			Program-specific operating grants and contributions	Program-specific capital grants and contributions	
Governmental activities:					
General government	\$ 10,845,007	\$ 127,958	\$ -	\$ -	\$ (10,717,049)
Public safety	2,657,302	-	-	-	(2,657,302)
Public works	7,472,608	-	3,850,527	453,145	(3,168,936)
Culture and recreation	2,821,144	215,709	-	-	(2,605,435)
Health, sanitation and welfare	6,806,062	-	1,532,819	-	(5,273,243)
Education	13,131,874	-	12,905,772	-	(226,102)
Interest on long-term obligations	1,106,154	-	-	-	(1,106,154)
Total governmental activities	<u>\$ 44,840,151</u>	<u>\$ 343,667</u>	<u>\$ 18,289,118</u>	<u>\$ 453,145</u>	<u>(25,754,221)</u>
General revenues					
Taxes:					
Property taxes					11,261,119
Municipal license taxes					7,631,074
Construction excise taxes					684,181
Sales tax					3,076,027
Total taxes					<u>22,652,401</u>
Grants and contributions, not restricted to specified programs					7,884,292
Unrestricted interest on deposits					160,416
Miscellaneous					1,142,340
Total general revenues					<u>31,839,449</u>
Net change in net assets					6,085,228
Net assets at beginning of fiscal year, as restated					87,063,295
Net assets at end of year					<u>\$ 93,148,523</u>

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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF GUAYAMA**  
**BALANCE SHEET – GOVERNMENTAL FUNDS**  
**JUNE 30, 2011**

	<u>Major governmental funds</u>				
	<u>General fund</u>	<u>Head start fund</u>	<u>Debt service fund</u>	<u>Other governmental funds</u>	<u>Total governmental funds</u>
<b>Assets</b>					
Cash in commercial banks	\$ 27,719,545	\$ -	\$ -	\$ 5,379,717	\$ 33,099,262
Account receivable, net of allowance of uncollectible accounts					
Taxes:					
Property taxes	-	-	81,251	-	81,251
Sales tax	155,592	-	-	-	155,592
Grants and contributions	-	218,182	-	1,446,955	1,665,137
Due from governmental entities	188,795	-	-	575,867	764,662
Due from other funds	2,006,939	-	-	4,800,378	6,807,317
Restricted assets:					
Cash in commercial banks	342,325	535,977	-	1,790,009	2,668,311
Cash in fiscal agent	-	-	5,138,000	6,557,139	11,695,139
Total assets	<u>\$ 30,413,196</u>	<u>\$ 754,159</u>	<u>\$ 5,219,251</u>	<u>\$ 20,550,065</u>	<u>\$ 56,936,671</u>
<b>Liabilities and Fund balances</b>					
<b>Liabilities</b>					
Accounts payable and accrued liabilities	\$ 798,982	\$ 272,788	\$ -	\$ 2,218,408	\$ 3,290,178
Intergovernmental payable	448,358	-	-	-	448,358
Due to other funds	2,083,709	481,371	-	4,242,237	6,807,317
Deferred revenues	7,842,778	-	-	510,992	8,353,770
Matured bonds due and payable	-	-	1,515,000	-	1,515,000
Accrued interest payable	-	-	532,264	-	532,264
Commitment and contingencies	15,984,516	-	-	-	15,984,516
Total liabilities	<u>27,158,343</u>	<u>754,159</u>	<u>2,047,264</u>	<u>6,971,637</u>	<u>36,931,403</u>
<b>Fund balances</b>					
Restricted	342,325	-	3,171,987	2,989,787	6,504,099
Committed	-	-	-	5,454,736	5,454,736
Assigned	1,064,400	-	-	5,133,905	6,198,305
Unassigned	1,848,128	-	-	-	1,848,128
Total fund balances	<u>3,254,853</u>	<u>-</u>	<u>3,171,987</u>	<u>13,578,428</u>	<u>20,005,268</u>
Total liabilities and fund balances	<u>\$ 30,413,196</u>	<u>\$ 754,159</u>	<u>\$ 5,219,251</u>	<u>\$ 20,550,065</u>	<u>\$ 56,936,671</u>

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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF GUAYAMA**  
 Reconciliation of the Balance Sheet - Governmental Funds  
 to the Statement of Net Assets  
 June 30, 2011

The amounts of governmental activities reported in the statement of net assets and the balance sheet-governmental funds, are different for the following reasons:

Total fund balance reported in the balance sheet - governmental funds	\$ 20,005,268
Add (Deduct):	
Capital assets used in governmental funds activities are not financial resources, therefore are not reported in the governmental funds	106,426,146
Capital outlay of real property held for sale in governmental fund activities are not financial resources, therefore, are not reported in the governmental funds	514,800
Deferred (unavailable) revenues in the governmental funds that are recognized as revenues in the statements of activities	188,795
Intergovernmental receivables related to Christmas bonus that are not considered available financial resources at fiscal year-end, therefore, are not reported in the governmental funds.	151,790
The following liabilities are not due (mature) in the current fiscal year, therefore are not reported in the governmental funds:	
Accrued employees' Christmas bonus	(457,507)
Bonds payable	(21,742,105)
Notes payable	(178,031)
Compensated absences	(2,427,863)
Solid waste landfill closure and postclosure cares costs	<u>(9,332,770)</u>
Net assets - governmental activities reported in statement of net assets	<u>\$ 93,148,523</u>

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

**Commonwealth of Puerto Rico**  
**Municipality of Guayama**  
Statement of Revenues, Expenditures and  
Changes in Fund Balances - Governmental Funds  
Fiscal Year Ended June 30, 2011

	<u>Major governmental funds</u>				
	<u>General fund</u>	<u>Head start fund</u>	<u>Debt service fund</u>	<u>Other governmental funds</u>	<u>Total governmental funds</u>
<b>Revenues:</b>					
Taxes:					
Property taxes	\$ 6,275,673	\$ -	\$ 5,886,457	\$ -	\$ 12,162,130
Municipal license taxes	7,631,074	-	-	-	7,631,074
Licences and permits	684,181	-	-	-	684,181
Sales taxes	2,395,938	-	388,105	291,985	3,076,028
Intergovernmental revenues	5,606,325	-	-	2,559,369	8,165,694
Grants and contributions	-	11,163,669	-	7,286,610	18,450,279
Charges for services	127,958	-	-	215,709	343,667
Interest on deposits	159,315	-	746	355	160,416
Miscellaneous	745,569	-	-	396,771	1,142,340
Total revenues	<u>23,626,033</u>	<u>11,163,669</u>	<u>6,275,308</u>	<u>10,750,799</u>	<u>51,815,809</u>
<b>Expenditures:</b>					
Current:					
General government	9,691,523	-	-	1,267,927	10,959,450
Public safety	2,493,947	-	-	60,996	2,554,943
Public works	4,330,183	-	-	2,371,127	6,701,310
Culture and recreation	1,670,803	-	-	175,397	1,846,200
Health, sanitation and welfare	4,731,204	-	-	2,022,651	6,753,855
Education	-	11,029,777	-	1,986,871	13,016,648
Debt service:					
Principal	113,526	-	1,543,000	-	1,656,526
Interest	38,503	-	1,067,651	-	1,106,154
Capital outlays	101,190	99,431	-	6,587,443	6,788,064
Total expenditures	<u>23,170,879</u>	<u>11,129,208</u>	<u>2,610,651</u>	<u>14,472,412</u>	<u>51,383,150</u>
Excess (deficiency) of revenues over (under) expenditures	<u>455,154</u>	<u>34,461</u>	<u>3,664,657</u>	<u>(3,721,613)</u>	<u>432,659</u>
<b>Other financing sources (uses):</b>					
Transfers-in from other funds	-	46,831	27,892	8,267,922	8,342,645
Transfers-out to other funds	(1,867,096)	(81,292)	(4,199,158)	(2,195,099)	(8,342,645)
Proceeds from issuance of bonds	-	-	-	628,000	628,000
Total other financing sources (uses), net	<u>(1,867,096)</u>	<u>(34,461)</u>	<u>(4,171,266)</u>	<u>6,700,823</u>	<u>628,000</u>
<b>Net change in fund balance</b>	<u>(1,411,942)</u>	<u>-</u>	<u>(506,609)</u>	<u>2,979,210</u>	<u>1,060,659</u>
<b>Fund balance at beginning of fiscal year</b>	4,666,795	-	3,678,596	10,599,218	18,944,609
<b>Fund balance at end of fiscal year</b>	<u>\$ 3,254,853</u>	<u>\$ -</u>	<u>\$ 3,171,987</u>	<u>\$ 13,578,428</u>	<u>\$ 20,005,268</u>

The accompanying notes to the basic 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 – GOVERNMENTAL FUNDS**  
**TO THE STATEMENT OF ACTIVITIES**  
**FISCAL YEAR ENED JUNE 30, 2011**

Governmental activities' amounts reported in the statements of activities and the statement of revenues, expenditures and changes in fund balances - governmental funds are difference because:

Net change in fund balances reported in statement of revenues, expenditures and changes in fund balance - governmental funds.	\$ 1,060,659
Add (Deduction)	
The following revenues recorded in the statement of activities do not provide current financial resource, therefore are deferred in the governmental funds:	
Decrease in Property tax deferred revenues	(901,003)
Governmental funds report capital outlays as expenditures. However, in the statement of activities the cost of those assets are allocated over their estimated useful lives as amortization expense. This is the amount by which capital outlays exceeded depreciation and amortization expense.	4,128,236
The cost of fourteen houses to be sold to low to moderate income families	514,800
Repayment of principal of long term obligation is an expenditure in the governmental funds but the repayment reduces long term liabilities in the statement of net assets.	1,656,526
Some expenses reported in the statement of activities do not required the use of current financial resources, therefore are not reported as expenditures in the governmental funds.	662,010
The landfill closure and postclosures care cost do not required the use of current financial resources and therefore are not reported as expenditures in the funds financial statement.	(408,000)
Proceeds from issuance of bond provide current financial resources to governmental fund, but issuing such debt increases long term liabilities in the statement of net assets.	<u>(628,000)</u>
	<u>\$ 6,085,228</u>
Net change in net assets as reported in the accompanying statement of activities	

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF GUAYAMA**  
**NOTES TO FINANCIAL STATEMENTS**  
**JUNE 30, 2011**

**1. Summary of Significant Accounting Policies**

The Municipality of Guayama (the Municipality) is a local municipal government in the Commonwealth of Puerto Rico (the Commonwealth) founded in 1736. The Municipality has full legislative, fiscal and all other governmental powers and responsibilities expressly assigned by Public Act No. 81 of August 30, 1991, as amended, known as Autonomous Municipalities Act of the Commonwealth of Puerto Rico (Act No. 81). The Municipality is one of seventy-eight municipalities legally separated from the Commonwealth's government.

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

The Municipality assumes either partial or full responsibility for providing services to its citizens related to public housing, welfare, public safety, health, sanitation, education, culture, recreation, urban development, economic development, and many other fiscal, general and administrative services.

**a) *Financial Reporting Model***

The accompanying basic financial statements present the financial position and the results of operations of the Municipality as a whole, and its various governmental funds as of and for the fiscal year ended June 30, 2011 in conformity with accounting principles generally accepted in the United States of America (GAAP), as prescribed by the Governmental Accounting Standards Board (GASB).

According to the financial reporting model established by GASB Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments* (GASB No. 34), the required basic financial statement presentation applicable to the Municipality is composed of the following elements: (1) government-wide financial statements (GWFS), (2) governmental fund financial statements (GFFS), (3) notes to basic financial statements, and (4) required supplementary information (RSI).

RSI is information presented along with, but separate from, the Municipality's basic financial statements. RSI is composed of the following elements: (1) Management's Discussion and Analysis (MD&A), (2) Budgetary Comparison Schedule - General Fund, and (3) Budgetary Comparison Schedule - Debt Service Fund.

*MD&A* is a narrative report that introduces the accompanying basic financial statements and provides an analytical overview of the Municipality's financial activities for the fiscal year ended June 30, 2011, based on the Municipality's knowledge of the transactions, events and conditions reflected in the basic financial statements. The MD&A also highlights certain key fiscal policies that control the Municipality's operations.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF GUAYAMA**  
**NOTES TO FINANCIAL STATEMENTS**  
**JUNE 30, 2011**

The *Budgetary Comparison Schedule - General Fund* and the *Budgetary Comparison Schedule - Debt Service Fund* are a companion of the actual results (using the budgetary basis of accounting, which differs from GAAP) with the original budget and the final amended budget for the General Fund and the Debt Service Fund. A budget to GAAP reconciliation is presented providing information of differences between the budgetary basis of accounting and GAAP.

**b) *Financial Reporting Entity***

The accompanying basic financial statements include all departments, agencies and municipal operational units that are under the legal and administrative control of the Mayor, and whose financial resources are under the legal custody and control of the Municipality's Director of Finance and Budget, as prescribed by Act No. 81.

The Municipality's management has considered all potential component units (whether governmental, not-for-profit, or profit-oriented) for which it may be financially accountable and other legally separate organizations for which the nature and significance of their relationship with the Municipality may be such that exclusion of their basic financial statements from those of the Municipality would cause the Municipality's basic financial statements to be misleading or incomplete.

GASB Statement No. 14, *The Financial Reporting Entity* (GASB No. 14), as amended, has set forth criteria to be considered in determining financial accountability for financial reporting purposes. These criteria include appointing a voting majority of an organization's governing body and: (1) the ability of the Municipality to impose its will on that organization or (2) the potential for the organization to provide specific financial benefits to, or impose specific financial burdens on, the Municipality.

On July 1, 2003, the Municipality adopted the provisions of GASB Statement No. 39, *Determining Whether Certain Organizations are Component Units - an Amendment of GASB Statement No. 14* (GASB No. 39). GASB No. 39 states that certain organizations for which a primary government is not financially accountable nevertheless warrant inclusion as part of the financial reporting entity because of the nature and significance of their relationship with the primary government, including their ongoing financial support of the primary government and its other component units.

According to GASB No. 39, a legally separate tax-exempt organization should be reported as a discretely presented component unit of a reporting entity if all of the following criteria are met:

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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF GUAYAMA**  
**NOTES TO FINANCIAL STATEMENTS**  
**JUNE 30, 2011**

In addition, GASB No. 39 states that other organizations should be evaluated as potential component units if they are closely related to, or financially integrated with, the primary government. Such types of entities may be presented as either blended or discretely presented component units, depending upon how they meet the criteria for each specified in GASB No. 14.

The Municipality's management has concluded that, based on the aforementioned criteria, there are no legally separate entities or organizations that should be reported as component units of the Municipality for the fiscal year ended June 30, 2011.

**c) *Government-wide Financial Statements***

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

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

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

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

- **Invested in capital assets, net of related debt** – These consist of capital assets, net of accumulated depreciation and amortization, reduced by the outstanding balances of bonds, notes and other debt that are attributed to the acquisition, construction or improvement of those assets. For the purposes of determining the outstanding debt attributed to capital assets, the total long-term debt related to the acquisition, construction or improvement of capital assets have been reduced by any related unspent debt proceeds and any related unamortized debt issuance costs.
- **Restricted net assets** – This net asset category consists of net resources restricted by external parties (such as creditors, grantors, contributors, laws or regulations of other governments, etc.), or net assets for which constraints are imposed by constitutional

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF GUAYAMA**  
**NOTES TO FINANCIAL STATEMENTS**  
**JUNE 30, 2011**

provisions or enabling legislation. Enabling legislation consists of legislation that authorizes the Municipality to assess, levy, charge or otherwise mandate payment of resources (from external resource providers). Enabling legislation establishes restrictions if it includes a legally enforceable requirement that those resources be used only for the specific purposes stipulated in the legislation.

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

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

The Municipality has reported the following types of restricted net assets in the accompanying statement of net assets:

- (1) ***Debt service*** – Represent net resources available to cover future debt service payments of bonds and notes payable.
  - (2) ***Capital projects*** – Represent net resources available to finance the acquisition, construction or improvement of major capital assets under contracts and other commitments.
  - (3) ***Other specified purposes*** – Represent net resources available from certain federal and state grants, which have been set aside to carry out several programs. Also, represent net resources available for the payment of certain accounts payable and commitments approved by the Government Development Bank for Puerto Rico (GDB), a component unit of the Commonwealth and fiscal agent of the Municipality.
- **Unrestricted** – This category consists of the excess of assets over related liabilities that are neither externally nor legally restricted, neither invested in capital assets. However, assets reported within unrestricted deficit often are designated to indicate that management does not consider them to be available for general operations.

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

The accompanying statement of activities presents the results of the Municipality's operations by showing how the Municipality's net assets changed during the year ended June 30, 2011, using a net (expense) revenue format. This statement presents the cost of each function/program as well as the extent to which each of the Municipality's functions, programs or other services either contributes to or draws from the Municipality's general revenues (such as property taxes, sales taxes, municipal license taxes, construction excise taxes, etc.).

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF GUAYAMA**  
**NOTES TO FINANCIAL STATEMENTS**  
**JUNE 30, 2011**

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

**General government:**

- Municipal legislature
- Mayor's office
- Department of finance
- Department of budget and management
- Department of human resources
- Department of public relations
- Department of municipal secretary
- Department of internal audit
- EDP Department

**Public safety:**

- Department of emergency management
- Department of municipal police

**Public works:**

- Department of public works
- Department of transportation
- Department of land use

**Culture and recreation:**

- Department of recreation and sports
- Department of tourism and culture

**Health, sanitation and welfare**

- Department of health
- Department of sanitation
- Department of elderly affairs
- Department of citizen affairs

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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF GUAYAMA**  
**NOTES TO FINANCIAL STATEMENTS**  
**JUNE 30, 2011**

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

- **Charges for services** – These generally consist of exchange or exchange-like transactions involving charges to customers or applicants who purchase, use or directly benefit from the goods, services or privileges provided, or are otherwise directly affected by the services. These include fees charged for specific services, charges for licenses and permits, and fines and forfeitures, among others.
- **Program-specific capital and operating grants and contributions** – These consist of transactions that are either mandatory or voluntary nonexchange transactions with other governments, organizations, or individuals that restrict the resources for use in a particular program. Capital grants and contributions consist of capital assets or resources that are restricted for capital purposes – to purchase, construct or renovate capital assets associated with a specific program. Operating grants and contributions consist of resources that are required to be used to finance the costs of operating a specific program or can be used either for operating or capital purposes of a specific program. Restricted capital and operating grants and contributions are program revenues because they are specifically attributable to a program and reduce the net expense of that program to the Municipality. They are reported net of estimated uncollectible amounts.

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

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

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

The Municipality classifies all of its activities as *governmental activities* in the accompanying GWFS. These are activities generally financed through taxes, intergovernmental revenues and

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF GUAYAMA**  
**NOTES TO FINANCIAL STATEMENTS**  
**JUNE 30, 2011**

other nonexchange revenues that can be used to support the Municipality's programs or services. These governmental activities are also generally reported in the GFFS.

The Municipality has no fiduciary activities, which are those in which the Municipality would be holding or managing net assets for specific individuals or other external parties in accordance with trust agreements or other custodial arrangements. In addition, the Municipality has no operations or activities that are financed and operated in a manner similar to private business enterprises, where the costs of providing goods or services to the general public (expenses, including depreciation) is financed primarily through user charges; or where the governing body has decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

**d) *Governmental Fund Financial Statements***

A fund is a fiscal and accounting entity consisting of a self-balancing set of accounts used to record assets, liabilities and residual equities, deficits or balances, and changes therein, which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with GAAP and/or special regulations, restrictions or limitations.

The accompanying Governmental Fund Financial Statements (GFFS) are composed of: (1) the balance sheet – governmental funds, and (2) the statement of revenues, expenditures and changes in fund balances – governmental funds.

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

The accompanying GFFS segregate governmental funds according to their intended purpose and are used in demonstrating compliance with legal, financial and contractual provisions. The minimum number of governmental funds is maintained consistent with legal and self-imposed managerial requirements established by the Municipality. For financial reporting purposes, the Municipality classifies its governmental funds within the following categories:

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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF GUAYAMA**  
**NOTES TO FINANCIAL STATEMENTS**  
**JUNE 30, 2011**

- **Special revenue funds** – The special revenue funds are nonmajor funds, as defined below, used by the Municipality to account for revenues derived from grants or other revenue sources (other than major capital projects) that are legally restricted, committed or assigned to expenditure for specific purposes other than debt services or capital projects. The uses and limitations of each special revenue fund are specified by municipal ordinances or federal and state statutes. However, resources restricted, committed or assigned to expenditure for purposes normally financed from the general fund are reported in the Municipality's general fund provided that all applicable legal requirements are appropriately satisfied. In this case, a special revenue fund to account for such kind of transactions will be used only if legally mandated.
  
- **Debt service fund** – The debt service fund is a major fund, as defined below, used by the Municipality to account for the accumulation of resources that are restricted for, and the payment of, principal and interest for: (1) bonds and notes for which debt service payments are legally mandated to be accounted for in a debt service fund and/or (2) general long-term debt for which the Municipality is being accumulating financial resources in advance, to pay principal and interest payments maturing in future years. Principal and accrued interest due on July 1 of the following fiscal year related to long-term debt for which debt service payments are accounted for in the debt service fund, are recorded as debt service fund's liabilities at June 30, if resources are available at June 30 for its payment.

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

- **Capital projects funds** – Capital projects funds are nonmajor funds, as defined below, used to account for the financial resources used in the acquisition or construction of major capital facilities, other assets and permanent improvements. Significant capital outlays financed from general obligation bond proceeds are accounted for also in the capital projects funds.

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

The focus of the GFFS is on major governmental funds, which generally represent the Municipality's most important funds. Accordingly, the Municipality is required to segregate governmental funds between major and nonmajor categories within the GFFS. Major individual governmental funds are reported individually as separate columns in the GFFS, while data from all nonmajor governmental funds are aggregated into a single column, regardless of fund type.

By definition, the Municipality's general fund is always considered a major governmental fund for financial reporting purposes. In addition, any other governmental fund is considered a major governmental fund if its total assets, liabilities, revenues or expenditures of that individual

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF GUAYAMA**  
**NOTES TO FINANCIAL STATEMENTS**  
**JUNE 30, 2011**

governmental fund if its total assets, liabilities, revenues or expenditures of that individual governmental fund are at least 10 percent of the corresponding element total (assets, liabilities, revenues or expenditures) for all governmental funds. For the purposes of applying the aforementioned major fund criteria, no eliminations of interfund balances have been made. Total revenues for these purposes means all revenues, including operating and nonoperating revenues (net of allowances for uncollectible accounts), except for other financing sources. Total expenditures for these purposes, means all expenditures, including operating and nonoperating expenditures, except for other financing uses. Based on the aforementioned criteria, the Municipality's major governmental funds reported in the accompanying GFFS are:

**General Fund** – This fund is used to account for all financial resources, except those required to be accounted for in another fund;

**Head Start Fund** – This fund is used to account for the receipts and disbursements of the head start program grant administered by the Administration for the Integral Care and Development of Children of the Commonwealth of Puerto Rico, as a pass-through entity of the U.S. Department of Health and Human Services;

**Debt Service Fund** – This fund is used to account for, and report for the accumulation of financial resources that are restricted for, and the payment of, principal and interest for: (1) bonds payable for which debt service payments are legally mandated to be accounted for in a debt service fund and (2) certain special long-term obligations for which the Municipality is being accumulating financial resources in advance to pay principal and interest payments maturing in future years.

The Municipality adopted the provisions of GASB Statement No. 54, Fund Balance Reporting and Governmental Fund Type Definitions (GASB 54), which enhanced the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied. This statement establishes fund balance classifications that comprise a hierarchy based primarily on the extent to which the Municipality is bound to observe constraints imposed upon the use to the resources reported in governmental funds. Pursuant to the provisions of this statement, the fund balances are reported in five categories:

- **Nonspendable:** Amounts that cannot be spent because they are either not in spendable form or they are legally or contractually required to remain intact, including but not limited to inventories, prepaid items, and long-term balances of loans and notes receivable.
- **Restricted:** Amounts the use of which is subject to constraints imposed by external parties, including creditors, grantors, and laws and regulations of other governments, or imposed by enabling legislation (that is, legislation that creates a new revenue source and restricts it use). Effectively, restrictions may be change or lifted only with the concern of resource providers.
- **Committed:** Amounts that can only be used for specific purposes pursuant to constraints imposed by formal action of the Municipal's highest level of decision making authority (Municipal Legislature through resolution and ordinances) and can only be hanged by a similar law, ordinance or resolution, no later than the end of fiscal year.
- **Assigned:** Amounts intended to be used by the Municipality for specific purposes, but do not meet the criteria to be classified as restricted or committed (generally executive orders approved by the Mayor). Intent can be expressed by the Municipal Legislature, the Mayor or by an official or body to which the Municipal Legislature delegates authority in conformity with the Autonomous Municipalities Act of Puerto Rico, as amended. In governmental funds other than the general fund, assigned fund balance represents the remaining amount that is not restricted or committed.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF GUAYAMA**  
**NOTES TO FINANCIAL STATEMENTS**  
**JUNE 30, 2011**

- Unassigned: Represent the residual classification for the Municipality's general fund and includes all spendable amounts not contained in the other classifications. In other funds, the unassigned classification is used only to report a deficit balance resulting from overspending for specific purposes for which amounts had been restricted, committed or assigned.

Negative fund balance amounts are assigned amounts reduced to the amount that will rise the fund balance to zero. Consequently, negative residual amounts is restricted, committed and assigned fund balance classifications have been reclassified to unassigned fund balances

At June 30, 2011, the accompanying fund financial statements reported fund balances as restricted, committed, assigned and unassigned.

The Municipality reports resources constrained to stabilization as a specified purpose (restricted or committed fund balance in the general fund) only if: (1) such resources meet the other criteria for those classifications, as described above and (2) the circumstances or conditions that signal the need for stabilization are identified in sufficient detail and are not expected to occur routinely. However, the Municipality has not entered into any stabilization-like arrangements, nor has set aside material financial resources for emergencies and has not established forma minimum fund balances amounts as of and for the fiscal year ended June, 30, 2011

In situations when an expenditure is made for a purpose for which amounts are available in multiple fund balance classifications, the Municipality uses restricted resources first, and then unrestricted resources. Within unrestricted resources, the Municipality generally spends committed resources first, followed by assigned resources, and then unassigned resources when expenditures.

The accompanying GFFS are accompanied by other statements and schedules required by GAAP: (1) the reconciliation of the balance sheet – governmental funds to the statement of net assets, (2) the reconciliation of the statement of revenues, expenditures and changes in fund balances – governmental funds to the statement of activities, (3) the budgetary comparison schedule – general fund, and (4) the budgetary comparison schedule – debt service fund.

*e) Measurement Focus and Basis of Accounting*

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

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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF GUAYAMA**  
**NOTES TO FINANCIAL STATEMENTS**  
**JUNE 30, 2011**

All revenues, expenses, gains, losses and assets resulting from nonexchange transactions are recorded using the criteria set forth by GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions* (GASB No. 33), which the Municipality adopted on July 1, 2002. GASB No. 33 established accounting and reporting standards for nonexchange transactions involving cash and financial or capital resources (for example, most taxes, grants and private donations). In a nonexchange transaction, the Municipality gives (or receives) value without directly receiving (or giving) equal value in return. This is different from an exchange transaction, in which each party receives and gives up essentially equal values. According to GASB No. 33, the Municipality groups its nonexchange transactions into the following four classes in the accompanying basic financial statements: (a) derived tax revenues, (b) imposed nonexchange revenues, (c) government mandated nonexchange transactions, and (d) voluntary nonexchange transactions.

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

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

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

Voluntary nonexchange transactions (such as donations and certain grants and entitlements) result from legislative or contractual agreements, other than exchanges, willingly entered into by two or more parties. In these types of transactions, receivables and revenues are generally accounted for in the same manner as government-mandated nonexchange transactions discussed above. Events that are neither exchange nor nonexchange transactions are recorded when it is probable that a loss has been incurred and the amount of loss is reasonably estimable. Receipts of any type of revenue sources collected in advance for use in the following period are recorded as deferred revenues.

According to GASB No. 34, all general capital assets and the unmatured long-term liabilities are recorded only in the accompanying statement of net assets. The measurement focus and the basis of accounting used in the accompanying GWFS differ significantly from the measurement focus and basis of accounting used in the preparation of the accompanying GFFS. Therefore, the accompanying GFFS include reconciliations, as detailed in the accompanying table of contents, to better identify the relationship between the GWFS and the GFFS.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF GUAYAMA**  
**NOTES TO FINANCIAL STATEMENTS**  
**JUNE 30, 2011**

**Governmental fund financial statements** – The accompanying GFFS are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are generally recognized as soon as they are both measurable and available. Revenues are generally considered to be available when they are collectible within the current year or soon enough thereafter to pay liabilities of the current year. For this purpose, the Municipality considers most revenues to be available if collected within 90 days after June 30, 2011, except for property taxes for which the availability period is 60 days. Revenue sources not meeting this availability criterion or collected in advance are recorded as deferred revenues at June 30, 2011.

The principal revenue sources considered susceptible to accrual include property taxes, municipal license taxes, sales taxes, intergovernmental grants and contributions and interest income. These principal revenue sources meet both measurability and availability criteria in the accompanying GFFS, except for amounts recorded as deferred revenues.

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

All revenues, expenses, gains, losses and assets resulting from nonexchange transactions are recorded in a similar manner to the GWFS, using the previously discussed criteria set forth by GASB No. 33 for nonexchange transactions, but subject to and limited by the availability criteria discussed above. Accordingly, property tax and municipal license tax receivables are also generally recorded in the fiscal year when an enforceable legal claim has arisen while property tax and municipal license tax revenues (net of amounts considered not collectible) are also generally recorded in the fiscal year when resources are required to be used or the first fiscal year that the use of the resources is permitted.

Receivables and revenues from federal and state grants and contributions, donations and entitlements are also generally recorded when all eligibility requirements imposed by the provider have been met (generally, as qualifying reimbursable expenditures are incurred).

Interest income is recorded when earned only if collected within 90 days after year-end since these would be considered both measurable and available.

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

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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF GUAYAMA**  
**NOTES TO FINANCIAL STATEMENTS**  
**JUNE 30, 2011**

Modifications to the accrual basis of accounting in accordance with GASBI No. 6 include:

- Employees' accumulated vacation, sick leave and compensatory time (compensated absences) is recorded as expenditure when consumed. The amount of the unpaid compensated absences has been reported only in the accompanying statements of net assets.
- Principal and interest on bonds and notes payable are recorded when they mature (when payment is due), except for principal and interest due in July 1 of the following fiscal year, which are recorded when resources are available in the debt service fund (generally June 30).
- Obligations under capital leases, amounts subject to claims and judgments under litigation and other long-term obligations are recorded only when they mature (when payment is due).
- Accounts payable and accrued liabilities not expected to be liquidated with available and expendable financial resources are recorded in the accompanying statement of net assets but not in the governmental funds.
- Executory purchase orders and contracts are recorded in the GFFS.

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

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

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

*f) Stewardship, Compliance and Accountability*

**Budgetary Control**

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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF GUAYAMA**  
**NOTES TO FINANCIAL STATEMENTS**  
**JUNE 30, 2011**

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

The Municipal Legislature has 10 business days, up to June 13, to discuss and approve the Project with modifications. The Municipal Legislature may amend the budgets submitted by the Mayor but may not increase any items so far to cause a deficit without imposing taxes or identifying other sources of revenue to cover such deficit. After the Municipal Legislature modifies and preliminarily approves the Project, the modified Project is sent back to the Mayor for his approval or rejection within 6 days. The Mayor may decrease or eliminate any line item but may not increase or insert any new line item in the budgets. The Mayor may also veto the budgets in their entirety and return it to the Municipal Legislature with his objections. If the Mayor rejects the Project, the Municipal Legislature will have up to 8 days to adopt or reject the recommendations or objections of the Mayor. The approved Project is sent again to the Mayor, which then would have 3 days to sign and approve it.

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

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

The Municipality's Department of Finance and Budget has the responsibility to ensure that budgetary spending control is maintained. For day-to-day management control, expenditures plus encumbrances may not exceed budgeted amounts at the expenditure-type level of each cost center (activity within a program within a fund). The Mayor may transfer unencumbered appropriations within programs within funds. The Municipal Legislature may transfer amounts among programs within and among funds.

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

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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF GUAYAMA**  
**NOTES TO FINANCIAL STATEMENTS**  
**JUNE 30, 2011**

**Budgetary Accounting**

The Municipality's annual budgets are prepared under the budgetary (statutory) basis of accounting, which is not in accordance with GAAP.

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

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

The accompanying budgetary comparison schedule provides information about the general fund's original budget, the amendments made to such budget, and the actual general fund's results of operations under the budgetary basis of accounting for the fiscal year ended June 30, 2011. Further details of the Municipality's budgetary control at the legal level may be obtained from the Budgetary Liquidation Report for the fiscal year ended June 30, 2011, which is prepared by the Municipality's Department of Finance. Copies of that report may be obtained by writing to the Municipality's Director of Finance.

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

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

***g) Unrestricted and Restricted Deposits***

The Municipality's deposits are composed of cash on hand and demand deposits in: (1) commercial banks, and (2) the Government Development Bank for Puerto Rico (GDB), a governmental bank and a major component unit of the Commonwealth, who is statutorily designated as fiscal agent of the Municipality, and (3) Municipal Revenue Collection Center (CRIM), in spanish acronym, a governmental entity responsible for the imposition and collection of property taxes on behalf of all municipalities of Puerto Rico.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF GUAYAMA**  
**NOTES TO FINANCIAL STATEMENTS**  
**JUNE 30, 2011**

The Municipality follows the practice of pooling cash. The balance in the pooled cash account is available to meet current operating requirements. Under the laws and regulations of the Commonwealth, public funds deposited by the Municipality in commercial banks must be fully collateralized for the amounts deposited in excess of the federal depository insurance generally provided by the Federal Deposits Insurance Corporation (FDIC). All securities pledged as collateral are held by agents designated by the Secretary of the Treasury of the Commonwealth, but not in the Municipality's name.

Cash with fiscal agent in the debt service funds consists of property tax and sales tax collections amounting to \$5,138,000, which are restricted for the payment of the Municipality's debt service, as required by law. Cash in fiscal agent recorded in the nonmajor governmental funds amounting to \$6,557,139, which is mainly restricted for: (1) the acquisition, construction or improvement of major capital assets and (2) the operations of federal and state funded programs.

Restricted cash in commercial banks for the Head Start fund, the General fund and the Other governmental funds, amounting to \$535,977, \$342,325 and \$1,790,009, respectively, restricted to: (1) finance the operations of the Head Start program, (2) finance the operations of all other federal and state funded programs recorded in the General fund and nonmajor special revenue funds, (3) finance the acquisition, construction and improvement of major capital assets.

***h) Real estate held for sale***

The real estate held for sale consists of fourteen (14) houses purchased to be sale to qualified low to moderate income families. This project is subsidized by the federal funds of the Community Development Block Grant - Entitlement Grant. This real estate is carried at its estimated net realizable sale price. The difference between the acquisition cost and the estimated net realizable sale price was accounted as a program expense for the period. The proceed from the sales will be accounted as a program income as required by the Grant.

***i) Unrestricted and Restricted Accounts and Notes Receivable***

In the accompanying GWFS, receivables consist of all revenues earned but not collected at June 30, 2011. Major receivable balances for the governmental activities include municipal license taxes, property taxes, sales taxes and intergovernmental receivables.

Tax receivables in the general fund represent uncollected property taxes and sales taxes. Restricted tax receivables in the debt service fund consist of uncollected property taxes, which are restricted for the payment of the Municipality's debt service, as established by law.

Intergovernmental receivables are composed of amounts owed to the Municipality for reimbursement of expenditures incurred pursuant to federal and state funded programs (recorded in the special revenue funds and the other governmental funds).

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

Activities among funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as either "due to/from other funds" (i.e. the current

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF GUAYAMA**  
**NOTES TO FINANCIAL STATEMENTS**  
**JUNE 30, 2011**

portion of interfund loans) or “advances to/from other funds” (i.e., the non-current portion of interfund loans). All other outstanding balances between funds are reported as “due to/from other funds.” Advances between funds, as reported in the GFFS, are offset by a fund balance reserve account in applicable governmental funds to indicate that they are not available for appropriation and are not expendable available financial resources.

**j) Capital Assets**

Capital assets used in governmental activities include land and land improvements, buildings, structures and building improvements, machinery and equipment, furniture and fixtures, licensed vehicles, construction in progress, and infrastructure. These assets are capitalized and reported in the accompanying statement of net assets. Infrastructure assets are generally stationary in nature and include roads, bridges, streets and sidewalks, drainage systems and other similar assets.

For financial reporting purposes, the Municipality defines capital assets as assets with an individual cost of \$500 or more at the date of acquisition or construction, and with useful lives extending beyond one year. All assets with individual costs under \$500 or with useful lives not exceeding one year, are charged directly to expense in the accompanying statement of activities. In the governmental funds, all capital assets are recorded as capital outlays (expenditures).

In the statement of net assets, all capital assets are recorded at cost, except for donated capital assets, which are recorded at their estimated fair value at the date of donation.

Estimated historical cost if actual cost was unavailable based on deflated current costs were used to value a significant portion of the infrastructure constructed or acquired prior to June 30, 2002. The method to deflate the current costs using an approximate price index was used only in the case of certain items for which their historical cost documentation was not available. Actual historical costs were used to value the infrastructure, land, building, structures, building improvements, construction in progress, machinery and equipment and licensed vehicles constructed or acquired during or after the year ended June 30, 2003.

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

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

	<u>Years</u>
Buildings, structures and building improvements	15 to 40
Infrastructure	15 to 40
Licensed vehicles	5

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF GUAYAMA**  
**NOTES TO FINANCIAL STATEMENTS**  
**JUNE 30, 2011**

Furniture, fixtures and work of arts	5 to 10
Machinery, equipment and computers	3 to 10

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

***k) Deferred Revenues***

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

- Potential revenue does not meet both the “measurable” and “available” criteria for revenue recognition in the current period. As previously discussed, available is defined as due (or past due) at June 30, and collected within 90 days (60 days for property taxes) thereafter to pay obligations due at June 30, or;
- The Municipality receives resources before it has a legal claim to them. In subsequent periods, when the revenue recognition criterion is met, the liability for deferred revenue is removed and revenue is recognized.

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

***l) Compensated Absences***

Compensated absences are accounted for under the provisions of Statement No. 16, *Accounting for Compensated Absences*, issued by GASB (GASB No. 16). Compensated absences include paid time off made available to employees in connection with vacation, sick leave and compensatory time. The liability for compensated absences recorded in the accompanying statement of net assets is limited to leave that: (1) is attributable to services already rendered on or before June 30, 2011 and (2) is not contingent on a specific event (such as illness) that is outside the control of the Municipality and the employee. The liability for compensated absences includes salary-related costs, which are directly and incrementally related to the amount of salary paid to the employee (such as employer’s share of social security taxes and medicare taxes).

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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF GUAYAMA**  
**NOTES TO FINANCIAL STATEMENTS**  
**JUNE 30, 2011**

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

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

**m) Long-term Debt**

The long-term liabilities reported in the accompanying statements of net assets include the Municipality's bonds, notes, obligation under capital leases, compensated absences, estimated for landfill closure and postclosure care costs and legal claims and judgments.

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

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

**n) Accounting for Pension Costs**

The Municipality adopted the provisions of GASB Statement No. 50, *Pension Disclosures* (GASB 50), which amended GASB Statement No. 27, *Accounting for Pensions by State and Local Government Employers* (GASB No. 27), by requiring disclosure of how the contractually required contribution rate is determined by governments participating in multi-employer cost-sharing pension plans.

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

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF GUAYAMA**  
**NOTES TO FINANCIAL STATEMENTS**  
**JUNE 30, 2011**

According to GASB No. 27, the Municipality accounts for pension costs from the standpoint of a participant in a multiple-employer cost-sharing plan. Accordingly, pension costs recognized in the accompanying basic financial statements are equal to the statutorily required contributions, with a liability recorded for any unpaid required contributions.

***o) Risk Management***

The Municipality carries commercial insurance covering casualty, theft, tort claims and other losses. Insurance policies are negotiated by the Puerto Rico Treasury Department (the Treasury Department) on behalf of all municipalities of Puerto Rico. The Treasury Department pays the insurance premiums on behalf of the Municipality and then is reimbursed each year through monthly equal payments deducted from the Municipality's gross property tax collections made by CRIM.

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

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

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

The Municipality also obtains medical insurance coverage for its employees. The current insurance policies have not been canceled or terminated at June 30, 2011. In the past three years, the Municipality has not settled claims that exceeded insurance coverage.

***p) Fund Balance Classification Policies and procedures***

For the fiscal year ended June 30, 2011, the Municipality implemented GASB Statement No. 54, Fund Balance Reporting and Governmental Fund Type Definitions (GASB 54). GASB 54 requires the use of new fund balance classifications that compose a hierarchy primarily based upon the extent to which the government is bound to follow constraints on the use of governmental fund resources. These classifications are described in note 1d, GASB 54 also clarified the definitions of the governmental fund types.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF GUAYAMA**  
**NOTES TO FINANCIAL STATEMENTS**  
**JUNE 30, 2011**

The effect of implementation of GASB 54 on the Municipality's financial statements was limited to the use of the new fund balance classifications. Implementation did not result in a change in beginning fund balances nor did it affect the types of governmental funds reported by the Municipality.

**q) *Interfund Activities***

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

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

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

**r) *Use of Estimates***

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

**s) *Municipal Solid Waste Landfill Closure and Postclosure Care Costs***

Municipal solid waste landfill closure and postclosure care costs are accounted for under the provisions of Statement No. 18, *Accounting for Municipal Solid Waste Landfill Closure and Postclosure Care Costs*, issued by GASB (GASB No. 18).

The estimated liability for municipal solid waste landfill closure and postclosure care costs (including monitoring and maintenance) includes an estimate of all costs to be incurred near or after the close of the Municipality's solid waste landfill. In the government-wide statement of net assets, this liability is recognized under the accrual basis of accounting over the useful life of the landfill, even though such costs will only be incurred near or after the close of the landfill.

The estimates of closing and postclosing costs include: (1) the cost of equipment and/or facilities that will be acquired near the time the landfill stops accepting waste or after for the purposes of postclosure care and monitoring, (2) the cost of applying the final cover and (3) the cost of postclosure maintenance and monitoring. These cost estimates are made using current costs (costs that would be incurred if these services would have been obtained during the current period) allocated in the accompanying statement of net assets based on the landfill capacity used through June 30, 2011. The liability is adjusted annually to reflect the effects of inflation, advances in technology, changes in regulations or similar changes.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF GUAYAMA**  
**NOTES TO FINANCIAL STATEMENTS**  
**JUNE 30, 2011**

Any changes in the estimated total current costs that occur before the landfill stops accepting solid waste are reported in the period of the changes, and an adjustment is made to the calculation, which is accounted for prospectively as a change in accounting estimate. On the other hand, the accounting for a horizontal expansion of the landfill has no effect in the factors used to calculate the accrued liability for the closure and postclosure costs of the original landfill. In this case, a separate calculation of the closure and postclosure care costs for the expanded portion of the landfill is made for each financial reporting period.

Changes in the estimated total current costs for landfill closure and postclosure care costs may also occur after the date that the landfill stops accepting solid waste. These changes may include changes due to inflation (or deflation), changes in technology, changes in closure and postclosure care requirements, corrections of errors in estimation, and changes in the extent of environmental remediation that is required. Changes in these estimates would be reported in the period in which the change is probable and reasonably estimable.

In the GFFS, municipal solid waste landfill closure and postclosure care costs are recorded in the accounting period in which they are due (when they mature) under the modified accrual basis of accounting.

## **2. DEPOSITS**

The Municipality maintains its deposits in various commercial banks located in Puerto Rico and Government Development Bank for Puerto Rico (GDB). Proceeds from bonds and funds related to certain grant awards are required by law to be held with GDB.

The Municipality adopted the provisions of GASB Statement No. 40 (GASB No. 40), *Deposit and Investment Risk Disclosure, an Amendment to GASB Statement No. 3*. This statement requires that state and local governments disclose essential risk information about deposits and investments. The disclosure requirements cover four main areas: (1) credit risk, (2) interest rate risk, (3) custodial credit risk, (4) foreign exchange exposure.

**Credit risk** – This is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. In compliance with the laws and regulations of the Commonwealth, the Municipality has adopted, as its custodial and credit risk policy, the *Statement of Investment Guidelines for the Government of the Commonwealth of Puerto Rico*. Accordingly the Municipality invests only in obligations of the Commonwealth, obligations of the United States of America, certificates of deposits, commercial paper, bankers' acceptances, or in pools of obligations of the municipalities of Puerto Rico, which are managed by GDB.

According to the aforementioned investment guidelines, the Municipality does not invest in marketable securities or any types of investments for which credit risk exposure may be significant. Therefore, the Municipality's management has concluded that the risk related to any possible loss related to defaults by commercial banks on the Municipality's deposits is considered low at June 30, 2011.

**Interest rate risk** – This is the risk that changes in interest rates of debt investments will adversely affect the fair value of an investment. The Municipality manages its exposure to declines in fair values by: (1) not including debt investments in its investment portfolio at June 30, 2011, (2) limiting the weighted average maturity of its investments to three months or less, and (3) keeping most of its bank deposits in interests bearing accounts generating interests at prevailing market rates. At June 30, 2011, the Municipality's investments in certificates of deposits are recorded at cost, which

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF GUAYAMA**  
**NOTES TO FINANCIAL STATEMENTS**  
**JUNE 30, 2011**

approximates their fair value. Therefore, the Municipality's management has concluded that at June 30, 2011, the interest rate risk associated with the Municipality's cash and cash equivalents is considered low.

**Custodial credit risk** – In the case of deposits, this is the risk that in the event of a bank failure, the Municipality's deposits may not be recovered. Pursuant to the *Statement of Investment Guidelines for the Government of the Commonwealth of Puerto Rico* the balances deposited in commercial banks by the Municipality are insured by the Federal Deposit Insurance Corporation (FDIC) generally up to a maximum of \$250,000 per depositor. In addition, public funds deposited in commercial banks by the Municipality are fully securities pledged as collateral are held, in the Municipality's name, by the agents of the Commonwealth's Secretary of Treasury. Deposits with GDB are uninsured and uncollateralized. However, no losses related to defaults by GDB on deposit transactions have been incurred by the Municipality through June 30, 2011. Therefore, the Municipality's management has concluded that at June 30, 2011 the custodial credit risk associated with the Municipality's cash and cash equivalents is considered low.

**Foreign exchange risk** – The risk that changes in exchange rates will adversely affect the value of an investment or a deposit. According to the aforementioned investment guidelines, the Municipality is prevented from investing in foreign securities or any other types of investments in which foreign exchange risk exposure may be significant. Accordingly, management has concluded that the foreign exchange risk related to the Municipality's deposits is considered low at June 30, 2011.

Cash and cash equivalents as of June 30, 2011, are classified in the accompanying financial statement as follows:

	<b>Major governmental funds</b>				
	<b>General fund</b>	<b>Head Start</b>	<b>Debt service fund</b>	<b>Other governmental funds</b>	<b>Total governmental funds</b>
<b>Unrestricted:</b>					
Cash in commercial banks	\$27,719,545	-	-	5,379,717	\$ 33,099,262
Total unrestricted deposits	27,719,545	-	-	5,379,717	33,099,262
<b>Restricted:</b>					
Cash in commercial banks	342,325	535,977	-	1,790,009	2,668,311
Cash in GDB, as fiscal agent	-	-	5,138,000	6,557,139	11,695,139
Total restricted deposits	342,325	535,977	5,138,000	8,347,148	14,363,450
Total carrying amount of deposits	\$28,061,870	535,977	5,138,000	13,726,865	\$ 47,462,712

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

### 3. MUNICIPAL LICENSE TAXES

The Municipality is authorized by Law No. 113 of July 10, 1974, as amended to impose and collect municipal license taxes on all trade or business activities operated by any natural or legal person

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF GUAYAMA**  
**NOTES TO FINANCIAL STATEMENTS**  
**JUNE 30, 2011**

within the territorial area of Guayama. This is a self-assessed tax generally based on the business volume measured by gross sales. The Municipality establishes the applicable tax rates. At June 30, 2011, the municipal tax rates imposed by the Municipality were as follows:

- Financial business – 1.50%
- Other organizations – 0.30% for annual revenues up to \$500,000, 0.40% for annual revenues more than \$500,000 up to \$999,999 and 0.50% over such volume of business.

Any taxpayers that have been granted with partial tax exemptions under any of the incentive tax laws of the Commonwealth ultimately pay municipal license taxes at reduced tax rates, generally between 60% and 90% under standard rates.

Each taxpayer must assess his/her corresponding municipal license tax by declaring his/her volume of business through a tax return to be filed every April 15 based on the actual volume of business generated in the preceding calendar year. Taxpayers with a sales volume of \$3 million or more must include audited financial statements with their tax returns. The tax can be paid by the taxpayer in two equal installments due on July 15 and January 15, subsequent to the filing of the declaration. The first installment of the tax covers the six-month period ended December 31, subsequent to the filing date of the declaration, while the second installment of the tax covers the six-month period ended June 30 of the subsequent calendar year. If a taxpayer elects to pay the tax in full on the filing date of the declaration (generally April 15), a 5% discount is granted automatically on the total tax amount due.

Any municipal license taxes collected in advance (that is, pertaining to a future period) are recorded as deferred revenues. Deferred municipal license tax revenues recorded in the accompanying GWFS and GFFS amounted to \$7,653,983 at June 30, 2011, which represents municipal licenses collected in advance for the taxable year 2011-2012.

#### **4. MUNICIPAL SALES AND USE TAX**

The State Public Law No. 117 of July 4, 2006 establish a local sales and use tax of 1.5% over the sale of goods and services made within the Municipalities boundaries. Under this Law, every business doing retail sales is required to register in the Puerto Rico Treasury Department (PRTD) to obtain a Retailer's Registration Certificate. The retailers are required to file monthly sales tax returns by the 20th day following the month in which the tax was collected.

A portion of the sales tax amounting 0.2% is restricted for the payment of long-term debt and is recorded in the debt service fund. The remaining portion of 1.3% is recorded in the general fund since is available for general operating purposes.

Sale tax receivable represents sales tax levied that were collected subsequent to June 30, 2011, but pertaining to current year period.

#### **5. INTERFUND BALANCES**

On July 1, 2001, the Municipality adopted the provisions of Statement No. 38, *Certain Financial Statement Note Disclosures, issued by the Governmental Accounting Standards Board*. This statement requires the disclosure of the flow of resources between funds and to assess the collectibility of interfund balances. Interfund balances at June 30, 2011 consisted of the following:

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF GUAYAMA**  
**NOTES TO FINANCIAL STATEMENTS**  
**JUNE 30, 2011**

<b>Transfers In:</b>	<b>Transfers Out:</b>				
	<b>Major funds</b>				<b>Total governmental funds</b>
	<b>General fund</b>	<b>Head start fund</b>	<b>Debt service fund</b>	<b>Other governmental funds</b>	
Major funds:					
General fund	\$ -	-	-	-	\$ -
Head start fund	2,125	-	-	44,706	46,831
Debt service fund	27,892	-	-	-	27,892
Nonmajor funds:					
Other governmental fund	1,837,079	81,292	4,199,158	2,150,393	8,267,922
<b>Total</b>	<b>\$ 1,867,096</b>	<b>81,292</b>	<b>4,199,158</b>	<b>2,195,099</b>	<b>\$ 8,342,645</b>

<b>Due to:</b>	<b>Due from:</b>				
	<b>Major funds</b>				<b>Total governmental funds</b>
	<b>General fund</b>	<b>Head start fund</b>	<b>Debt service fund</b>	<b>Other governmental funds</b>	
Major funds:					
General fund	\$ -	481,371	-	1,525,569	\$ 2,006,940
Head start fund	-	-	-	-	-
Debt service fund	-	-	-	-	-
Nonmajor funds:					
Other governmental fund	2,083,709	-	-	2,716,668	4,800,377
<b>Total</b>	<b>\$ 2,083,709</b>	<b>481,371</b>	<b>-</b>	<b>4,242,237</b>	<b>\$ 6,807,317</b>

The principal purposes of inter-fund receivables and payables are; (1) recognize the outstanding balance of the loans granted between municipality's fund to temporarily cover the payroll and other operating costs of several federally and state funded programs, and; (2) to cover special funds deficit.

The principal purposes of inter-fund transfers are; (1) to recognized the excess of cash in redemption funds reclaimed by the Municipality during fiscal year 2010-2011, and; (2) to cover special funds deficit.

At June 30, 2011, all amounts due to among funds are considered collectible by the Municipality's management.

**6. CAPITAL ASSETS**

Capital asset activity for the year ended June 30, 2011, was as follows:

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF GUAYAMA**  
**NOTES TO FINANCIAL STATEMENTS**  
**JUNE 30, 2011**

	Balance at beginning of fiscal year	Increases	Decreases	Balance at end of fiscal year
Governmental activities				
Cost basis:				
Capital assets, not being depreciated/amortized:				
Land	\$ 41,871,851	\$ -	\$ -	\$ 41,871,851
Construction in progress	6,549,400	4,242,729	-	10,792,129
Total capital assets, not being depreciated/amortized	<u>48,421,251</u>	<u>4,242,729</u>	<u>-</u>	<u>52,663,980</u>
Capital assets, being depreciated/amortized:				
Buildings, structures, and improvements	50,241,516	165,130	-	50,406,646
Infrastructure and infrastructure improvements	16,070,569	1,035,809	-	17,106,378
Equipment	1,632,446	224,259	-	1,856,705
Computers	331,868	44,131	-	375,999
Works of art	7,400	-	-	7,400
Furnitures	919,067	6,551	-	925,618
Licensed vehicles	1,661,939	554,648	-	2,216,587
Total capital assets, being depreciated/amortized	<u>70,864,805</u>	<u>2,030,528</u>	<u>-</u>	<u>72,895,333</u>
Total cost basis of capital assets	<u>119,286,056</u>	<u>6,273,257</u>	<u>-</u>	<u>125,559,313</u>
Less: accumulated depreciation and amortization:				
Buildings, structures, and improvements	5,756,948	1,257,840	-	7,014,788
Infrastructure and infrastructure improvements	7,572,406	478,667	-	8,051,073
Equipment	1,155,034	186,727	-	1,341,761
Computers	247,706	52,163	-	299,869
Works of art	3,704	740	-	4,444
Furnitures	868,716	22,139	-	890,855
Licensed vehicles	1,383,632	146,745	-	1,530,377
Total accumulated depreciation and amortization	<u>16,988,146</u>	<u>2,145,021</u>	<u>-</u>	<u>19,133,167</u>
Net capital assets	<u>\$ 102,297,910</u>	<u>4,128,236</u>	<u>-</u>	<u>\$ 106,426,146</u>

Depreciation and amortization expense for the fiscal year ended June 30, 2011 was charged to functions/programs as follow:

Governmental activities	
General government	\$ 128,986
Public Safety	102,360
Public Works	771,298
Culture and recreation	974,944
Health and Welfare	52,207
Education	115,226
Total depreciation and amortization expense	<u>\$ 2,145,021</u>

The Municipality did not have complete and accurate accounting records of capital assets at June 30, 2011. In addition, the infrastructure assets recorded in the accompanying statement of net assets are not supported adequately in the accounting records of the Municipality.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF GUAYAMA**  
**NOTES TO FINANCIAL STATEMENTS**  
**JUNE 30, 2011**

**7. Employees' Retirement Systems**

**a) Plan Description**

The Municipality's employees participate in the Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS), a cost-sharing multi-employer (as related to the Municipality's reporting entity) defined pension plan established by the Commonwealth. Substantially all full-time employees of the Commonwealth and substantially all municipalities are covered by ERS under the terms of Public Act No. 447 of May 15, 1951, as amended (Act No. 447). All regular and temporary employees of the Municipality become plan members of ERS at the date of employment, while it is optional for officers appointed.

ERS members, other than those joining it after March 31, 1990, are eligible for the benefits described below:

- **Retirement Annuity**

ERS members are eligible for a retirement annuity upon reaching the following age:

<b>Policemen and firemen:</b>	<b>Other employees:</b>
50 with 25 years of credited service	55 with 25 years of credited service
58 with 10 years of credited service	58 with 10 years of credited service

ERS members are eligible for monthly benefit payments determined by the application of the stipulated benefit ratios to the member's average compensation. Average compensation is computed based on the highest 36 months of compensation recognized by ERS. The annuity, for which a member is eligible, is limited to a minimum of \$300 per month and a maximum of 75 percent of the average compensation.

- **Merit Annuity**

ERS members are eligible for merit annuity with a minimum of 30 years or more of credited service. The annuity for which the plan member is eligible is limited to a minimum of 65 percent and a maximum of 75 percent of the average compensation.

- **Deferred Retirement Annuity**

A participating employee who ceases to be an employee of the Municipality after having accumulated a minimum of ten years of credited service qualifies for retirement benefits provided his/her contributions are left in ERS until reaching 58 years of age.

- **Coordinated Plan**

On the coordinated plan, by the time the employee reaches 65 years old and begins to receive social security benefits, the pension benefits are reduced by the following:

- i. \$165 per month, if retired with 55 years of age and 30 years of credited service
- ii. a \$110 per month, if retired with less than 55 years of age and 30 years of credited service
- iii. All other between \$82 and \$100 per month.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF GUAYAMA**  
**NOTES TO FINANCIAL STATEMENTS**  
**JUNE 30, 2011**

- iv. Disability annuities under the coordinated plan are also adjusted at age 65 and in some cases can be reduced over \$165 per month.

- ***Non-Coordinated Plan***

On the non-coordinated plan the participating employee and does not have any change on the pension benefits upon receiving social security benefits.

- ***Reversionary Annuity***

An ERS member, upon retirement, could elect to receive a reduced retirement annuity giving one or more benefit payments to his/her dependents. The life annuity payments would start after the death of the retiree for an amount not less than \$240 per year or greater than the annuity payments being received by the retiree.

- ***Occupational Disability Annuity***

A participating employee, who as a direct result of the performance of his/her occupation is totally and permanently disabled, is eligible for a disability annuity of 50 percent of the compensation received at the time of the disability.

- ***Nonoccupational Disability Annuity***

A participating employee, totally and permanently disabled for causes not related to his/her occupation and with no less than 10 years of credited service, is eligible for an annuity of 1.50 percent of the average compensation of the first 20 years of credited services, increased by 2 percent for every additional year of credited service in excess of 20 years.

- ***Death Benefits***

***Occupational:***

(a) **Surviving spouse** – annuity equal to 50 percent of the participating employee's salary at the date of the death.

(b) **Children** - \$10 per month for each child, minor or student, up to a maximum benefit per family of \$100.

***Nonoccupational:***

**Beneficiary** – the contributions and interest accumulated as of the date of the death plus an amount equal to the annual compensation at the time of the death.

***Post-retirement:***

Beneficiary with surviving spouse age 60 or over and a child, 18 or under, up to 30 percent (60 percent, if not covered under Title II of the Social Security Act) (increased to 50 percent effective January 1, 2004) of retiree's pension or otherwise the excess, if any, of the

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF GUAYAMA**  
**NOTES TO FINANCIAL STATEMENTS**  
**JUNE 30, 2011**

accumulated contributions at the time of retirement over the total annuity benefits received before death, limited to a minimum of \$750.

- ***Refunds***

A participating employee who ceases his/her employment with the Municipality without the right to a retirement annuity has the right to a refund of the contributions to ERS plus any interest earned thereon.

- ***Cost of Living Adjustment for Pension Benefits***

Public Act No. 10 of May 21, 1992 (Act No. 10) provided for increases of 3 percent every three or more years of retirement. Act No. 10 requires further legislation to grant this increase every three years subject to the presentation of actuarial studies regarding its costs and the source of financing. To protect the financial health of ERS, the increase granted during 2001 and the one granted on January 1, 2004 are being financed by the Municipality and the other participating employers.

To avoid any economic impact on ERS, the employers are responsible for contributing to ERS the amounts to cover the benefit payments and the employer and employee contributions with respect to the participants covered until the participants reach the normal retirement age.

- ***Amendment to Act No. 447 effective January 1, 2000 to create a Defined Contribution Plan***

On September 24, 1999, Public Act No. 305, an amendment to Act No. 447, was enacted to establish a defined contribution plan, known as *System 2000*, to cover employees joining ERS on or after January 1, 2000.

Employees that participated in the original plan as of December 31, 1999, had the opportunity to elect to either stay in the defined benefit plan or transfer to System 2000. Employees that joined the Municipality on or after January 1, 2000, were only allowed to become members of System 2000.

System 2000 is a hybrid defined contribution plan, also known as a cash balance plan. Under this new plan, there is a pool of plan assets, which is invested by the System, together with those of the cost-sharing multi-employer defined benefit plan. Neither the Commonwealth nor the Municipality guarantee benefits at retirement age. The annuity is based on a formula which assumes that each fiscal year the employee's contribution (with a minimum of 8.28 percent of the employee's salary up to a maximum of 10 percent) is invested as instructed by the employee in an account which either: (1) earns a fixed rate based on the two-year Constant Maturity Treasury Notes, (2) earns a rate equal to 75 percent of the return of the ERS' investment portfolio (net of management fees), or (3) earns a combination of both alternatives. Participants receive periodic account statements similar to those of defined contribution plans showing their accrued balances. Disability benefits are not granted under System 2000, rather are provided to those participants that voluntarily elect to participate in a private insurance long-term disability program. The employers' contributions (9.28 percent

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF GUAYAMA**  
**NOTES TO FINANCIAL STATEMENTS**  
**JUNE 30, 2011**

of the employee's salary) with respect to employees under System 2000 will continue and will be used to fund the cost-sharing multi-employer defined benefit plan.

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

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

- ***Amendments to Act No. 447***

In June and July 2003, the Governor of the Commonwealth signed three Public Acts that provided the following certain benefits to retirees:

- (a) Increase in minimum monthly pension payments to \$300, effective January 1, 2004.
- (b) Triennial 3 percent increase in all pensions, effective January 1, 2004.
- (c) Increase in widow and/or beneficiaries to 50 percent of the benefit received by the deceased pensioner, effective January 1, 2004.

All the benefits granted will be funded through budgetary assignments in the Municipality's general fund with respect to its retired employees.

The Board of Trustees of ERS approved, effective November 17, 2003, an increase in the amount granted on personal loans to participating employees from \$3,000 to \$5,000.

- b) Funding Policy***

The contribution requirement to ERS is established by law and is not actuarially determined. These contributions are as follows:

Municipality and other employers	9.28 percent of applicable payroll
Employees:	
Coordination plan:	5.78 percent of gross salary up to \$6,600 per year, plus 8.28 percent of gross salary in excess of \$6,600.
Supplementation plan:	8.28 percent of gross salary. This is the only choice available to police officers, firefighters and majors.

The total pension expenditures recorded in the category of administration for the fiscal years ended on June 30, 2009, 2010 and 2011 were, approximately, \$598,000, \$666,000 and \$658,000, respectively.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF GUAYAMA**  
**NOTES TO FINANCIAL STATEMENTS**  
**JUNE 30, 2011**

**8. LONG-TERM DEBT**

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

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

In addition, before any new bonds or notes are issued, the revenues of the debt service fund should be sufficient to cover the projected debt service requirement. At June 30, 2011, the Municipality is in compliance with the debt limitation requirements. The general long-term debt activity for the year ended June 30, 2011 was as follows:

	Balance at June 30, 2010	Borrowings or additions	Payments or deductions	Balance at June 30, 2011	Balance due within one year
Bonds payable:					
Public Improvements Bonds	\$ 362,105	-	28,000	334,105	\$ 29,000
Municipal General Obligation Bonds	19,395,000	43,000	1,035,000	18,403,000	1,111,000
Municipal General Obligation Notes	755,000	585,000	85,000	1,255,000	160,000
Special Obligation Bonds	205,000	-	25,000	180,000	25,000
Special Obligation Notes	3,290,000	-	205,000	3,085,000	220,000
	<u>24,007,105</u>	<u>628,000</u>	<u>1,378,000</u>	<u>23,257,105</u>	<u>1,545,000</u>
Notes payable:					
CRIM:					
LIMS	168,842	-	110,904	57,938	57,938
Law 42	122,715	-	2,623	120,092	2,788
Compensated absences	3,112,927	-	685,064	2,427,863	1,312,550
Estimated liability for municipal solid waste landfill closure and postclosure care costs	8,924,770	408,000	-	9,332,770	-
Total	<u>\$ 36,336,359</u>	<u>1,036,000</u>	<u>2,176,591</u>	<u>35,195,768</u>	<u>\$ 2,918,276</u>

**a) Bonds and Notes Payable**

The Municipality issues general and special (public improvements) obligations bonds and notes to provide for the acquisition and construction of major capital facilities and equipment, as well as, to cover certain operating needs. Bonds and notes payable at June 30, 2011 is composed of the following debts:

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF GUAYAMA**  
**NOTES TO FINANCIAL STATEMENTS**  
**JUNE 30, 2011**

	<u>Outstanding Amount</u>
<b>Public Improvement Bonds:</b>	
1995 serial bonds, original amount of \$27,000, due in annual principal installments ranging from \$1,000 to \$2,000; plus interest due in annual installments at a rate of 4.50% through January 1, 2020	\$ 13,000
1995 serial bonds, original amount of \$550,000, due in annual principal installments ranging from \$27,000 to \$55,105; plus interest due in annual installments at a rate of 4.50% through January 1, 2020	321,105
Total public improvement bonds	<u>334,105</u>
<b>General Obligation Bonds:</b>	
1998 serial bonds, original amount of \$825,000, due in annual principal installments ranging from \$80,000 to \$90,000; plus interest due in annual installments at a rate of 4.50% through January 1, 2012	175,000
1996 serial bonds, original amount of \$5,105,000, due in annual principal installments ranging from \$210,000 to \$450,000; plus interest due in semiannual installments at rates not to exceed 6.63% through July 1, 2020	3,255,000
1999 serial bonds, original amount of \$4,590,000, due in annual principal installments ranging from \$140,000 to \$385,000; plus interest due in semiannual installments rates not to exceed 5.60% through July 1, 2024	3,495,000
1999 serial bonds, original amount of \$3,840,000, due in annual principal installments ranging from \$220,000 to \$370,000; plus interest due in semiannual installments rates not to exceed 5.01% through July 1, 2017	2,095,000
2003 serial bonds, original amount of \$705,000, due in annual principal installments ranging from \$20,000 to \$60,000; plus interest due in semiannual installments rates not to exceed 5.02% through July 1, 2027	585,000
2003 serial bonds, original amount of \$2,450,000, due in annual principal installments ranging from \$65,000 to \$190,000; plus interest due in semiannual installments rates not to exceed 5.02% through July 1, 2027	2,035,000
2004 serial bonds, original amount of \$1,810,000, due in annual principal installments ranging from \$70,000 to \$150,000; plus interest due in semiannual installments rates not to exceed 5.25% through July 1, 2023	1,405,000
2005 serial bonds, original amount of \$1,810,000, due in annual principal installments ranging from \$105,000 to \$170,000; plus interest due in semiannual installments rates not to exceed 4.73% through July 1, 2019	1,245,000
2005 serial bonds, original amount of \$4,745,000, due in annual principal installments ranging from \$125,000 to \$325,000; plus interest due in semiannual installments rates not to exceed 5.02% through July 1, 2029	4,070,000
2011 serial bonds, original amount of \$43,000, due in annual principal installments ranging from \$1,000 to \$4,000; plus interest due in annual installments at a rate of 4.50% through January 1, 2036	43,000
Total general obligation bonds	<u>18,403,000</u>
<b>General Obligation Notes:</b>	
2009 general obligation note, original amount of \$400,000, due in annual principal installments ranging from \$45,000 to \$70,000; plus interest due in semiannual installments rates not to exceed 7.50% through July 1, 2016	355,000
2010 general obligation note, original amount of \$355,000, due in annual principal installments ranging from \$40,000 to \$60,000; plus interest due in semiannual installments rates not to exceed 7.50% through July 1, 2016	315,000
2011 general obligation note, original amount of \$585,000, due in annual principal installments ranging from \$65,000 to \$105,000; plus interest due in semiannual installments rates not to exceed 7.50% through July 1, 2017	585,000
Total general obligation notes:	<u>1,255,000</u>

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF GUAYAMA**  
**NOTES TO FINANCIAL STATEMENTS**  
**JUNE 30, 2011**

	<u>Outstanding Amount</u>
Special Obligation Bonds:	
1997 serial bonds, original amount of \$400,000, due in annual principal installments ranging from \$25,000 to \$40,000; plus interest due in semiannual installments rates not to exceed 5.00% through July 1, 2016	180,000
Special Obligation Notes:	
2009 special obligation note, original amount of \$3,475,000, due in annual principal installments ranging from \$205,000 to \$420,000; plus interest due in semiannual installments at rates not to exceed 7.50% through July 1, 2020	<u>3,085,000</u>
Total bonds and notes payable	<u>\$ 23,257,105</u>

The General Obligation Bonds and the Public Improvements 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.

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

Interest rates on serial bonds subject to variable rates are reviewed periodically by GDB and are based on the fluctuation of GDB's weighted average rate for its commercial paper program. Under this program, GDB issues commercial paper in the U.S. taxable and tax-exempt markets, in the Eurodollar market and to corporations that have tax exemption under the Commonwealth's Industrial Incentives Act and qualify for benefits provided by the U.S. Internal Revenue Code Section 936.

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

<u>Year ending June 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2012	\$ 1,545,000	\$ 1,050,298	\$ 2,595,298
2013	1,647,000	1,172,413	2,819,413
2014	1,658,000	1,080,097	2,738,097
2015	1,784,000	982,996	2,766,996
2016	1,901,000	877,934	2,778,934
2017-2021	9,069,105	2,753,141	11,822,246
2022-2026	3,954,000	913,727	4,867,727
2027-2031	1,685,000	153,720	1,838,720
2032-2036	14,000	2,115	16,115
Totals	<u>\$ 23,257,105</u>	<u>\$ 8,986,440</u>	<u>\$ 32,243,545</u>

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF GUAYAMA**  
**NOTES TO FINANCIAL STATEMENTS**  
**JUNE 30, 2011**

**b) Property Tax Advances**

On October 27, 1994, the Municipality entered into a financing agreement to pay the debt related to the excess of property tax advances over collections made by the Puerto Rico Treasury Department. During the fiscal year ended on June 30, 2011 the debt was completely paid.

**c) Notes Payable to CRIM**

**LIMS** – On 2001, the Municipality entered into a financing agreement with CRIM for the payment of the Municipality's share of the cost of an information management system, acquired by CRIM on behalf of all municipalities, for the management of a digital database of taxpayers properties located in Puerto Rico. The face amount of the loan was \$889,671. It is due in annual principal installments ranging from \$54,639 to \$57,938, plus interest due in semiannual installments at a rate of 5.95% through November 28, 2011. At June 30, 2011, the balance of this note amounted to \$57,938. The principal and interest maturities are as follows:

<u>Year ending June 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2012	\$ 57,938	\$ 1,724	\$ 59,662
Total	<u>\$ 57,938</u>	<u>\$ 1,724</u>	<u>\$ 59,662</u>

**Law 42** – On 2002, the Municipality entered into a financing agreement with CRIM for the repayment of bonds issued for the sale of delinquent accounts. The face amount of the loan was \$138,029. It is due in semiannual principal installments ranging from \$1,292 to \$4,935; plus interest due in semiannual installments at a rate of 6.19% through July 1, 2032. At June 30, 2011, the balance of this note amounted to \$120,092. The principal and interest maturities are as follows:

<u>Year ending June 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2012	\$ 2,788	\$ 7,388	\$ 10,176
2013	2,963	7,213	10,176
2014	3,149	7,027	10,176
2015	3,347	6,829	10,176
2016	3,557	6,619	10,176
2017-2021	21,433	29,447	50,879
2022-2026	29,068	21,812	50,880
2027-2031	39,422	11,458	50,880
2032	14,366	898	15,264
Total	<u>\$ 120,092</u>	<u>\$ 98,691</u>	<u>\$ 218,783</u>

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF GUAYAMA**  
**NOTES TO FINANCIAL STATEMENTS**  
**JUNE 30, 2011**

*d) Compensated Absences*

At June 30, 2011, the liability for compensated absences is composed as follows:

	<b>Due within one year</b>	<b>Due after one year</b>	<b>Total</b>
Vacations	\$ 534,378	\$ 125,809	\$ 660,187
Sick leave	391,103	989,504	1,380,607
Compensatory time	387,069	-	387,069
Total	<b>\$1,312,550</b>	<b>\$ 1,115,313</b>	<b>\$ 2,427,863</b>

*e) Landfill Closure and Postclosure Cost*

According to the regulations set forth by the U.S. Environment Protection Agency (EPA) in its "Solid Waste Disposal Facility Criteria", issued on October 9, 1991, the Municipality is required to place a final cover on the Municipality's landfill site when it stops accepting waste, and to perform certain maintenance and monitoring functions at the site for 30 years after closure. In accordance with GASB No. 18, the Municipality has to perform a study of the activities that need available space and to comply with applicable state and federal regulations. The Municipality has recorded an estimated liability of \$9,332,770 in the accompanying GWFS, using estimated current costs allocated, based on an estimate of the actual landfill capacity used at June 30, 2011. The portion of the estimated current costs to be incurred in future years is approximately \$409,000. Actual costs may be different to the recorded estimated liability due to inflation, changes in technology, or changes in Acts and regulations. At June 30, 2011 the Municipality has not perform a study of the activities that need to be implemented at the Municipality's solid waste landfill facilities and has not adjusted an estimated liability in accordance with that study.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF GUAYAMA**  
**NOTES TO FINANCIAL STATEMENTS**  
**JUNE 30, 2011**

**9. FUND BALANCES**

As of June 30 2011, fund balance is comprised of the following:

Fund balances	<u>Major governmental funds</u>				
	<u>General fund</u>	<u>Head start fund</u>	<u>Debt service fund</u>	<u>Other governmental funds</u>	<u>Total governmental funds</u>
Restricted					
Debt service	\$ -	\$ -	\$ 3,171,987	\$ -	\$ 3,171,987
General government	342,325	-	-	-	342,325
Public safety	-	-	-	239,502	239,502
Public works	-	-	-	506,200	506,200
Health, sanitation and welfare	-	-	-	438,726	438,726
Capital outlays	-	-	-	1,805,359	1,805,359
Committed					
Capital outlays	-	-	-	5,454,736	5,454,736
Assigned					
General government	733,014	-	-	3,823,118	4,556,132
Public works	314,480	-	-	318,801	633,281
Public safety	1,000	-	-	-	1,000
Health, sanitation and welfare	10,521	-	-	57,937	68,458
Culture and recreation	5,385	-	-	654,947	660,332
Capital outlays	-	-	-	279,102	279,102
Unassigned	1,848,128	-	-	-	1,848,128
Total fund balances	<u>\$ 3,254,853</u>	<u>\$ -</u>	<u>\$ 3,171,987</u>	<u>\$ 13,578,428</u>	<u>\$ 20,005,268</u>

**10. COMMITMENTS AND CONTINGENCIES**

**CLAIMS AND JUDGMENTS** - The Municipality is, at present, a defendant in a number of legal matters that arise from alleged improper application of policies and negligence in the ordinary course of the Municipality's activities. With respect to pending litigation, the Municipality has reported liabilities of \$225,000 in the government wide statement of net assets.

It is management's opinion, based on the advice of the legal counsel, that the potential claims against the Municipality not covered by insurance will not materially affect the financial resources for its payment.

In addition, the Municipality is a defendant or co-defendant in several legal proceedings, which are in discovery stage. Certain of these claims are covered by insurance. Legal counsels with the information currently available can not determine the final outcome of these proceeding. However, it has been the Municipality's experience that such actions are settled for amounts substantially less than the claim amounts.

**FEDERAL GRANTS** - In the normal course of operations, the Municipality receives grants from various Federal and State agencies. The grant programs are subject to audit by agents of the granting authority, the purpose of which is to ensure compliance with conditions precedent to the granting of funds. Any liability for reimbursement which may arise as the result of these audits is not believed to be material.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF GUAYAMA**  
**NOTES TO FINANCIAL STATEMENTS**  
**JUNE 30, 2011**

**11. SUBSEQUENT EVENTS**

- On October 30, 2003 the Municipal Legislature approved Ordinance 33, authorizing the issuance of General Obligation Bonds in the amount of \$284,000, for the construction of Bo. Pozuelo's sewer system. This bond is payable with resources collected through the Municipal Redemption Fund.
- On September 2, 2010 the Municipality's executive branch approved Resolution Number 14, authorizing the issuance of a Special Note in the amount of \$178,900, for the purchase of equipment. This bond is payable with resources collected through the Municipal Redemption Fund.
- On September 28, 2011 the Municipal Legislature approved Ordinance Number 9, authorizing the issuance of General Obligation Bonds in the amount of \$12,035,000, for the construction and improvement of municipal facilities. This bond is payable with resources collected through the Municipal Redemption Fund.
- On November 30, 2011 the Municipal Legislature approved Ordinance Number 17, authorizing the issuance of General Obligation Bonds in the amount of \$2,665,000, for the improvement of municipal facilities. This bond is payable with resources collected through the Municipal Redemption Fund.

**12. FUTURE ADOPTION OF ACCOUNTING PRONOUNCEMENTS**

The GASB has issued the following accounting standards that have effective dates after June 30, 2011:

- GASB Statement No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*. This Statement is effective for periods beginning after June 30, 2012;
- GASB Statement No. 59, *Financial Instruments Omnibus*. This statement is effective for periods beginning after June 30, 2011;
- GASB Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*. This statement is effective for periods beginning after December 31, 2012;
- GASB Statement No. 61, *The Financial Reporting Entity: Omnibus- an amendment of GASB Statements No. 14 and No. 34*. This statement is effective for periods beginning after June 30, 2013;
- GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre- November 30, 1989 FASB and AICPA Pronouncements*. This statement is effective for periods beginning after December 31, 2012;
- GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources and Net Position*. This statement is effective for periods beginning after December 31, 2012;
- GASB Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions (an amendment of GASB Statement No. 53)*. This statement is effective for periods beginning after June 30, 2013;

The Authority's management has concluded that the future adoption of these GASB Statements will not have a significant impact on the Authority's basic financial statements.

**REQUIRED SUPPLEMENTARY  
INFORMATION**

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF GUAYAMA**

**BUDGETARY COMPARISON SCHEDULE – GENERAL FUND  
FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

	<u>Budgeted Amounts</u>		Actual amounts (budgetary basis)	Variance with final budget - over (under)
	<u>Original</u>	<u>Final</u>		
<b>Revenues:</b>				
Property taxes	\$ 7,225,727	\$ 6,592,040	\$ 6,592,040	\$ -
Municipal license taxes	8,130,000	8,130,000	7,631,074	(498,926)
Construction exise taxes	450,000	450,000	684,181	234,181
Charges for services	205,000	205,000	127,958	(77,042)
Intergovernmental grants and contributions	3,809,418	5,260,809	3,278,656	(1,982,153)
Investment earnings	125,000	125,000	159,315	34,315
Miscellaneous	290,000	290,000	145,569	(144,431)
Total revenues	<u>20,235,145</u>	<u>21,052,849</u>	<u>18,618,793</u>	<u>(2,434,056)</u>
<b>Expenditures:</b>				
Current:				
General government	9,568,738	11,212,699	8,749,888	2,462,811
Public safety	2,360,130	2,119,910	2,108,026	11,884
Public works	4,117,930	4,323,482	4,293,270	30,212
Culture and recreation	1,567,400	1,500,890	1,500,583	307
Health, sanitation and Welfare	2,620,947	1,895,868	1,895,717	151
Total expenditures	<u>20,235,145</u>	<u>21,052,849</u>	<u>18,547,484</u>	<u>2,505,365</u>
<b>Excess of revenues over expenditures</b>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 71,309</u>	<u>\$ 71,309</u>
<b>Explanation of Differences:</b>				
<b>Sources/inflows of financial resources:</b>				
Actual amounts (budgetary basis) "available for appropriations" from the budgetary comparison schedule				\$ 18,618,793
Differences - budget basis to GAAP:				
Net decrease in receivables				2,011,302
Resources considered revenues for financial reporting but not for budgetary purposes				2,995,938
Total revenues as reported on the statement of revenues, expenditures and changes in fund balances - governmental funds				<u>\$ 23,626,033</u>
<b>Uses/outflows of financial resources:</b>				
Actual amounts (budgetary basis) "total charges to appropriations" from the budgetary comparison schedule				\$ 18,547,484
Differences - budget basis to GAAP:				
Net increase in payables				2,284,908
Nonbudget expenditures				2,848,193
Prior year encumbrances recorded as current year expenditures for GAAP basis				463,029
Current-year encumbrances recorded as current expenditures for Budgetary basis				(811,433)
Resources considered expenditures for budgetary but are not expenses for financial reporting purposes				(128,839)
Operating transfer-out to other funds				(32,463)
Total expenditures as reported on the statement of revenues, expenditures and changes in fund balances - governmental funds				<u>\$ 23,170,879</u>

See accompanying notes to the budgetary comparison schedule - general fund.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF GUAYAMA**

**NOTES TO BUDGETARY COMPARISON SCHEDULE – GENERAL FUND**  
**AS OF JUNE 30, 2011**

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

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

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

The accompanying Budgetary Comparison Schedule – General Fund, provides information about the general fund's original budget, the amendments made to such budget, and the actual general fund's results of operations under the budgetary basis of accounting for the fiscal year ended June 30, 2011.

Except for the General Fund and the Debt Service Fund, the Municipality legally does not adopt budgets for its major special revenues and capital projects funds. Accordingly, neither accompanying basic financial statements, nor required supplementary information includes statements or revenues and expenditures – budget and actual-budgetary basis, or budgetary comparison schedules, respectively, for these major programs.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF GUAYAMA**

**BUDGETARY COMPARISON SCHEDULE – DEBT SERVICE FUND  
AS OF JUNE 30, 2011**

	Budgeted amounts		Actual amounts (budgetary basis)	Variance with final budget- over (under)
	Original	Final		
Revenues:				
Property taxes	\$2,181,978	\$2,181,978	\$ 5,849,357	\$ 3,667,379
Total revenues	2,181,978	2,181,978	5,849,357	3,667,379
Expenditures:				
Debt service:				
Principal	993,978	993,978	1,148,000	154,022
Interest	1,188,000	1,188,000	1,023,393	(164,607)
Total expenditures	\$2,181,978	\$2,181,978	2,171,393	\$ (10,585)
Excess of revenues over expenditures	\$ -	\$ -	\$ 3,677,964	\$ 3,677,964

**Reconciliation of differences:**

Sources/inflows of financial resources:

Actual amounts (budgetary basis) "available for appropriations"  
from the budgetary comparison schedule \$ 5,849,357

Differences - budgetary basis to GAAP:  
Resources considered revenues for financial reporting  
but not for budgetary purposes 388,851

Differences in bases of accounting:  
Net increase in property tax receivable 37,100

Total revenues reported on the statement of revenue,  
expenditures and changes in fund balances - governmental funds \$ 6,275,308

Uses/outflows of financial resources:

Actual amounts (budgetary basis) "total charges to appropriations"  
from the budgetary comparison schedule \$ 2,171,393

Differences - budgetary basis to GAAP:  
Resources considered expenses for financial reporting purposes but are not  
expenditures for budgetary purposes 297,466

Differences in bases of accounting:  
Net increase in matured bonds due and payable 150,000  
Net increase in matured interest due and payable (8,208)

Total expenditures reported on the statement of revenues,  
expenditures and changes in fund balances - governmental funds \$ 2,610,651

See accompanying notes to the budgetary comparison schedule - debt service fund.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF GUAYAMA**

**NOTES TO BUDGETARY COMPARISON SCHEDULE – DEBT SERVICE FUND  
AS OF JUNE 30, 2011**

An annual budget has to be prepared under the budgetary basis of accounting, which is not in accordance with GAAP for the Debt Service Fund. Under the budgetary basis of accounting, revenues are generally recognized when cash is received.

Property tax revenues are used by GDB for the payment of principal and interest of bonds issued by them. Budgeted transfers out from the General Fund are made to finance budgetary debt requirements of Operational Bonds paid through CRIM.

The accompanying Budgetary Comparison Schedule – Debt Service Fund, provides information about the Debt Service fund's original budget and the actual results of operations under the budgetary basis of accounting for the fiscal year ended June 30, 2011.

Except for the General Fund and the Debt Service Fund, the Municipality legally does not adopt budgets for its major special revenues and capital projects funds. Accordingly, neither accompanying basic financial statements, nor required supplementary information include statements or revenues and expenditures – budget and actual-budgetary basis, or budgetary comparison schedules, respectively, for these major programs.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF GUAYAMA**

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

<u>Federal Grantor/Pass-through Grantor/Program or Cluster Title</u>	<u>Federal CFDA Number</u>	<u>Pass-through Entity Identifying Number</u>	<u>Expenditures</u>
<b>U.S. DEPARTMENT OF AGRICULTURE:</b>			
Direct Program:			
Water and Waste Disposal System for Rural Communities	10.760		\$ 725,592
Pass-Through – State Department of Education:			
Child and Adult Care Food Program	10.558	N/AV	1,073,144
<b>Total U.S. Department of Agriculture</b>			<u>1,798,736</u>
<b>U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT:</b>			
Direct Program:			
Community Development Block Grant – Entitlement Grants	14.218		2,816,201
Community Development Block Grant ARRA Entitlement Grants (CDBG-R) – (Recovery Act Funded)	14.253		326,800
Total CDBG – Entitlement Grants Cluster			<u>3,143,001</u>
Section 8 Housing Choice Vouchers Program	14.871		1,120,560
Homelessness Prevention and Rapid Re- housing Program (Recovery Act Funded)	14.257		412,259
Pass-Through State – State Department of Family:			
Emergency Shelter Grants	14.231	N/AV	10,623
<b>Total U.S. Department of Housing and Urban Development</b>			<u>4,686,443</u>
<b>U.S. DEPARTMENT OF HOMELAND SECURITY:</b>			
Pass-Through – State Governor Office			
Disaster Grants – Public Assistance	97.036	N/AV	96,315
<b>Total U.S. Department of Homeland Security:</b>			<u>96,315</u>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF GUAYAMA**

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

<u>Federal Grantor/Pass-through Grantor/Program or Cluster Title</u>	<u>Federal CFDA Number</u>	<u>Pass-through Entity Identifying Number</u>	<u>Expenditures</u>
<b>U.S. DEPARTMENT OF LABOR</b>			
Pass-Through – Puerto Rico Human Resources and Occupational Development Council:			
WIA Youth Activities	17.259	N/AV	93,390
<b>Total U.S. Department of Labor:</b>			<u>93,390</u>
<b>U.S. DEPARTMENT OF TRANSPORTATION</b>			
Pass-Through – Transit Safety Commission of the Commonwealth of Puerto Rico:			
Alcohol Traffic Safety and Drunk Driving Prevention Incentive Grants	20.601	N/AV	36,207
<b>Total U.S. Department of Transportation:</b>			<u>36,207</u>
<b>U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICE</b>			
Pass-Through – State Administration for Children and Families:			
Head Start Program	93.600	241-2010-000200	11,129,208
ARRA- Head Start Program	93.708	02SE9944/01	754,224
Total Head Start Cluster			<u>11,883,432</u>
<b>Total U.S. Department of Health and Human Service:</b>			<u>11,883,432</u>
<b>U.S. DEPARTMENT OF ENERGY:</b>			
Pass-through State – Office of the Energy Affairs Administration:			
Energy Efficiency and Conservation Block Grant Program ( <b>Recovery</b> )	81.128	N/AV	161,161
<b>Total U.S. Department of Energy</b>			<u>161,161</u>
<b>TOTAL EXPENDITURES OF FEDERAL AWARDS</b>			<u>\$ 18,755,684</u>

See accompanying Notes to Schedule of Expenditures of Federal Awards

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF GUAYAMA**

**NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

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**NOTE 1 – GENERAL**

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of the Municipality of **Guayama**, Puerto Rico (Municipality) and is presented on the modified accrual basis. 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. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the general-purpose financial statements. The reporting entity is defined in Note (1) (A) to the general-purpose combined financial statements.

**NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

1. The accompanying Schedule of Expenditures of Federal Awards is prepared from Municipality's accounting records and is not intended to present financial position or the results of operations.
2. The Municipality in accordance with the terms, records the financial transactions and conditions of the grants, which are consistent with accounting principles generally accepted in the United States of America.
3. Expenditures are recognized in the accounting period in which the liability is incurred, if measurable or when actually paid, whichever occurs first.

**NOTE 3 – FEDERAL CFDA NUMBER**

The CFDA numbers included in this Schedule are determined based on the program name, review of grant contract information and the Office of Management and Budget's Catalogue of Federal Domestic Assistance.

**NOTE 4 – PASS-THROUGH GRANTOR'S NUMBER**

State or local government redistribution of federal awards to the Municipality, treated as if they were received directly from the federal government. OMB Circular A-133 requires the schedule to include the name of the pass-through entity and identifying number assigned by the pass-through entity for federal awards received as a sub recipient. Numbers identified as N/AV are not available.

**NOTE 5 – MAJOR PROGRAMS**

Major programs are identified in the Summary of Auditor's Results Section of the Schedule of Findings and Questioned Costs.

*Pedro C. Ortíz Ledée*

**Certified Public Accountant**

**INDEPENDENT AUDITORS' 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  
Members of the Municipal Legislature  
Municipality of Guayama, Puerto Rico**

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of Municipality of **Guayama**, Puerto Rico (Municipality), as of and for the fiscal year ended June 30, 2011, which collectively comprise the Municipality's basic financial statements and have issued our report thereon dated March 31, 2012. The report on the governmental fund financial statements was unqualified. In addition, the report on the governmental wide financial statement has an adverse opinion because of the omission of certain capital assets and for the estimate made by management of the liability of the solid waste landfill. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

**Internal Control Over Financial Reporting**

In planning and performing our audit, we considered the Municipality's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Municipality's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Municipality's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not design to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying Schedule of Findings and Questioned Costs, we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses and other deficiencies that we consider to be significant deficiencies.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying Schedule of Findings and Questioned Costs to be material weaknesses. Findings 11-III-01, 11-III-02 and 11-III-03.

A *significant deficiency* is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described in the accompany Schedule of Findings and Questioned Costs to be significant deficiencies. Finding 11-II-04.

**INDEPENDENT AUDITORS' 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 and Other Matters**

As part of obtaining reasonable assurance about whether the Municipality's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and 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 instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying Schedule of Findings and Questioned Costs as items 11-III-01, 11-III-02 and 11-III-03.

We noted certain matters that we reported to management of the Municipality in a separate letter dated March 31, 2012.

The Municipality's responses to the findings identified in our audit are described in the accompanying Schedule of Findings and Questioned Costs. We did not audit the Municipality's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the management, the Honorable Mayor and Members of the Municipal Legislature, the Office of the Commissioner of Municipal Affairs, others within the entity, federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

  
Pedro C. Ortiz Ledee, CPA  
License Number 5200

Guayama, Puerto Rico  
March 31, 2012



*Pedro C. Ortíz Ledée*

**Certified Public Accountant**

**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH REQUIREMENTS THAT  
COULD HAVE A DIRECT AND MATERIAL EFFECT ON EACH MAJOR PROGRAM AND ON  
INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-  
133**

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

**Compliance**

We have audited Municipality of **Guayama**, Puerto Rico (Municipality) compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each Municipality's major federal programs for the fiscal year ended June 30, 2011. The Municipality's major federal programs are identified in the summary of auditor's results section of the accompanying Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the Municipality's management. Our responsibility is to express an opinion on Municipality's compliance based on our audit.

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

As described in items 11-III-06, 11-III-07 and 11-III-09 in the accompanying Schedule of Findings and Questioned Costs, the Municipality did not comply with requirements regarding Cash Management, Davis Bacon Act and Reporting that are applicable to its Head Start Cluster. Compliance with such requirements is necessary, in our opinion, for the Municipality to comply with the requirements applicable to that program.

In our opinion, except for the noncompliance described in the preceding paragraph, the Municipality complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the fiscal year ended June 30, 2011. The results of our auditing procedures also disclosed other instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying Schedule of Findings and Questioned Costs as items 11-III-05, 11-III-08, 11-III-10, 11-III-11, 11-III-12, 11-III-13, 11-III-14, 11-III-15 and 11-III-16.

**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH REQUIREMENTS THAT  
COULD HAVE A DIRECT AND MATERIAL EFFECT ON EACH MAJOR PROGRAM AND ON  
INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-  
133 (CONTINUED)**

**Internal Control over Compliance**

Management of the Municipality is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered Municipality's internal control over compliance with the requirements that could have a direct and material effect on a major federal program to determine the 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, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Municipality's internal control over compliance.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over compliance that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies or material weaknesses have been identified. However, as discussed below, we identified certain deficiencies in internal control over compliance that we considered to be material weaknesses and other deficiencies that we consider to be significant deficiencies.

A *deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that a material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. We consider the deficiencies in internal control over compliance described in the accompanying Schedule of Findings and Questioned Costs as items 11-III-06, 11-III-07 and 11-III-09 to be material weaknesses.

A *significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance. We considered the deficiencies in internal control over compliance described in the accompanying Schedule of Findings and Questioned costs as items 11-III-05, 11-III-08, 11-III-10, 11-III-11, 11-III-12, 11-III-13, 11-III-14, 11-III-15 and 11-III-16 to be significant deficiencies.

**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH REQUIREMENTS THAT  
COULD HAVE A DIRECT AND MATERIAL EFFECT ON EACH MAJOR PROGRAM AND ON  
INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-  
133 (CONTINUED)**

The Municipality's responses to the findings identified in our audit are described in the accompanying Schedule of Findings and Questioned Costs. We did not audit the Municipality's responses and, accordingly, we express no opinion on the responses.

This report is intended solely for the information and use of the management, the Honorable Mayor and Members of the Municipal Legislature, the Office of the Commissioner of Municipal Affairs, others within the entity, federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.



Pedro C. Ortiz Ledee, CPA  
License Number 5200

Guayama, Puerto Rico  
March 31, 2012



**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF GUAYAMA**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

**SECTION I – SUMMARY OF AUDITOR’S RESULTS**

**Financial Statements**

Type of auditor’s report issued:	<b>Unqualified for fund financial statements and adverse for governmental-wide financial statements</b>	
Internal control over financial reporting:		
Material weakness identified?	Yes <b>X</b>	No
Significant deficiencies identified?	Yes <b>X</b>	None reported
Noncompliance material to financial statements noted?	Yes <b>X</b>	No

**Federal Awards**

Internal Control over major programs:		
Material weakness identified?	Yes <b>X</b>	No
Significant deficiencies identified?	Yes <b>X</b>	None reported
Type of auditor’s report issued on compliance for major programs:	<b>Unqualified, except for Head Start Program Cluster</b>	
Any audit findings disclosed that are required to be reported in accordance with Circular A-133, Section .510(a)?	Yes <b>X</b>	No

**Identification of major programs**

CFDA Number	Name of Federal Program or Cluster
10.558	Child and Adult Care Food Program
10.760	Water and Waste Disposal Systems for Rural Communities
14.218/ 14.253	Community Development Block Grant Cluster
14.871	Section 8 Housing Choice Voucher Program
93.600/ 93.708	Head Start Program Cluster

Dollar threshold used to distinguish between Type A and Type B programs	\$562,671
Auditee qualified as low-risk auditee?	Yes                  No <b>X</b>

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF GUAYAMA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

FOR THE FISCAL YEAR ENDED JUNE 30, 2011

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SECTION II – FINANCIAL STATEMENTS FINDINGS

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<b>FINDING</b>	<b>11-II-01</b>
<b>REQUIREMENT</b>	<b>ACCOUNTING RECORDS AND REPORTING SYSTEM</b>
<b>CONDITION</b>	The Municipality did not maintain an accounting system that generates accurate accounting information for the preparation of the financial statements in conformity with generally accepted accounting principles (GAAP).
<b>CONTEXT</b>	<p>During our examination of the accounting cycle, we noted that the Municipality's accounting records are maintained in a cash and budgetary basis and at the end of year, personnel of the finance department and external consultants summarized in electronic worksheets the revenues, expenditures, encumbrances, capital assets transactions, accounts receivables, accounts payable and long term-debts. These worksheets are used for the preparation of the financial statements.</p> <p>Also, we noted the following conditions during our evaluation of the accounting cycle:</p> <ul style="list-style-type: none"><li>a. Accounting transactions are currently accounted simultaneously through a manual and a computerized accounting system for which no reconciliation procedures are made among them. These accounting systems does not provide for a self balancing set of accounts for each fund operated by the Municipality.</li><li>b. No adequate year-end closing entries procedures are made to account for all transactions affecting all funds.</li></ul>
<b>CRITERIA</b>	Chapter VIII, Article 8.010 (b) of State Act Number 81- <i>Ley de Municipios Autonomos del Estado Libre Asociado de Puerto Rico</i> of August 30, 1991, states that the Municipality must maintain its fund accounting in accordance with GAAP. In addition, Article 8.010 (c) states that uniform accounting system used by the Municipality must produce reliable reports and financial statements provide complete information about the results of the Municipality's operations and include the necessary internal controls to account for all funds, capital assets and other assets.
<b>CAUSE</b>	The Municipality has not established effective internal control procedures over the preparation of the financial statements and the transactions recorded on its accounting records.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF GUAYAMA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

FOR THE FISCAL YEAR ENDED JUNE 30, 2011

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SECTION II – FINANCIAL STATEMENTS FINDINGS

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<b>FINDING</b>	<b>11-II-01 (CONTINUED)</b>
<b>REQUIREMENT</b>	<b>ACCOUNTING RECORDS AND REPORTING SYSTEM</b>
<b>EFFECT</b>	The Municipality is not in compliance with Chapter VIII, Articles 8.010 (b) and (c) of the State Law Number 81 of August 30, 1991.
<b>RECOMMENDATION</b>	We recommend management to establish the necessary internal controls and procedures in order to maintain a complete accounting system that provides for the preparation of financial statements in accordance with GAAP.
<b>MANAGEMENT RESPONSE AND CORRECTIVE ACTION PLAN</b>	The Municipality maintains two set of accounting records; a manual system and the computerized. The manual system is the one we are using for financial reporting and the preparation of financial statements, in coordination with our external consultants. We will continue with this practice until we acquire new accounting software. Also, we acquire new accounting software for the accounting transactions related to revenues.  Responsible Person: Amílcar Ayala Finance Department Director Implementation Date: December, 2012

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF GUAYAMA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

FOR THE FISCAL YEAR ENDED JUNE 30, 2011

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SECTION II – FINANCIAL STATEMENTS FINDINGS

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<b>FINDING</b>	<b>11-II-02</b>
<b>REQUIREMENT</b>	<b>ACCOUNTING RECORDS- CAPITAL ASSETS</b>
<b>CONDITION</b>	The Municipality does not have an effective system to account for capital assets, including the infrastructure assets.
<b>CONTEXT</b>	During our examination of the property records, we noted that the Municipality does not have adequate internal controls and procedures to ensure that all capitalizable expenditures and dispositions are recorded in the capital assets subsidiary ledger. Also, the Municipality did not have adequate supporting documentation of the cost of the infrastructure assets reported in the property records. These infrastructure assets should be reported as part of the capital assets of the Municipality according to Statement No. 34 of the Governmental Accounting Standards Board (GASB 34). In addition, the Municipality did not perform periodical physical inventories of its capital assets.
<b>CRITERIA</b>	Chapter VIII, Article 8.010 (c) (3) of the State Law Number 81- <i>Ley de Municipios Autonomos del Estado Libre Asociados de Puerto Rico de 1991</i> of August 30, 1991, stated that Municipality should maintain updated property accounting records.
<b>CAUSE</b>	The Municipality did not maintain an adequate control of the accountability of its capital assets.
<b>EFFECT</b>	The Municipality is not in compliance with Chapter VIII, Article 8.010 (c) (3) of the State Law Number 81 of August 30, 1991.
<b>RECOMMENDATION</b>	We recommend management and the Property Division of the Municipality to make an inventory of the capital assets, supported by adequate documentation and reconcile it with the capital assets subsidiary ledger.
<b>MANAGEMENT RESPONSE AND CORRECTIVE ACTION PLAN</b>	The Finance Department is scheduling an update of its capital assets inventory to comply with GASB 34 and reconcile it with a physical inventory of Municipality's capital assets. Also we are considering the Municipality's infrastructure inventory compose of streets, roads and bridges.

Responsible Person: Amílcar Ayala  
Finance Department Director  
Implementation Date: July, 2012

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF GUAYAMA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

FOR THE FISCAL YEAR ENDED JUNE 30, 2011

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SECTION II – FINANCIAL STATEMENTS FINDINGS

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<b>FINDING NUMBER</b>	<b>11-II-03</b>
<b>REQUIREMENT</b>	<b>ACCOUNTING RECORDS- MUNICIPAL SOLID WASTE LANDFILL CLOSURE AND POSTCLOSURE CARE AND MAINTENANCE COSTS</b>
<b>CONDITION</b>	The Municipality did not adjust in its government wide financial statements, the required liability for closure and post closure care costs based on an adequate study of the activities of the solid waste landfill.
<b>CONTEXT</b>	At June 30, 2011, the Municipality did not realize the required study of the available space and the estimated cost of the closing and post closing of the Municipality's waste landfill. In addition, the amount of expenses recorded in the financial statements is based on an estimate made by the Municipality's management.
<b>CRITERIA</b>	Regulations set forth by the U.S. Environmental Protection Agency (EPA) in its "Solid Waste Disposal Facility Criteria"; the Municipality is required to place a final cover on the Municipality's solid waste landfill site when it stops accepting waste, and to perform certain maintenance and monitoring functions at the site for 30 years after closure. GASB 18 requires the Municipality to perform a study of the activities that need to be implemented at the Municipality's solid waste landfill facilities to guarantee the maximum yield of available space and to comply with applicable state and federal regulations. Based on this study, the Municipality must recognize a liability in its statement of net assets at June 30, 2011.
<b>CAUSE</b>	The Municipality did not maintain an adequate control of the accountability of the closure and post closure care costs of Municipal solid waste landfill. In addition, the Municipality did not perform the study required by EPA and GASB 18.
<b>EFFECT</b>	The Municipality is not in compliance with GASB 18 and the "Solid Waste Disposal Facility Criteria" issued by the U.S. Environmental Protection Agency.
<b>RECOMMENDATION</b>	We recommend management to perform the study of the activities that need to be implemented at the Municipality's solid waste landfill facilities and determine the amount of the liability that should be reported in the governmental activities.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF GUAYAMA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

FOR THE FISCAL YEAR ENDED JUNE 30, 2011

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SECTION II – FINANCIAL STATEMENTS FINDINGS

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<b>FINDING NUMBER</b>	<b>11-II-03 (CONTINUED)</b>
<b>REQUIREMENT</b>	<b>ACCOUNTING RECORDS- MUNICIPAL SOLID WASTE LANDFILL CLOSURE AND POSTCLOSURE CARE AND MAINTENANCE COSTS</b>
<b>MANAGEMENT RESPONSE AND CORRECTIVE ACTION PLAN</b>	<p>The Municipality's management gave instructions to request a confirmation from the external consultant, in charge of the solid waste landfill, about the maximum yield of available space to calculate the liability of the closure and post closure at June 30, 2012.</p> <p>Responsible Person: Amílcar Ayala Finance Department Director</p> <p>Implementation Date: July, 2012</p>

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF GUAYAMA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

FOR THE FISCAL YEAR ENDED JUNE 30, 2011

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SECTION II – FINANCIAL STATEMENTS FINDINGS

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<b>FINDING NUMBER</b>	<b>11-II-04</b>
<b>REQUIREMENT</b>	<b>ACCOUNTING RECORDS- CASH/ BANK RECONCILIATIONS</b>
<b>CONDITION</b>	The Municipality does not have effective internal control procedures to ensure that the bank reconciliations accounted in the General Fund (current and payroll account) were prepared accurately, in a timely manner and reconciled with the accounting records.
<b>CONTEXT</b>	During our cash test, we noted that the Municipality does not have effective internal control procedures to ensure the prompt preparation of the bank reconciliations of the current account and the payroll account of the General Fund. During our audit procedures, we found that the Municipality did not prepared the bank reconciliations of this two accounts, the reconciliation process for this two accounts consists only of including the ending bank balance less an approximation of the outstanding checks of the month. Also, we noted that there was not an updated Model 4a (the manual accounting system that summarized the cash transactions of the Municipality), for the monthly cash transactions of the General Fund and the special revenue funds. In addition, during our examination of the accounting records, we noted that the Municipality did not have adequate internal control over the cash transactions of a bank account were the Municipality pooled the cash balances of various non federal special revenue funds. This situation caused that various non federal special revenue funds, restricted funds as definition, were used as loans, to paid operational costs of other special revenue funds.
<b>CRITERIA</b>	Chapter IV, Section 12 of the Municipal Administration Regulatory Manual of the Puerto Rico Commissioner's Office for Municipal Affair (OCAM), establishes that the accounting system of the municipalities shall provide for the timely and accurate preparation of bank reconciliations. In addition, the Municipality shall prepare a monthly report of revenues and disbursements, which has to be reconciled with the bank reconciliations. Also, Article 8.004 (c) of the State Law Number 81 - <i>Ley de Municipios Autónomos del Estado Libre Asociado de Puerto Rico de 1991</i> - August 30, 1991, states that the restricted funds received by the Municipality should be only used for the purposes established by these resources. In addition, Article 8.010 (C) (2) and (3) of State Act Number 81- <i>Ley de Municipios Autonomos del Estado Libre Asociado de Puerto Rico</i> of August 30, 1991, stated that Municipality should maintain accurate accounting records and funds controls.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF GUAYAMA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

FOR THE FISCAL YEAR ENDED JUNE 30, 2011

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SECTION II – FINANCIAL STATEMENTS FINDINGS

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<b>FINDING NUMBER</b>	<b>11-II-04 (CONTINUED)</b>
<b>REQUIREMENT</b>	<b>ACCOUNTING RECORDS- CASH/ BANK RECONCILIATIONS</b>
<b>CAUSE</b>	The Municipality's internal control procedures failed to assure that the bank reconciliations were prepared in a complete manner and within the time required by law and properly reconciled with the accounting records.
<b>EFFECT</b>	The Municipality is not in compliance with Chapter IV, Section 12 of the Municipal Administration Regulatory Manual of the OCAM and Chapter VIII, Article 8.004 (c) and Article 8.010 (c ) (2) (3) of the State Act No. 81.
<b>RECOMMENDATION</b>	We recommend management to continue improving its internal control procedures over the preparation of the bank reconciliations and assure that accounting records are reconciled with these bank reconciliations within a reasonable amount of time, in order to maintain proper control over cash. We recommend management to continue strengthening the procedures in order to obtain and maintain all the required documentation regarding the special revenue funds transactions.
<b>MANAGEMENT RESPONSE AND CORRECTIVE ACTION PLAN</b>	We gave instructions to the responsible person to strengthen internal control on the preparation of the bank reconciliation. Also, we are going to monitor that these bank reconciliations were prepared in a reasonable amount of time in order to comply with the regulations and to monitor proper control on cash.  Responsible Person: Amílcar Ayala Finance Department Director Implementation Date: July, 2012

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF GUAYAMA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

FOR THE FISCAL YEAR ENDED JUNE 30, 2011

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SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

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<b>FINDING NUMBER</b>	<b>11-III-05</b>
<b>FEDERAL PROGRAM</b>	<b>HEAD START (CFDA NO. 93.600) / ARRA- HEAD START (CFDA NO. 93.708) U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES; PASS THROUGH COMMONWEALTH OF PUERTO RICO- ADMINISTRATION FOR CARE AND INTEGRAL DEVELOPMENT OF CHILDHOOD (ACUDEN)</b>
<b>REQUIREMENT</b>	<b>COMPLIANCE AND INTERNAL CONTROL</b>
<b>NONCOMPLIANCE</b>	<b>ALLOWABLE COST</b>
<b>CONDITION</b>	During the fiscal year 2010-2011, the Programs disbursed funds without the appropriate supporting documentation established by the State and Federal Regulations.
<b>CONTEXT</b>	<p>During our grant disbursement test, we examined eighty six (86) and sixteen (16) non payroll payments vouchers from Head Start and ARRA Head Start, respectively and noted the following conditions:</p> <ol style="list-style-type: none"><li>a. In twenty five (25) voucher payments for construction projects and purchase of goods and services, we did not found evidence in the invoices or the receiving reports of the period were the jobs were performed or the services or goods were received. Also, we did not found evidence in three (3) voucher payments of the receiving reports;</li><li>b. In three (3) voucher payments, the purchase orders were not signed by the responsible officials that authorize those payments;</li><li>c. In three (3) voucher payments, we did not found evidence of the original invoices. Also, we found that for one (1) voucher payment, the invoice was received before the services were performed;</li><li>d. In six (6) voucher payments, the purchase orders were prepared after the services and the invoices were received by the Program. In addition, we found that for one (1) voucher payment, the services were not rendered during the contract period.</li></ol>
<b>CRITERIA</b>	45 CFR, Subtitle A, Section 92.20 (b) (6) has established that accounting records must be supported by source documentation such as canceled checks, paid bills, payrolls, time and attendance records, contracts, sub-grant awards documents, and others. Also, CFR 45 Subtitle A, Section 92.20 (b) (3) states that effective control and accountability must be maintained for all grant and subgrant cash, real and personal property and other assets. Grantees and subgrantees must adequately safeguard all such property and must assure that it is used solely for authorized purposes.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF GUAYAMA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

FOR THE FISCAL YEAR ENDED JUNE 30, 2011

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

<b>FINDING NUMBER</b>	<b>11-III-05 (CONTINUED)</b>
<b>FEDERAL PROGRAM</b>	<b>HEAD START (CFDA NO. 93.600) / ARRA- HEAD START (CFDA NO. 93.708) U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES; PASS THROUGH COMMONWEALTH OF PUERTO RICO- ADMINISTRATION FOR CARE AND INTEGRAL DEVELOPMENT OF CHILDHOOD (ACUDEN)</b>
<b>REQUIREMENT</b>	<b>COMPLIANCE AND INTERNAL CONTROL</b>
<b>NONCOMPLIANCE</b>	<b>ALLOWABLE COST (CONTINUED)</b>
<b>CAUSE</b>	The Program failed to maintain an adequate control over the maintenance of the documents that justify the disbursement.
<b>EFFECT</b>	The Program is not in compliance with 45 CFR, Subtitle A, Section 92.20 (b) (3) and (6).
<b>RECOMMENDATION</b>	We recommend management to continue strengthening the internal controls and procedures designed to appropriately review the payments vouchers and all the supporting documentation prior to the issuance of a payment and assure that the requisition requested to the pass-through agency are used for the activities allowed by the Program.
<b>QUESTIONED COSTS</b>	None
<b>MANAGEMENT RESPONSE AND CORRECTIVE ACTION PLAN</b>	We gave instructions to the responsible person to evaluate every transaction including the corresponding documents (invoices, receiving reports, among others) to strength the internal control and procedures before the issuance of a payment or transfer of funds. This critical step will assure that the requisition requested to the pass-through agency are used for the activities allowed by the Program.  Responsible Person: Diana Pomales Head Start Program Director Implementation Date: April, 2012

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF GUAYAMA**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

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**SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

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<b>FINDING NUMBER</b>	<b>11-III-06</b>
<b>FEDERAL PROGRAM</b>	<b>HEAD START (CFDA NO. 93.600) / ARRA- HEAD START (CFDA NO. 93.708) U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES; PASS THROUGH COMMONWEALTH OF PUERTO RICO- ADMINISTRATION FOR CARE AND INTEGRAL DEVELOPMENT OF CHILDHOOD (ACUDEN)</b>
<b>REQUIREMENT</b>	<b>COMPLIANCE AND INTERNAL CONTROL</b>
<b>NONCOMPLIANCE</b>	<b>CASH MANAGEMENT</b>
<b>CONDITION</b>	The Municipality did not minimize the time between the receiving of the request of funds from the pass-through entity and the disbursement of funds.
<b>CONTEXT</b>	During our Cash Management test, we noted that the Municipality maintained an average cash balance of approximately \$361,443 and \$134,253 in the Head Start and ARRA Head Start bank reconciliations, respectively. In addition, the Programs did not disburse in a timely manner the request of funds advanced by the pass-through entity.
<b>CRITERIA</b>	Code of Federal Regulation 45, Subpart C, Section 92.20 (b) (7) states that the Program must maintain procedures for minimizing the time elapsed between the transfer of funds from the U.S. Treasury and disbursement made by grantees and sub grantees when advance payment procedures are used.
<b>CAUSE</b>	The Municipality did not maintain appropriate cash management procedures in order to disburse the funds requested to the pass-through entity in a timely manner.
<b>EFFECT</b>	The Municipality is not in compliance with Code of Federal Regulation 45, Subpart C, Section 92.20 (b) (7).
<b>RECOMMENDATION</b>	We recommended management to strengthen its disbursement procedures to minimize the time between the transfer of funds by the pass through and disbursement made by the Program.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF GUAYAMA**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

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**SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

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<b>FINDING NUMBER</b>	<b>11-III-06 (CONTINUED)</b>
<b>FEDERAL PROGRAM</b>	<b>HEAD START (CFDA NO. 93.600) / ARRA- HEAD START (CFDA NO. 93.708) U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES; PASS THROUGH COMMONWEALTH OF PUERTO RICO- ADMINISTRATION FOR CARE AND INTEGRAL DEVELOPMENT OF CHILDHOOD (ACUDEN)</b>
<b>REQUIREMENT</b>	<b>COMPLIANCE AND INTERNAL CONTROL</b>
<b>NONCOMPLIANCE</b>	<b>CASH MANAGEMENT</b>
<b>MANAGEMENT RESPONSE AND CORRECTIVE ACTION PLAN</b>	<p>Actually we are trying to request in the monthly advances only the actual obligations for the month. Also, we will continue strengthening the internal controls and the procedures to minimize the time between the receipt of the request of funds and the cash disbursements.</p> <p>Responsible Person: Diana Pomales Head Start Program Director</p> <p>Implementation Date: April, 2012</p>

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF GUAYAMA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

FOR THE FISCAL YEAR ENDED JUNE 30, 2011

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SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

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<b>FINDING NUMBER</b>	<b>11-III-07</b>
<b>FEDERAL PROGRAM</b>	<b>HEAD START (CFDA NO. 93.600) / ARRA- HEAD START (CFDA NO. 93.708) U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES; PASS THROUGH COMMONWEALTH OF PUERTO RICO- ADMINISTRATION FOR CARE AND INTEGRAL DEVELOPMENT OF CHILDHOOD (ACUDEN)</b>
<b>REQUIREMENT</b>	<b>INTERNAL CONTROL</b>
<b>NONCOMPLIANCE</b>	<b>DAVIS-BACON ACT</b>
<b>CONDITION</b>	During the fiscal year 2010-2011, the Program disbursed funds without obtaining the payrolls required by the Davis-Bacon Act.
<b>CONTEXT</b>	During our grant disbursement test, we noted that the Programs disbursed funds for construction improvements for five (5) Head Start centers and found that the Programs neither received nor maintained evidence of the contractors' required certified payrolls that shall be obtained weekly. Also, the Programs are not assuring that the prevailing wages are paid to the contractors' employees.
<b>CRITERIA</b>	Davis- Bacon Act, 42 USC 5310.
<b>CAUSE</b>	The Program failed to apply all the monitoring procedures developed to test applicable contractors with respect to the payment of prevailing wages.
<b>EFFECT</b>	The Program is not in compliance with Davis- Bacon Act, 42 USC 5310.
<b>RECOMMENDATION</b>	We recommended management to obtain the contractor's payrolls to be reviewed on a weekly basis and to document adequately, that the wages paid by the contractors are in accordance with the wages established by the Department of Labor and revise that all the employees that were interviewed were included in the contractor's weekly payrolls.
<b>QUESTIONED COSTS</b>	None

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF GUAYAMA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

FOR THE FISCAL YEAR ENDED JUNE 30, 2011

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SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

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<b>FINDING NUMBER</b>	<b>11-III-07 (CONTINUED)</b>
<b>FEDERAL PROGRAM</b>	<b>HEAD START (CFDA NO. 93.600) / ARRA- HEAD START (CFDA NO. 93.708) U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES; PASS THROUGH COMMONWEALTH OF PUERTO RICO- ADMINISTRATION FOR CARE AND INTEGRAL DEVELOPMENT OF CHILDHOOD (ACUDEN)</b>
<b>REQUIREMENT</b>	<b>INTERNAL CONTROL</b>
<b>NONCOMPLIANCE</b>	<b>DAVIS-BACON ACT</b>
<b>MANAGEMENT RESPONSE AND CORRECTIVE ACTION PLAN</b>	We will gave instructions to the responsible person to assure that the contractor certify the payrolls will be evaluate and include as part of the established process.  Responsible Person: Diana Pomales Head Start Program Director Implementation Date: April, 2012

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF GUAYAMA**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

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**SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

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<b>FINDING NUMBER</b>	<b>11-III-08</b>
<b>FEDERAL PROGRAM</b>	<b>HEAD START (CFDA NO. 93.600) / ARRA- HEAD START (CFDA NO. 93.708) U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES; PASS THROUGH COMMONWEALTH OF PUERTO RICO- ADMINISTRATION FOR CARE AND INTEGRAL DEVELOPMENT OF CHILDHOOD (ACUDEN)</b>
<b>REQUIREMENT</b>	<b>COMPLIANCE AND INTERNAL CONTROL</b>
<b>NONCOMPLIANCE</b>	<b>PERIOD OF AVAILABILITY</b>
<b>CONDITION</b>	The Programs disbursed funds for goods and services received after the period of availability.
<b>CONTEXT</b>	The Head Start Program obtained a waiver in July 20, 2010 to liquidate the outstanding obligations at February 28, 2010. During our grant disbursement test, we examined eighty four (84) voucher payments and noted that the Program disbursed funds amounting to \$249,561, for the purchase of equipment and office and educational materials, which were received after the period of availability. These obligations were not accounts payables at the end of the period of availability. Also, we found, that the Program paid two purchases orders that were not included in the authorized waiver. In addition, we noted that in December 2010, the ARRA- Head Start Program extended the duration of a construction contract, after the end of the funding period.
<b>CRITERIA</b>	Code of Federal Regulation 45, Section 92.23 (b) states that a grantee must liquidate all obligations incurred under the award not later than 90 days after the end of the funding period (or as specified in a program regulation) to coincide with the submission of the annual Financial Status Report (SF-269). The Federal agency may extend this deadline at the request of the grantee. Also, Clause Eighth (8) number sixteen (16) of the Contract between the Municipality and the Administration for Care and Integral Development of Childhood (ACUDEN), states that the Federal regulation establish a term of ninety (90) days to liquidate obligations payable at year end. After this date there is no authorization for the payment of obligations with Federal funds and the grantee should liquidate the obligations with its General Funds.
<b>CAUSE</b>	The Program failed to obligate, in a timely manner, the purchases of equipment and materials.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF GUAYAMA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

FOR THE FISCAL YEAR ENDED JUNE 30, 2011

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

<b>FINDING NUMBER</b>	<b>11-III-08 (CONTINUED)</b>
<b>FEDERAL PROGRAM</b>	<b>HEAD START (CFDA NO. 93.600) / ARRA- HEAD START (CFDA NO. 93.708) U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES; PASS THROUGH COMMONWEALTH OF PUERTO RICO- ADMINISTRATION FOR CARE AND INTEGRAL DEVELOPMENT OF CHILDHOOD (ACUDEN)</b>
<b>REQUIREMENT</b>	<b>COMPLIANCE AND INTERNAL CONTROL</b>
<b>NONCOMPLIANCE</b>	<b>PERIOD OF AVAILABILITY</b>
<b>EFFECT</b>	The Program is not in compliance with Code of Federal Regulation 45, Section 92.23 (b) and Clause Eighth (8) number sixteen (16) of the Contract between the Municipality and ACUDEN.
<b>RECOMMENDATION</b>	We recommend management to improve the existing controls, to assure that the purchases orders are prepared in a timely basis. In addition, the Program should continue strengthening the internal controls and procedures designed to appropriately review the payment voucher and all the supporting documentation prior to the issuance of a payment.
<b>QUESTIONED COSTS</b>	None
<b>MANAGEMENT RESPONSE AND CORRECTIVE ACTION PLAN</b>	We gave instructions to the responsible person to prepare the purchases orders in a timely basis and to strength the internal control prior to the issuance of a payment  Responsible Person: Diana Pomales Head Start Program Director Implementation Date: April, 2012

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF GUAYAMA**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

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**SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

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<b>FINDING NUMBER</b>	<b>11-III-09</b>
<b>FEDERAL PROGRAM</b>	<b>HEAD START (CFDA NO. 93.600) / ARRA- HEAD START (CFDA NO. 93.708) U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES; PASS THROUGH COMMONWEALTH OF PUERTO RICO- ADMINISTRATION FOR CARE AND INTEGRAL DEVELOPMENT OF CHILDHOOD (ACUDEN)</b>
<b>REQUIREMENT</b>	<b>COMPLIANCE AND INTERNAL CONTROL</b>
<b>NONCOMPLIANCE</b>	<b>REPORTING</b>
<b>CONDITION</b>	The Municipality did not maintained adequate internal controls of the accounting transactions of the Head Start and ARRA-Head Start programs.
<b>CONTEXT</b>	During our Reporting test, we noted that the Municipality does not maintained adequate accounting records and does not summarized the information of all the financial transactions related to assets, liabilities, revenues and expenditures of the Programs, in a formal general ledger. Also, we found that the accounting personnel did not reconcile the amounts reported in the monthly reports submitted to the pass-through agency and the accounting records. In addition, the in kind contributions of the Programs did not agree with the accounting records and the monthly reports submitted to the pass-through entity. Also, the Head Start Program did not maintain adequate internal controls over the accounting records to adequately separate the administrative and programmatic costs of the Program.
<b>CRITERIA</b>	Code of Federal Regulations 45, 92.20 (b) (2), states that grantees and subgrantees must maintain records which adequately identify the source and application of funds provided for financially-assisted activities. These records must contain information pertaining to grant or subgrant awards and authorizations, obligations, unobligated balances, assets, liabilities, outlays or expenditures and income.
<b>CAUSE</b>	The Program failed to establish adequate internal controls over the transactions recorded on its accounting records and the accurate submission of the monthly reports to the pass through agency.
<b>EFFECT</b>	The Program did not submit accurate monthly reports to the pass-through entity in order to comply with the federal regulation.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF GUAYAMA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

FOR THE FISCAL YEAR ENDED JUNE 30, 2011

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SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

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<b>FINDING NUMBER</b>	<b>11-III-09 (CONTINUED)</b>
<b>FEDERAL PROGRAM</b>	<b>HEAD START (CFDA NO. 93.600) / ARRA- HEAD START (CFDA NO. 93.708) U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES; PASS THROUGH COMMONWEALTH OF PUERTO RICO- ADMINISTRATION FOR CARE AND INTEGRAL DEVELOPMENT OF CHILDHOOD (ACUDEN)</b>
<b>REQUIREMENT</b>	<b>COMPLIANCE AND INTERNAL CONTROL</b>
<b>NONCOMPLIANCE</b>	<b>REPORTING</b>
<b>RECOMMENDATION</b>	The Program should adopt as the accounting system the software provided by the pass through entity. In addition, the Program should continue implementing adequate procedures to ensure that financial information submitted to the pass-through entity in its monthly reports agrees with the accounting records.
<b>QUESTIONED COSTS</b>	None
<b>MANAGEMENT RESPONSE AND CORRECTIVE ACTION PLAN</b>	We will give instructions to the Program accountant to maintain a general ledger that includes all the financial transactions related to assets, liabilities, revenues and expenditures of the Program. In addition, we will give instructions that the monthly reports should reconcile with the accounting records. Also, the pass-through entity is implementing an accounting software program to standardize the financial information of the Program.  Responsible Person: Diana Pomales Head Start Program Director Implementation Date: July, 2012

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF GUAYAMA**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

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**SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

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<b>FINDING</b>	<b>11-III-10</b>
<b>FEDERAL PROGRAMS</b>	<b>COMMUNITY DEVELOPMENT BLOCK GRANT-ENTITLEMENT GRANT (CFDA NO. 14.218) / COMMUNITY DEVELOPMENT BLOCK GRANT ARRA ENTITLEMENT GRANTS (CDBG-R) (RECOVERY ACT FUNDED) (CFDA NO. 14.253)U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT</b>
<b>REQUIREMENT</b>	<b>COMPLIANCE AND INTERNAL CONTROL</b>
<b>NONCOMPLIANCE</b>	<b>CASH MANAGEMENT</b>
<b>CONDITION</b>	The Programs did not minimize the time between the receiving of the request of funds from the pass-through entity and the disbursement of funds.
<b>CONTEXT</b>	During our Cash Management test, we examined nine (9) requests of funds made by the Programs and found that five (5) requests took between four (4) and fourteen (14) days from the moment the funds were received and the issuance of the checks. In addition, we noted that the Programs maintained a combined average cash balance of approximately \$67,701.
<b>CRITERIA</b>	Code of Federal Regulations 24, 85.20 (b) (7) states, that procedures for minimizing the time elapsing between the transfer of funds from the U.S Treasury and disbursement by grantees and sub grantees must be whenever advance payment procedures used.
<b>CAUSE</b>	The Federal Programs and Finance Department of the Municipality did not maintain appropriate cash management procedures in order to request funds to the pass-through agency only for immediate needs.
<b>EFFECT</b>	The Program is not in compliance with Code of Federal Regulations 24, 85.20 (b) (7).
<b>RECOMMENDATION</b>	We recommend management to strengthen its disbursements procedures to minimize the time between the transfer of funds by the pass-through and disbursement made by the Municipality.
<b>QUESTIONED COSTS</b>	None

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF GUAYAMA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

FOR THE FISCAL YEAR ENDED JUNE 30, 2011

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SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

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<b>FINDING</b>	<b>11-III-10 (CONTINUED)</b>
<b>FEDERAL PROGRAMS</b>	<b>COMMUNITY DEVELOPMENT BLOCK GRANT-ENTITLEMENT GRANT (CFDA NO. 14.218) / COMMUNITY DEVELOPMENT BLOCK GRANT ARRA ENTITLEMENT GRANTS (CDBG-R) (RECOVERY ACT FUNDED) (CFDA NO. 14.253)U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT</b>
<b>REQUIREMENT</b>	<b>COMPLIANCE AND INTERNAL CONTROL</b>
<b>NONCOMPLIANCE</b>	<b>CASH MANAGEMENT</b>
<b>MANAGEMENT RESPONSE AND CORRECTIVE ACTION PLAN</b>	We will continue strengthening the internal controls and the procedures to minimize the time between the receipt of funds and the cash disbursements.  Responsible Person: Vanessa Velázquez Federal Program Director Implementation Date: April, 2012

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF GUAYAMA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

FOR THE FISCAL YEAR ENDED JUNE 30, 2011

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SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

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<b>FINDING NUMBER</b>	<b>11-III-11</b>
<b>FEDERAL PROGRAM</b>	<b>COMMUNITY DEVELOPMENT BLOCK GRANT-ENTITLEMENT GRANT (CFDA NO. 14.218) U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT</b>
<b>REQUIREMENT</b>	<b>COMPLIANCE AND INTERNAL CONTROL</b>
<b>NONCOMPLIANCE</b>	<b>PROCUREMENT AND SUSPENSION AND DEBARMENT</b>
<b>CONDITION</b>	The Program did not include in the contracts, all the clauses required by the Federal regulations.
<b>CONTEXT</b>	<p>During our contract provisions test, we examined three (3) construction contracts, formalized during fiscal year 2010-2011, to verify the completeness of its clauses and noted that the following clauses were missing:</p> <ul style="list-style-type: none"><li>❖ One (1) contract did not include a provision for legal remedies when the contractor violates the terms;</li><li>❖ Three (3) contracts did not include a provision for the compliance with executive order 11246;</li><li>❖ Three (3) contracts did not include a provision for compliance with Sections 103 and 107 “Contract Work Hours &amp; Safety Standards Act;</li><li>❖ Three (3) construction contracts did not include a provision for compliance with the Energy Policy and Conservation Act (Pub L. 94-163, 89 Stat 871);</li><li>❖ Three (3) contracts did not include a provision for compliance with the Copeland “Anti-kickback”;</li><li>❖ Three (3) contracts did not include a provision for retention of all required records for three (3) years.</li></ul>
<b>CRITERIA</b>	Code of Federal Regulations 24, Subpart C, Section 85.36 (i) (1-13) establishes all the required clauses that contracts should include.
<b>CAUSE</b>	The Program did not maintain appropriate procurement standard procedures to assure that contracts include all the required clauses.
<b>EFFECT</b>	The Municipality is not in compliance with Code of Federal Regulations 24, Subpart C, Section 85.36 (i) (1-13).

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF GUAYAMA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

FOR THE FISCAL YEAR ENDED JUNE 30, 2011

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SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

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<b>FINDING NUMBER</b>	<b>11-III-11 (CONTINUED)</b>
<b>FEDERAL PROGRAM</b>	<b>COMMUNITY DEVELOPMENT BLOCK GRANT-ENTITLEMENT GRANT (CFDA NO. 14.218) U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT</b>
<b>REQUIREMENT</b>	<b>COMPLIANCE AND INTERNAL CONTROL</b>
<b>NONCOMPLIANCE</b>	<b>PROCUREMENT AND SUSPENSION AND DEBARMENT</b>
<b>RECOMMENDATION</b>	We recommend management to update the contract model according with the Federal requirements.
<b>QUESTIONED COSTS</b>	None
<b>MANAGEMENT RESPONSE AND CORRECTIVE ACTION PLAN</b>	We gave instructions to the responsible person to verify the contracts to strength the internal control by including all the required clauses according to Federal regulations. We are going to implement a checklist for the contract clauses that has to be included as part of the improvement for the procurement standard procedure. Also, we are going to update the contract model according to Federal requirement.  Responsible Person: Vanessa Velázquez Federal Program Director Implementation Date: April, 2012

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF GUAYAMA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

FOR THE FISCAL YEAR ENDED JUNE 30, 2011

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SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

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<b>FINDING NUMBER</b>	<b>11-III-12</b>
<b>FEDERAL PROGRAM</b>	<b>SECTION 8 HOUSING CHOICE VOUCHERS PROGRAM (CFDA 14.871) U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT</b>
<b>REQUIREMENT</b>	<b>COMPLIANCE AND INTERNAL CONTROL</b>
<b>NONCOMPLIANCE</b>	<b>SPECIAL TEST- DEPOSITORY AGREEMENTS</b>
<b>CONDITION</b>	The Municipality failed to enter in a depository agreement with its financial institution.
<b>CONTEXT</b>	During our evaluation, we did not identify evidence of a depository agreement in the form required by HUD with the depository institution of the Municipality.
<b>CRITERIA</b>	Code of Federal Regulation 24, Subpart D, Section 982.156 (a) states that unless otherwise required or permitted by HUD, all program receipts must be promptly deposited with a financial institution selected as depository by the PHA in accordance with HUD requirements. In addition, Code of Federal Regulations 24, 982.156 (c) states that the PHA must enter into an agreement with depository in the form required by HUD.
<b>CAUSE</b>	The Municipality's management failed to enter into agreements in the form required by HUD with its financial institution.
<b>EFFECT</b>	The Program is not in compliance with Code of Federal Regulation 24, Subpart D, Section 982.156 (a) and (c).
<b>RECOMMENDATION</b>	We recommend management to contact its financial institution and formalize, as soon as possible, the depository agreement in the form established by HUD.
<b>QUESTIONED COSTS</b>	None
<b>MANAGEMENT RESPONSE AND CORRECTIVE ACTION PLAN</b>	Actually we are in the process of verifying with our financial institution the formalization of the depository agreement in the form established by HUD.  Responsible Person: Vanessa Velázquez Federal Program Director Implementation Date: Immediately

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF GUAYAMA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

FOR THE FISCAL YEAR ENDED JUNE 30, 2011

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SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

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<b>FINDING NUMBER</b>	<b>11-III-13</b>
<b>FEDERAL PROGRAM</b>	<b>CHILD AND ADULT CARE FOOD PROGRAM (CFDA NO. 10.558) U.S. DEPARTMENT OF AGRICULTURE; PASS THROUGH COMMONWEALTH OF PUERTO RICO- DEPARTMENT OF EDUCATION</b>
<b>REQUIREMENT</b>	<b>COMPLIANCE AND INTERNAL CONTROL</b>
<b>NONCOMPLIANCE</b>	<b>CASH MANAGEMENT</b>
<b>CONDITION</b>	The Program did not minimize the time between the receiving of the request of funds from the pass-through entity and the disbursement of funds.
<b>CONTEXT</b>	During our Cash Management test, we noted that during the fiscal year 2010-2011, the Program maintained an average monthly cash balance of approximately \$273,734 in books.
<b>CRITERIA</b>	Code of Federal Regulations 7, Subpart C, Section 3016.20 (b) (7) states, procedures for minimizing the time elapsing between the transfer of funds from the U.S. Treasury and disbursement by grantees and subgrantees must be followed.
<b>CAUSE</b>	The Program and Finance Department of the Municipality did not maintain appropriate cash management procedures, in order to request funds to the pass-through only for immediate needs.
<b>EFFECT</b>	The Program is not in compliance with Code of Federal Regulations 7, Subpart C, Section 3016.20 (b) (7).
<b>RECOMMENDATION</b>	We recommend management to strengthen its disbursements procedures to minimize the time between the transfer of funds by the state and disbursement made by the Municipality.
<b>QUESTIONED COSTS</b>	None
<b>MANAGEMENT RESPONSE AND CORRECTIVE ACTION PLAN</b>	We will give instructions to the Finance Department to issue the checks in approximately three (3) days once the receipt of funds from the State are received. Responsible Person: Diana Pomales Head Start Program Director Implementation Date: April, 2011

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF GUAYAMA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

FOR THE FISCAL YEAR ENDED JUNE 30, 2011

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SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

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<b>FINDING NUMBER</b>	<b>11-III-14</b>
<b>FEDERAL PROGRAM</b>	<b>CHILD AND ADULT CARE FOOD PROGRAM (CFDA NO. 10.558) U.S. DEPARTMENT OF AGRICULTURE; PASS THROUGH COMMONWEALTH OF PUERTO RICO- DEPARTMENT OF EDUCATION</b>
<b>REQUIREMENT</b>	<b>COMPLIANCE AND INTERNAL CONTROL</b>
<b>NONCOMPLIANCE</b>	<b>PERIOD OF AVAILABILITY</b>
<b>CONDITION</b>	The Program disbursed funds for goods after the period of availability.
<b>CONTEXT</b>	During our grant disbursement test, we examined sixteen (16) voucher payments and noted that the Program disbursed funds in January 27, 2011, amounting to \$51,760 for the purchase of food received in August 2010, a month after the end of the period of availability.
<b>CRITERIA</b>	Code of Federal Regulation 7, Subpart C, Section 3016.23 (b) states that a grantee must liquidate all obligations incurred under the award not later than 90 days after the end of the funding period (or as specified in a program regulation) to coincide with the submission of the annual Financial Status Report (SF-269). The Federal agency may extend this deadline at the request of the grantee.
<b>CAUSE</b>	The Program failed to obligate and liquidate, in a timely manner, the purchases for food for the Head Start centers.
<b>EFFECT</b>	The Program is not in compliance with Code of Federal Regulation 7, Subpart C, Section 3016.23 (b).
<b>RECOMMENDATION</b>	We recommend management to improve the existing controls, to assure that the purchases orders are prepared in a timely basis. In addition, the Program should continue strengthening the internal controls and procedures designed, to issue the checks within the period of availability.
<b>QUESTIONED COSTS</b>	None

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF GUAYAMA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

FOR THE FISCAL YEAR ENDED JUNE 30, 2011

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SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

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<b>FINDING NUMBER</b>	<b>11-III-14 (CONTINUED)</b>
<b>FEDERAL PROGRAM</b>	<b>CHILD AND ADULT CARE FOOD PROGRAM (CFDA NO. 10.558) U.S. DEPARTMENT OF AGRICULTURE; PASS THROUGH COMMONWEALTH OF PUERTO RICO- DEPARTMENT OF EDUCATION</b>
<b>REQUIREMENT</b>	<b>COMPLIANCE AND INTERNAL CONTROL</b>
<b>NONCOMPLIANCE</b>	<b>PERIOD OF AVAILABILITY</b>
<b>MANAGEMENT RESPONSE AND CORRECTIVE ACTION PLAN</b>	We will gave instructions to the Program staff that all the obligations for services and goods have to be paid during the period of availability.  Responsible Person: Diana Pomaes Head Start Program Director Implementation Date: April, 2012

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF GUAYAMA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

FOR THE FISCAL YEAR ENDED JUNE 30, 2011

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

<b>FINDING NUMBER</b>	<b>11-III-15</b>
<b>FEDERAL PROGRAM</b>	<b>WATER AND WASTE DISPOSAL SYSTEMS FOR RURAL COMMUNITIES (CFDA NO. 10.760) U.S. DEPARTMENT OF AGRICULTURE</b>
<b>REQUIREMENT</b>	<b>COMPLIANCE AND INTERNAL CONTROL</b>
<b>NONCOMPLIANCE</b>	<b>ALLOWABLE COST</b>
<b>CONDITION</b>	During the fiscal year 2010-2011, the Program disbursed funds without the appropriate supporting documentation established by the State and Federal Regulations.
<b>CONTEXT</b>	During our grant disbursement test, we examined five (5) non payroll payments vouchers from the Program and noted that in three (3) voucher payments amounting \$259,208, the purchase orders were prepared after the construction services and the invoices were received by the Municipality. Also, we found that for those voucher payments, the construction services were not rendered during the contract or the contract amendments period.
<b>CRITERIA</b>	7 CFR, Part 3016.20 (b) (2) states that grantees and sub grantees must maintain records which adequately identify the source and application of funds provided for financially- assisted activities. These records must contain information pertaining to grant or subgrant awards and authorizations, obligations, unobligated balances, assets, liabilities, outlays or expenditures and income.
<b>CAUSE</b>	The Program failed to maintain an adequate control over the maintenance of the documents that justify the disbursement.
<b>EFFECT</b>	The Program is not in compliance with 7 CFR, Part 3016.20 (b) (2).
<b>RECOMMENDATION</b>	We recommend management to continue strengthening the internal controls and procedures designed to appropriately review the payments vouchers and all the supporting documentation prior to the issuance of a payment.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF GUAYAMA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

FOR THE FISCAL YEAR ENDED JUNE 30, 2011

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SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

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<b>FINDING NUMBER</b>	<b>11-III-15 (CONTINUED)</b>
<b>FEDERAL PROGRAM</b>	<b>WATER AND WASTE DISPOSAL SYSTEMS FOR RURAL COMMUNITIES (CFDA NO. 10.760) U.S. DEPARTMENT OF AGRICULTURE</b>
<b>REQUIREMENT</b>	<b>COMPLIANCE AND INTERNAL CONTROL</b>
<b>NONCOMPLIANCE</b>	<b>ALLOWABLE COST</b>
<b>QUESTIONED COSTS</b>	None
<b>MANAGEMENT RESPONSE AND CORRECTIVE ACTION PLAN</b>	We gave instructions to the responsible person to evaluate every transaction including the corresponding documents (invoices, receiving reports, among others) to strength the internal control and procedures before the issuance of a payment or transfer of funds.  Responsible Person: Amílcar Ayala Finance Department Director Implementation Date: April, 2012

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF GUAYAMA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

FOR THE FISCAL YEAR ENDED JUNE 30, 2011

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SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

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<b>FINDING NUMBER</b>	<b>11-III-16</b>
<b>FEDERAL PROGRAM</b>	<b>WATER AND WASTE DISPOSAL SYSTEMS FOR RURAL COMMUNITIES (CFDA NO. 10.760) U.S. DEPARTMENT OF AGRICULTURE</b>
<b>REQUIREMENT</b>	<b>INTERNAL CONTROL</b>
<b>NONCOMPLIANCE</b>	<b>DAVIS-BACON ACT</b>
<b>CONDITION</b>	During the fiscal year 2010-2011, the Municipality disbursed funds without evaluating the compliance with the Davis-Bacon Act.
<b>CONTEXT</b>	During our grant disbursement test, we noted that the Municipality disbursed funds for a construction of a water disposal system in Punta Pozuelo and found that there were no adequate procedures to ensure that the contractor was complying with the Davis Bacon Act. We did not found evidence that the Municipality was verifying weekly, the contractor's payroll to assure that it was paying the prevailing wages to the employees.
<b>CRITERIA</b>	Davis- Bacon Act, 42 USC 5310.
<b>CAUSE</b>	The Municipality failed to apply all the monitoring procedures developed to test applicable contractors with respect to the payment of prevailing wages.
<b>EFFECT</b>	The Municipality is not in compliance with Davis- Bacon Act, 42 USC 5310.
<b>RECOMMENDATION</b>	We recommended management to obtain the contractor's payrolls to be reviewed on a weekly basis and to document adequately, that the wages paid by the contractors are in accordance with the wages established by the Department of Labor and revise that all the employees that were interviewed were included in the contractor's weekly payrolls.
<b>QUESTIONED COSTS</b>	None
<b>MANAGEMENT RESPONSE AND CORRECTIVE ACTION PLAN</b>	We will gave instructions to the responsible person to assure that the contractor certify the payrolls will be evaluate and include as part of the established process. Responsible Person: Amílcar Ayala Finance Department Director Implementation Date: April, 2012

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF GUAYAMA**

**SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

FINDING NUMBER	COMPLIANCE	CFDA NUMBER	QUESTIONED COSTS	AUDITEE COMMENTS
10-III-04	Cash Management	93.600 93.708	None	No corrective action has been taken.  The auditor reissued the finding for the current year. Finding reference 11-III-06
10-III-05	Davis-Bacon Act	93.600	None	No corrective action has been taken.  The auditor reissued the finding for the current year. Finding reference 11-III-07
10-III-06	Matching, Level of Effort, Earmarking	93.600 93.708	None	Full corrective action has been taken.  We obtained and matched the required in-kind contribution for the program year 2010-2011.
10-III-07	Period of Availability	93.600	None	No corrective action has been taken.  The auditor reissued the finding for the current year. Finding reference 11-III-08
10-III-08	Procurement, Suspension and Debarment	93.600	None	Full corrective action has been taken.  The internal controls over the procurement process have been improved.
10-III-09	Reporting	93.600 93.708	None	No corrective action has been taken.  The auditor reissued the finding for the current year. Finding reference 11-III-09

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF GUAYAMA**

**SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS (CONTINUED)**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

FINDING NUMBER	COMPLIANCE	CFDA NUMBER	QUESTIONED COSTS	AUDITEE COMMENTS
10-III-10	Activities Allowed or Unallowed	14.871	None	Full corrective action has been taken.  System and procedures corrected.
10-III-11	Special Test- Depository Agreement	14.871	None	No corrective action has been taken.  The auditor reissued the finding for the current year. Finding reference 11-III-12
10-III-12	Cash Management	10.558	None	No corrective action has been taken.  The auditor reissued the finding for the current year. Finding reference 11-III-13
10-III-13	Period of Availability	10.558	None	No corrective action has been taken.  The auditor reissued the finding for the current year. Finding reference 11-III-14
10-III-14	Procurement and Suspension and Debarment	10.558	None	Full corrective action has been taken.  We included all the required clauses in the Contracts and verified the suppliers in the EPLS.
10-III-15	Reporting	10.558	None	Full corrective action has been taken.  We are preparing the reports in accordance with the requirements established by the pass-through entity.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF GUAYAMA**

**SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS (CONTINUED)**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

FINDING NUMBER	COMPLIANCE	CFDA NUMBER	QUESTIONED COSTS	AUDITEE COMMENTS
09-III-04	Allowable Cost/ Cost Principles	93.600	\$87,101	No corrective action has been taken.  The auditors did not identified during fiscal year 2010-2011 transactions related to this finding.
09-III-05	Cash Management	93.600	None	No corrective action has been taken.  The auditor reissued the finding for the current year. Finding reference 11-III-06
09-III-06	Davis-Bacon Act	93.600	None	No corrective action has been taken.  The auditor reissued the finding for the current year. Finding reference 11-III-07
09-III-07	Matching, Level of Effort, Earmarking	93.600	None	Full corrective action has been taken.  We obtained and matched the required in-kind contribution for the program year 2010-2011.
09-III-08	Period of Availability	93.600	None	No corrective action has been taken.  The auditor reissued the finding for the current year. Finding reference 11-III-08
09-III-09	Procurement, Suspension and Debarment	93.600	None	Full corrective action has been taken.  The internal controls over the procurement process have been improved.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF GUAYAMA**

**SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS (CONTINUED)**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

FINDING NUMBER	COMPLIANCE	CFDA NUMBER	QUESTIONED COSTS	AUDITEE COMMENTS
09-III-10	Allowable Cost/ Cost Principles	14.218	None	Full corrective action has been taken.  We strengthened the internal controls and procedures over the payment process.
09-III-11	Equipment and Real Property Management	14.218	None	Full corrective action has been taken.  System and procedures improved and corrected.
09-III-12	Procurement and Suspension and Debarment	14.218	None	Partial corrective action has been taken.  We reimburse the amount of questioned cost for the acquisition of a motor vehicle. In addition, we are verifying the suppliers in the EPLS. Finding reference 11-III-11
09-III-13	Subrecipient Monitoring	14.218	None	Full corrective action has been taken.  We are monitoring the subrecipients once a year.
09-III-14	Activities Allowed or Unallowed	14.871	None	Full corrective action has been taken.  System and procedures corrected.
09-III-15	Cash Management	10.558	None	No corrective action has been taken.  The auditor reissued the finding for the current year. Finding reference 11-III-13
09-III-16	Period of Availability	10.558	None	No corrective action has been taken.  The auditor reissued the finding for the current year. Finding reference 11-III-14

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF GUAYAMA**

**SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS (CONTINUED)**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

FINDING NUMBER	COMPLIANCE	CFDA NUMBER	QUESTIONED COSTS	AUDITEE COMMENTS
09-III-17	Procurement and Suspension and Debarment	10.558	None	Full corrective action has been taken.  We included all the required clauses in the Contracts and verified the suppliers in the EPLS.
09-III-18	Reporting	10.558	None	Full corrective action has been taken.  We are preparing the reports in accordance with the requirements established by the pass-through entity.
08-05	Cash Management	93.600	None	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.
08-06	Matching, Level of Effort, Earmarking – Matching	93.600	None	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.
08-07	Matching, Level of Effort, Earmarking – Administrative Cost Limits	93.600	None	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.