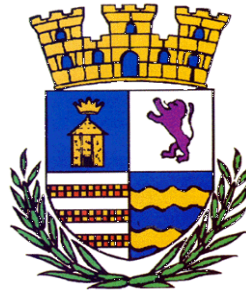
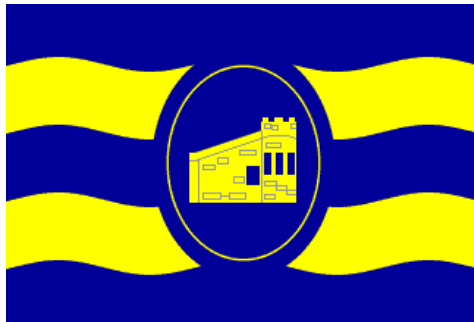


**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA, PUERTO RICO**

***BASIC FINANCIAL STATEMENTS, REQUIRED SUPPLEMENTARY
INFORMATION AND INDEPENDENT
AUDITOR'S REPORT***

***AS OF AND FOR THE FISCAL YEAR ENDED
JUNE 30, 2009***



***Hon. Martín Vargas Morales
Mayor***

***Mrs. Ivette Pacheco
Finance Director***

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA, PUERTO RICO**

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INDEPENDENT AUDITOR'S REPORT

Honorable Mayor and Members of the
Municipal Assembly
Municipality of Guánica, Puerto Rico

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of **Municipality of Guánica, Puerto Rico**, as of and for the year ended June 30, 2009, which collectively comprise the Municipality of Guánica's basic financial statements as listed in the table of contents. These financial statements are the responsibility of Municipality of Guánica, Puerto Rico'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.

In our opinion the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information of the Municipality of Guánica, Puerto Rico, as of June 30, 2009, and the respective changes in financial position, for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 18, 2009, on our consideration of the Municipality of Guánica, Puerto Rico'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.

INDEPENDENT AUDITOR'S REPORT

(CONTINUED)

The management's discussion and analysis and budgetary comparison information on pages 3 through 15 and 56 through 58, are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Roman Toro & Co.

ROMAN TORO & CO., CSP
LICENSE #35 - IN FORCE

Yauco, Puerto Rico
December 18, 2009

Stamp #2474115 was affixed to
the original of this report

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA, PUERTO RICO
Management Discussion and Analysis
For the Fiscal Year ended June 30, 2009

Our discussion and analysis of the Municipality of Guánica's financial performance provides an overview of the Municipality's financial activities for the fiscal year ended June 30, 2009. Because this MD&A is designed to focus on the current year activities, resulting changes and currently known facts, we encourage reader to consider the information presented in this MD&A in conjunction with the additional information furnished in the accompanying basic financial statements.

FINANCIAL HIGHLIGHTS

- The Municipality has reported assets amounting to \$26.94 million in the accompanying statement of net assets, of which most significant are capital assets, cash and cash equivalents amounting to \$21.88 million and \$4.38 million, respectively.
- The Municipality's capital assets increased as a result of this year's operations. Capital assets as of June 30, 2009 are \$21.88 million, as compared to \$19.07 million for the year ended June 30, 2008, for a 13.95% of increase.
- The assets of the Municipality exceeded its liabilities by 8.48 million at June 30, 2009, represented as "net assets" in the accompanying statements of net assets. Restricted and unrestricted (deficit) net assets amounted to \$2.03 million and \$(9.32) million, respectively. Net assets invested in capital assets amounted \$15.77 million.
- During the year, the Municipality reported revenues of \$10.4 million in the General Fund of total revenues restricted and unrestricted of \$14.35 million.
- Long term liabilities principal payments were \$.76 million.
- The Municipality has reported total expenses amounting to \$15.13 million in the accompanying statement of activities.

USING THIS ANNUAL REPORT

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA, PUERTO RICO
Management Discussion and Analysis
For the Fiscal Year ended June 30, 2009

Overview of the Basic Financial Statements

The Municipality's financial statements include three components:

1. the government-wide financial statements
2. the fund financial statements
3. notes of the financial statements

These components are described below:

Government-wide financial statement: Are designed to provide reader with a broad of the Municipality's operations and finance as whole in a manner similar to Private-sector business. These statements provide short-term and long-term information about the Municipality's financial position, which assist the Municipality's management to determine the economic condition at the end of the fiscal year. These financial statements are prepared using the flow of economic resources measurement focus and the accrual basis of accounting. The governmental-wide financial statements include; the statement of net assets and the statement of activities.

The Statement of Net Assets and the Statement of Activities

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

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

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

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

Reporting the Municipality's Most Significant Funds

Fund Financial Statement: Report the financial position and results of operations of the Municipality's governmental funds. The Fund Financial Statement components are the Balance Sheet-government funds and the Statements of Revenues, Expenditures and Changes in Fund Balance. The Fund Financial Statements provide detailed information about the most significant funds, not the Municipality as a whole. Some funds are required to be established by bond covenants.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA, PUERTO RICO
 Management Discussion and Analysis
 For the Fiscal Year ended June 30, 2009

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

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

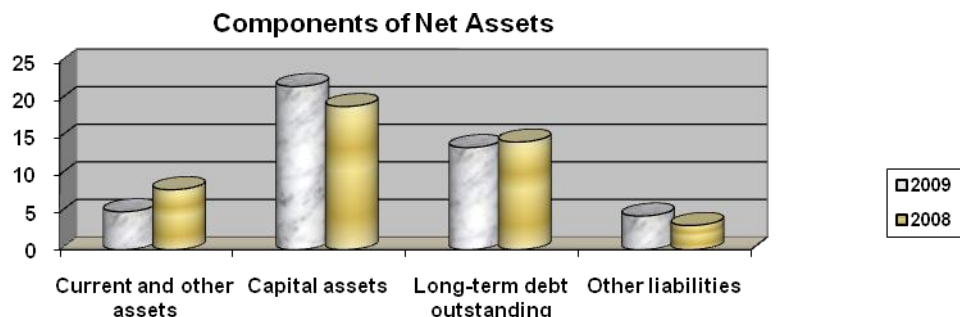
THE MUNICIPALITY AS A WHOLE

The Municipality's *combined* net assets increases from a year ago, from \$9.09 million to \$9.43 million. Our analysis below focuses on the net assets (Table 1) and changes in net assets (Table 3) of the Municipality's governmental activities.

Table 1
NET ASSETS
(in Million)

| | Governmental Activities | |
|--|--------------------------------|----------------|
| | 2009 | 2008 |
| Current and other assets | \$ 5.05 | \$ 7.99 |
| Capital assets | <u>21.89</u> | <u>19.08</u> |
| Total assets | <u>26.94</u> | <u>27.07</u> |
| Long-term debt outstanding | (13.71) | (14.34) |
| Other liabilities | <u>(4.75)</u> | <u>(3.29)</u> |
| Total liabilities | <u>(18.46)</u> | <u>(17.63)</u> |
| Net assets: | | |
| Invested in capital assets, net of related debt | 15.77 | 10.63 |
| Restricted for: | | |
| Debt services | .50 | .45 |
| Capital project | 1.11 | 6.43 |
| Other specified purpose | .42 | .02 |
| Unrestricted (Deficit) | <u>(9.32)</u> | <u>(8.27)</u> |
| Net Assets | <u>\$ 8.48</u> | <u>\$ 9.26</u> |

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA, PUERTO RICO
Management Discussion and Analysis
For the Fiscal Year ended June 30, 2009



Net assets of the Municipality’s governmental activities decreased by \$.95 million (\$8.48 million compared to \$9.43 million). *Unrestricted* net assets, the part of net assets that can be used to finance day-to-day operations without constraints established by debt covenants, enabling legislation or other legal requirements, changed from approximately \$(8.31) million at June 30, 2008 to a \$(9.32) million at June 30, 2009. The following is a condensed presentation of the Municipality’s results of operations, as reported in the government-wide financial statements:

Comparative Condensed Statement of Activities:

| | <u>2009</u> | <u>2008</u> |
|---|---------------------------|---------------------------|
| Revenues: | | |
| Program revenues: | | |
| Operating grants and contributions | \$3,022,398 | \$1,796,402 |
| Capital grants and contributions | 1,583,846 | |
| Charges for services | 61,718 | 264,165 |
| General revenues: | | |
| Property taxes | 1,356,167 | 1,819,208 |
| Municipal license taxes | 393,471 | 363,337 |
| Sales and uses tax | 275,367 | 809,669 |
| Unrestricted intergovernmental contributions and reimbursements | 7,277,970 | 7,277,283 |
| Unrestricted interest on deposit | 339,494 | 120,062 |
| Other | 42,428 | 865,985 |
| Total revenues | <u>14,352,859</u> | <u>13,316,111</u> |
| Expenses: | | |
| General government | 8,815,347 | 6,766,475 |
| Public works and sanitation | 2,235,937 | 2,774,006 |
| Public Safety | 1,176,183 | 988,860 |
| Culture and recreation | 685,050 | 699,316 |
| Health and welfare | 1,835,466 | 1,623,330 |
| Interest and bonds, notes and capital lease obligations | 386,401 | 294,834 |
| Total expenses | <u>15,134,384</u> | <u>13,146,821</u> |
| Net (decrease) increase in net assets | (781,525) | 169,290 |
| Net assets-at the beginning of the year, as restated | <u>9,261,525</u> | <u>9,092,235</u> |
| Net assets- at end of the year | <u><u>\$8,480,000</u></u> | <u><u>\$9,261,525</u></u> |

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA, PUERTO RICO
Management Discussion and Analysis
For the Fiscal Year ended June 30, 2009

Financial analysis of the Municipality's Governmental Funds

The Municipality uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. The focus of the Municipality's governmental fund is to provide information on near-term inflow, outflow, and balance of spend able resources. Such information is useful in assessing the Municipality's financial requirements. In particular, unreserved fund balance may serve as an useful measure of a government's net resources available for spending at the end of fiscal year. The following is a condensed presentation of the Municipality's balance sheet and results of operations of government fund:

| | 2009 | 2008 |
|--|--------------------|-------------------|
| Comparative Condensed Balance Sheet-Governmental funds: | | |
| Total assets-major funds | 7,378,809 | 9,866,611 |
| Total assets-nonmajor funds | 1,551,036 | 1,355,658 |
| Total assets | 8,929,845 | 11,222,269 |
| Total liabilities-major funds | 7,223,256 | 5,520,694 |
| Total liabilities-nonmajor funds | 1,723,534 | 1,307,226 |
| Total liabilities | 8,946,790 | 6,827,920 |
| Fund Balances: | | |
| Reserved-major funds | 3,687,401 | 7,142,068 |
| Reserved-nonmajor funds | | |
| Unreserved-major funds | (3,531,848) | (2,796,151) |
| Unreserved-nonmajor funds | (172,498) | 48,432 |
| Total fund balances | (16,945) | 4,394,349 |
| Comparative Condensed Statement of Operations-Governmental funds: | | |
| Total revenues-mayor funds | 12,549,928 | 10,500,547 |
| Total revenues-nonmayor funds | 1,802,931 | 2,815,564 |
| Total revenues | 14,352,859 | 13,316,111 |
| Total expenditures-major funds | 16,578,757 | 11,995,797 |
| Total expenditures-nonmajor funds | 2,015,089 | 2,384,173 |
| Total expenditures | 18,593,846 | 14,379,970 |
| Other Financial Sources-major funds(excluding operating transfers among funds) | | 4,287,324 |
| Net changes in fund balances | (4,240,987) | 3,223,465 |

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA, PUERTO RICO
Management Discussion and Analysis
For the Fiscal Year ended June 30, 2009

Governmental Activities

Total revenues of Municipality's governmental activities increased by (\$1.04 million) while total expenses increased by (\$4.2 million). The Municipality of Guánica took the following major actions this year to improve the financial position:

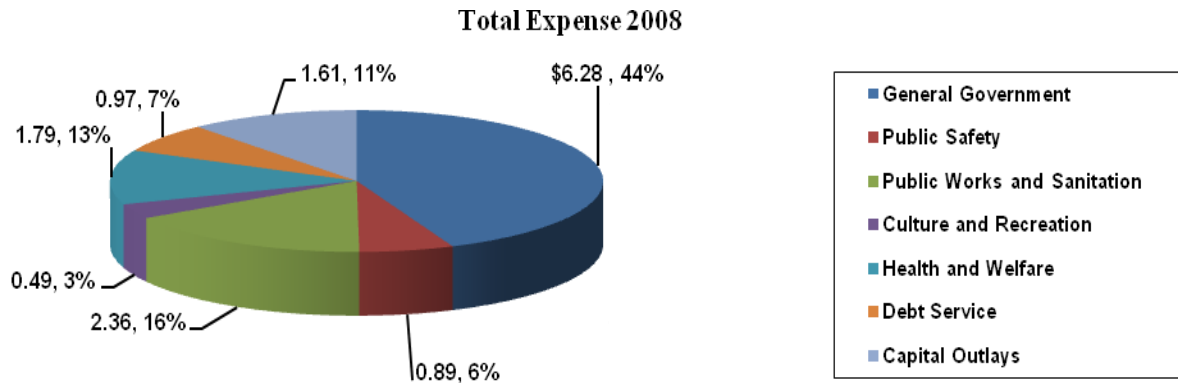
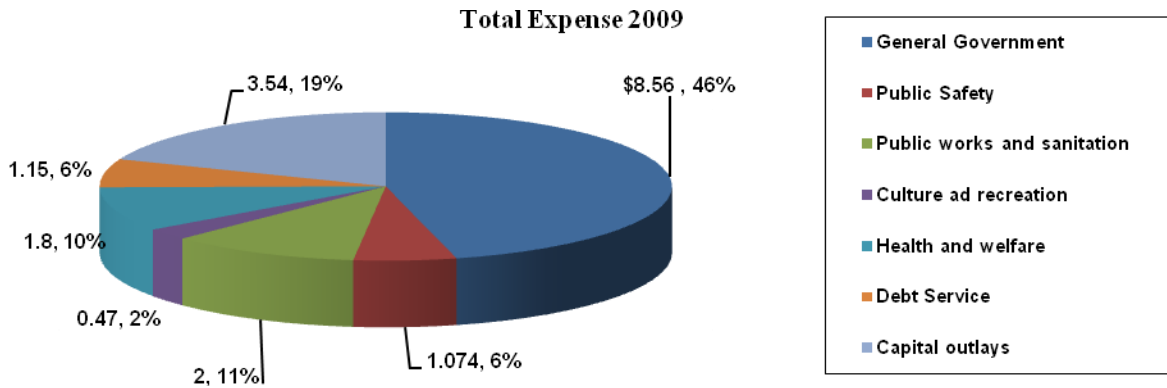
- The Mayor of the Municipality of Guánica still has a Finance Auxiliar Director to improve the collections of municipal licensed tax and property tax revenues; supervise the operations of the official and auxiliary collector of the Municipality.
- In the budget respect the administration of the Municipality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

Expenses during the fiscal year ended June 30, 2009 was substantially related to the following:

Table 2
Governmental Activities
(in Million)

| | Total expenses | |
|-----------------------------|-----------------------|-------------|
| | 2009 | 2008 |
| General Government | \$ 8.56 | \$ 6.28 |
| Public Safety | 1.07 | .89 |
| Public works and sanitation | 2.00 | 2.36 |
| Culture and recreation | .47 | .49 |
| Health and welfare | 1.80 | 1.79 |
| Debt service | 1.15 | .97 |
| Capital outlays | 3.54 | 1.61 |
| Totals | \$18.59 | \$14.39 |

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA, PUERTO RICO
 Management Discussion and Analysis
 For the Fiscal Year ended June 30, 2009



The cost of all governmental activities this year was \$18.59 million compared to \$14.39 million last year. Table 2 presents the cost of each of the Municipality of Guanica’s largest programs.

The major sources of general revenue are property taxes, municipal license taxes, sales tax and grant and contributions not restricted, which in total represent \$ 11.13 (77%) and \$ 10.03 (76%) of all revenues in 2009 and 2008, respectively.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA, PUERTO RICO
Management Discussion and Analysis
For the Fiscal Year ended June 30, 2009

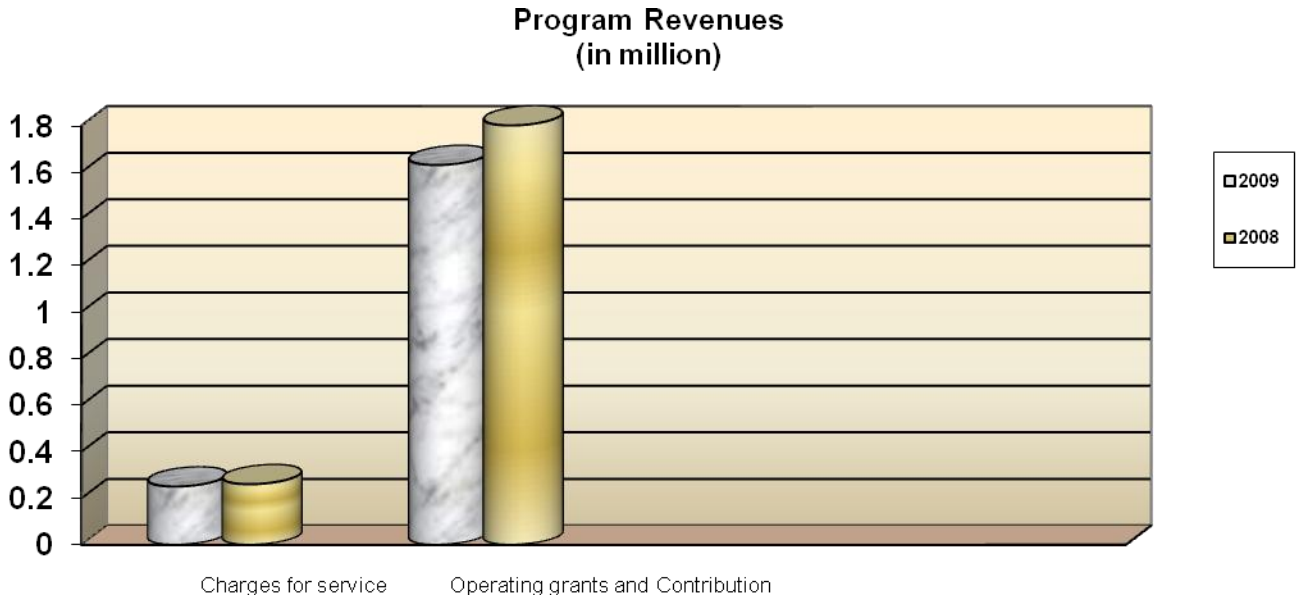
Table 3
Governmental Activities
(in Million)

| | General Revenues by major sources | |
|--------------------------|--|-------------|
| | 2009 | 2008 |
| Property taxes | \$ 1.32 | \$ 1.82 |
| Municipal license taxes | .39 | .36 |
| Sale tax | .62 | .81 |
| Grants and contributions | 8.80 | 7.28 |
| Totals | \$ 11.13 | \$ 10.27 |

Table 4
Governmental Activities
(in Million)

| | Program Revenues by major sources | |
|-----------------------------------|--|-------------|
| | 2009 | 2008 |
| Charges for service | \$.61 | \$.26 |
| Operating Grants and Contribution | 1.58 | 1.80 |
| Totals | \$2.19 | \$2.06 |

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA, PUERTO RICO
Management Discussion and Analysis
For the Fiscal Year ended June 30, 2009



THE MUNICIPALITY’S FUND

As the Municipality completed the year, its governmental funds reported a combined fund balance of \$.16 million, which is less than last year total of \$3.92 million.

General Fund Budgetary Highlights

Over the course of the year, the Municipal Assembly revised the Municipality of Guánica budget several times. These budget amendments fall into various categories. The first category includes amendments and supplemental appropriations that were approved shortly after the beginning of the year and reflect the actual beginning balances (versus the amounts we estimated in May 2008).

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA, PUERTO RICO
Management Discussion and Analysis
For the Fiscal Year ended June 30, 2009

CAPITAL ASSET AND DEBT ADMINISTRATION

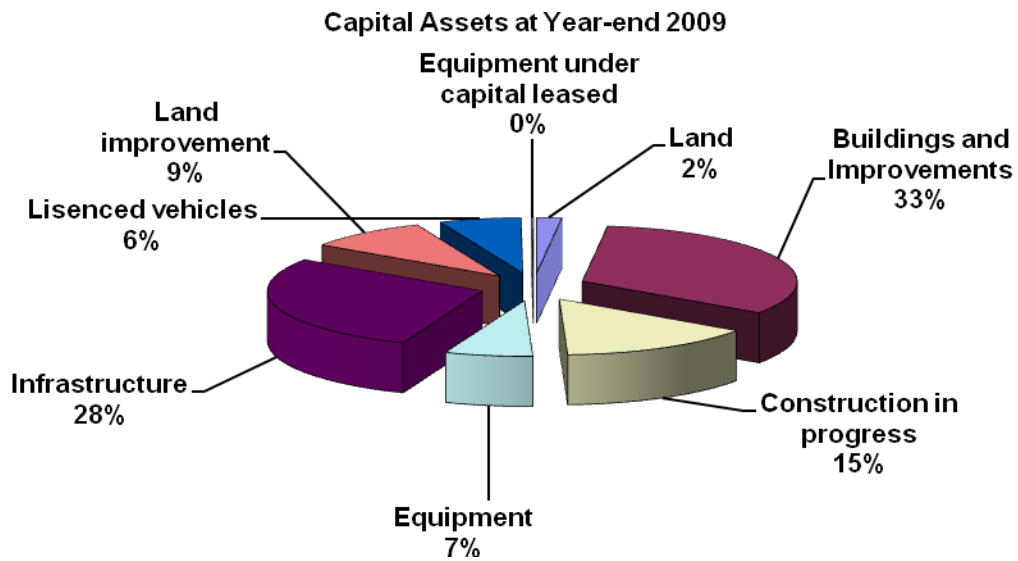
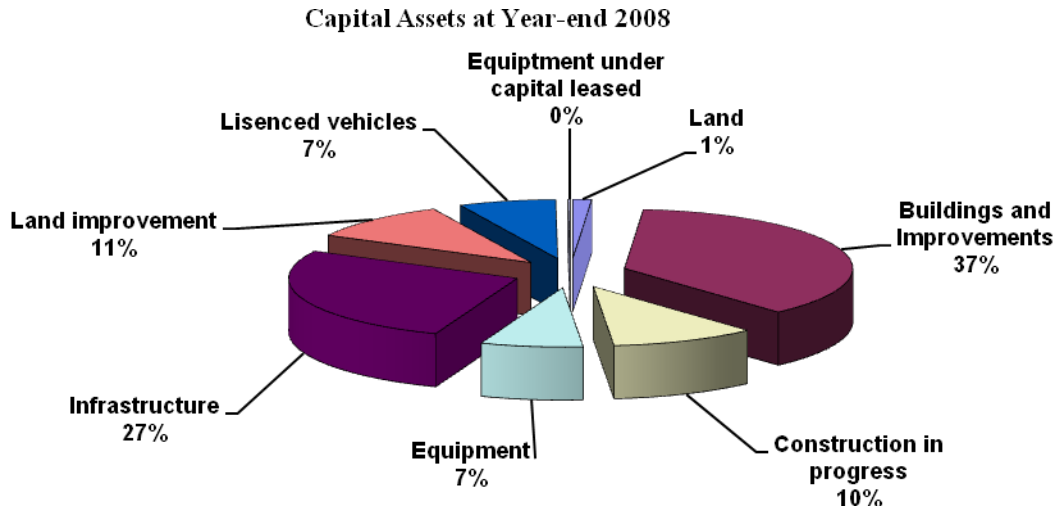
Capital Assets

As of June 30, 2009, the Municipality of Guánica had \$ 21.73 million invested in a broad range of capital assets, including buildings, parks, roads, bridges, and equipment. (See Table 5). This amount represents a net increase (including additions and deductions) of \$2.65 million, or 14 %, over last year. In this table you see few changes in amount compared to last year due to reclassifications of real property to proper division.

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

| | <i>Governmental</i> | |
|--------------------------------|---------------------|----------------|
| | <i>Activities</i> | |
| | <u>2009</u> | <u>2008</u> |
| Land | \$.59 | \$.37 |
| Land improvement | 2.89 | 2.89 |
| Buildings and Improvements | 10.28 | 10.28 |
| Construction in progress | 4.62 | 2.87 |
| Licensed vehicles | 1.93 | 1.91 |
| Equipment | 2.01 | 2.01 |
| Equipment under capital leases | .04 | .04 |
| Infrastructure | <u>8.95</u> | <u>7.47</u> |
| Totals | <u>\$31.31</u> | <u>\$27.84</u> |

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA, PUERTO RICO
 Management Discussion and Analysis
 For the Fiscal Year ended June 30, 2009



More detailed information about the Municipality's capital assets is presented in Note 11 to the financial statements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA, PUERTO RICO
 Management Discussion and Analysis
 For the Fiscal Year ended June 30, 2009

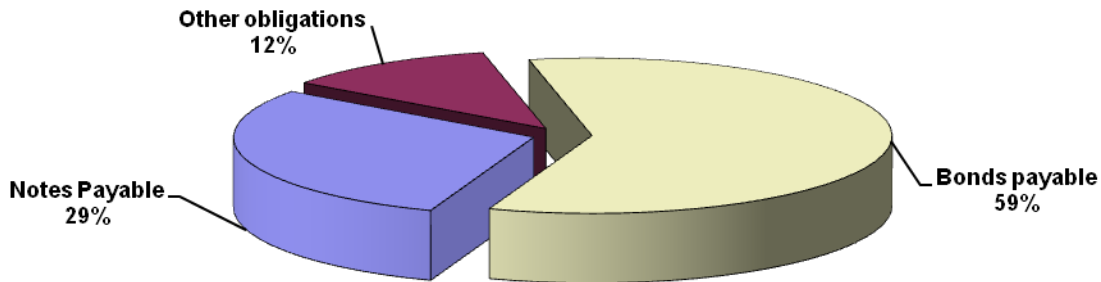
Debt

At year-end, the Municipality had \$13.62 million in bonds and notes outstanding versus \$14.34 million last year, a decrease of .05 percent, as shown in Table 6.

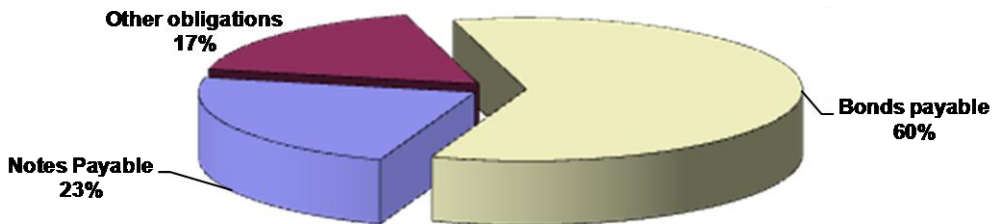
Table 6
Outstanding Debt, at Year-End
(in Thousands)

| | Governmental Activities | |
|-------------------|------------------------------------|-------------|
| | 2009 | 2008 |
| Bonds payable | \$8.14 | \$8.45 |
| Notes Payable | 3.14 | 4.23 |
| Other obligations | 2.42 | 1.66 |
| Totals | \$13.70 | \$14.34 |

Outstanding Debt, at Year-end 2008



Outstanding Debt, at Year-end 2009



COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA, PUERTO RICO
Management Discussion and Analysis
For the Fiscal Year ended June 30, 2009

The Municipality is required to limit the amount of general obligation debt to 10% of the total assessment of property located within the Municipality, for bonds to be repaid with the proceeds of property taxes restricted for debt services. Other obligations include accrued vacation and sick leave, claims and judgments, and christmas bonus.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

The Municipality's elected and appointed officials considered many factors when setting the fiscal-year 2009 budget.

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

If these estimates are realized, the Municipality's budgetary General Fund balance is expected to increase modestly by the close of 2010.

CONTACTING THE MUNICIPALITY'S FINANCIAL MANAGEMENT

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

BASIC FINANCIAL STATEMENTS

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA, PUERTO RICO
STATEMENT OF NET ASSETS
JUNE 30, 2009**

| ASSETS | Governmental Activities |
|---|------------------------------------|
| Cash | \$ 568,890 |
| Due from: | |
| Commonwealth Government (Note 3) | 164,063 |
| Federal Government (Note 3) | 511,676 |
| Restricted assets: | |
| Cash | 596,486 |
| Cash with fiscal agents | 3,214,748 |
| Capital assets (Note 5): | |
| Land and construction in progress | 5,208,265 |
| Other capital assets, net | <u>16,680,089</u> |
| Total capital assets, net | <u>21,888,354</u> |
| Total assets | <u>\$26,944,217</u> |
| LIABILITIES | |
| Accounts payable | \$ 2,033,263 |
| Payroll taxes and withholdings | 460,635 |
| Interest payable | 166,814 |
| Due to other agencies | 1,336,940 |
| Deferred revenues: | |
| Municipal license taxes | 242,118 |
| Federal grants | 513,039 |
| Long term liabilities (Note 7) : | |
| Due within one year | 694,463 |
| Due in more than one year | <u>13,016,945</u> |
| Total liabilities | <u>18,464,217</u> |
| NET ASSETS | |
| Invested in capital assets, net of related debt | 15,773,442 |
| Restricted for: | |
| Capital projects | 1,110,857 |
| Debt service | 506,522 |
| Other specified purposes | 417,339 |
| Unrestricted | <u>(9,328,160)</u> |
| Total net assets | <u>\$ 8,480,000</u> |

The accompanying notes are an integral part of this statement

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA, PUERTO RICO**

**STATEMENT OF ACTIVITIES
FISCAL YEAR ENDED JUNE 30, 2009**

| Functions | Expenses | Program Revenues | | | Net (Expenses) Revenues and Change in Net Assets |
|---------------------------------|---------------------|--|--|--|--|
| | | Fees, Fines and Charges for services | Operating Grants and Contributions | Capital Grants and Contributions | |
| Governmental Activities: | | | | | |
| General government | \$ 8,815,347 | \$61,718 | \$ 417,190 | \$ - | \$(8,336,439) |
| Public works | 2,191,162 | - | - | 1,583,846 | (607,316) |
| Public safety | 1,176,183 | - | - | - | (1,176,183) |
| Culture and recreation | 685,050 | - | - | - | (685,050) |
| Health and welfare | 1,835,466 | - | 1,754,205 | - | (81,261) |
| Urban development | 44,775 | - | 851,003 | - | 806,228 |
| Interest on long term debt | <u>386,401</u> | - | - | - | <u>(386,401)</u> |
| Total | <u>\$15,134,384</u> | <u>\$61,718</u> | <u>\$3,022,398</u> | <u>\$1,583,846</u> | <u>\$(10,466,422)</u> |
| General revenues: | | | | | |
| Taxes: | | | | | |
| | | | | | \$ 1,356,167 |
| | | | | | 393,471 |
| | | | | | 275,367 |
| | | | | | 1,451,303 |
| | | | | | 5,826,667 |
| | | | | | 339,494 |
| | | | | | <u>42,428</u> |
| | | | | | <u>9,684,897</u> |
| | | | | | (781,525) |
| | | | | | <u>9,261,525</u> |
| | | | | | <u>\$ 8,480,000</u> |

The accompanying notes are an integral part of this statement.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA, PUERTO RICO**

**BALANCE SHEET
GOVERNMENTAL FUNDS
JUNE 30, 2009**

| | <u>Major Funds</u> | | | | | | |
|--------------------------------------|--------------------|--|-------------------------|--|---|---|---|
| | <u>General</u> | <u>Community Legislative Resolutions</u> | <u>Debt Service</u> | <u>Capital Improvement Loan Fund</u> | <u>Housing Choice Voucher Sec 8 Program</u> | <u>Other Governmental Funds</u> | <u>Total Governmental Funds</u> |
| Assets | | | | | | | |
| Cash and cash equivalents | \$ 568,890 | \$ - | \$ - | \$ - | \$ - | \$ - | \$ 568,890 |
| Due from: | | | | | | | |
| Commonwealth Government | 157,708 | - | 5,150 | - | - | 1,205 | 164,063 |
| Federal Government | | - | | | 4,433 | 507,243 | 511,676 |
| Other funds (Note 4) | 1,274,038 | 2,222,072 | - | - | 99 | 377,772 | 3,873,981 |
| Restricted assets: | | | | | | | |
| Cash and cash equivalents | - | 96,760 | - | - | 264,593 | 235,134 | 596,487 |
| Cash with fiscal agents | <u>-</u> | <u>-</u> | <u>988,186</u> | <u>1,796,880</u> | <u>-</u> | <u>429,682</u> | <u>3,214,748</u> |
| Total assets | <u>\$2,000,636</u> | <u>\$2,318,832</u> | <u>\$993,336</u> | <u>\$1,796,880</u> | <u>\$269,125</u> | <u>\$1,551,036</u> | <u>\$8,929,845</u> |
| Liabilities and fund balances | | | | | | | |
| Liabilities: | | | | | | | |
| Accounts payable | \$1,284,747 | \$ - | \$ - | \$ 325,285 | \$ 2,099 | \$ 421,132 | \$2,033,263 |
| Payroll taxes and withholdings | 460,635 | - | - | - | - | - | 460,635 |
| Matured bonds and interest payable | - | - | 486,814 | - | - | - | 486,814 |
| Due to: | | | | | | | |
| Commonwealth Government | 1,336,940 | - | - | - | - | - | 1,336,940 |
| Other funds | 2,194,727 | 701,336 | - | 184,198 | 4,357 | 789,363 | 3,873,981 |
| Deferred revenues: | | | | | | | |
| Municipal license taxes (Note 6) | 242,118 | - | - | - | - | - | 242,118 |
| Federal grants (Note 6) | <u>-</u> | <u>-</u> | <u>-</u> | <u>-</u> | <u>-</u> | <u>513,039</u> | <u>513,039</u> |
| Total liabilities | <u>5,519,167</u> | <u>701,336</u> | <u>486,814</u> | <u>509,483</u> | <u>6,456</u> | <u>1,723,534</u> | <u>8,946,790</u> |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA, PUERTO RICO
BALANCE SHEET
GOVERNMENTAL FUNDS (CONTINUED)
JUNE 30, 2009**

Major Funds

| | General | Commonwealth Legislative Resolutions | Debt Service | Capital Improvement Loan Fund | Housing Choice Voucher Sec 8 Program | Other Governmental Funds | Total Governmental Funds |
|---|--------------------|---|-------------------------|--|---|---|---|
| Fund balances (deficits): | | | | | | | |
| Reserved for: | | | | | | | |
| Encumbrances | 13,317 | - | - | - | - | - | 13,317 |
| Debt service | - | - | 506,522 | - | - | - | 506,522 |
| Capital projects | - | 1,617,496 | - | 1,287,397 | - | - | 2,904,893 |
| Other specified purposes | - | - | - | - | 262,669 | - | 262,669 |
| Unreserved | <u>(3,531,848)</u> | <u>-</u> | <u>-</u> | <u>-</u> | <u>-</u> | <u>(172,498)</u> | <u>(3,704,346)</u> |
| Total fund balances (deficits) | <u>(3,518,531)</u> | <u>1,617,496</u> | <u>506,522</u> | <u>1,287,397</u> | <u>262,669</u> | <u>(172,498)</u> | <u>(16,945)</u> |
| Total liabilities and fund balances (deficits) | <u>\$2,000,636</u> | <u>\$2,318,832</u> | <u>\$993,336</u> | <u>\$1,796,880</u> | <u>\$269,125</u> | <u>\$1,551,036</u> | <u>\$ 8,929,845</u> |

The accompanying notes are an integral part of this statement

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA, PUERTO RICO**

**RECONCILIATION OF TOTAL GOVERNMENTAL FUND BALANCE
TO NET ASSETS OF GOVERNMENTAL ACTIVITIES
JUNE 30, 2009**

| | | |
|--|----------------|----------------------------|
| Total governmental fund balances: | | \$ (16,945) |
| Amounts reported for governmental activities in the statement of net assets are different because: | | |
| Capital assets used in governmental activities are not financial resources and therefore are not reported in the funds: | | 21,888,353 |
| Long term liabilities, including bonds payable, are not due and payable in the current period and therefore are not reported in the funds: | | |
| General obligation bonds and notes | 7,825,000 | |
| Note payable to CRIM-LIMS | 48,452 | |
| Loan to PR Treasury Department | 1,374,775 | |
| Note payable to PR Labor Department | 176,544 | |
| Note payable to PR Land Authority | 118,064 | |
| Note payable to CRIM ACT 42 Excess of Property Tax Advance | 962,668 | |
| Financing agreements with PR Water and Sewer Authority | 70,000 | |
| Compensated absences | 1,438,637 | |
| Note payable to FEMA | 750,467 | |
| Judgments and Claims | 106,658 | |
| Payable to CRIM (property tax advances) | 370,911 | |
| Christmas bonus | <u>149,232</u> | <u>(13,391,408)</u> |
| Net assets of governmental activities: | | <u>\$ 8,480,000</u> |

The accompanying notes are an integral part of this statement

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA, PUERTO RICO
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES- GOVERNMENTAL FUNDS
FISCAL YEAR ENDED JUNE 30, 2009

| | <u>Major Funds</u> | | | | | | <u>Total Governmental Funds</u> |
|--|--------------------|---|-------------------------|---|---|---|---|
| | <u>General</u> | <u>Commonwealth Legislative Resolutions</u> | <u>Debt Service</u> | <u>Capital Improvement Loan</u> | <u>Housing Choice Voucher Sec 8 Program</u> | <u>Other Governmental Funds</u> | |
| | Revenues: | | | | | | |
| Taxes: | | | | | | | |
| Property taxes (Note 8) | \$ 1,154,052 | \$ - | \$ 202,116 | \$ - | \$ - | \$ - | \$ 1,356,168 |
| Municipal license taxes (Note 10) | 393,471 | - | - | - | - | - | 393,471 |
| Sales and use taxes (Note 9) | 275,367 | - | - | - | - | - | 275,367 |
| Intergovernmental (Note 11): | | | | | | | |
| Commonwealth government | 7,220,257 | 1,194,715 | - | - | - | 389,131 | 8,804,103 |
| Federal government | - | 19,412 | - | - | 242,790 | 1,366,606 | 1,628,808 |
| Licenses, permits and other local taxes | 907,463 | 2,465 | 355,105 | - | - | - | 1,265,033 |
| Fees, fines and charges for services | 209,215 | 1,975 | - | - | - | 36,797 | 247,987 |
| Interest | 212,801 | 303 | 3,194 | 112,807 | - | 10,389 | 339,494 |
| Other | <u>28,091</u> | <u>-</u> | <u>-</u> | <u>10,681</u> | <u>3,648</u> | <u>8</u> | <u>42,428</u> |
| Total Revenues | <u>10,400,717</u> | <u>1,218,870</u> | <u>560,415</u> | <u>123,488</u> | <u>246,438</u> | <u>1,802,931</u> | <u>14,352,859</u> |
| Expenditures: | | | | | | | |
| Current: | | | | | | | |
| General government | 5,413,500 | 749,301 | - | 1,327,718 | - | 1,056,600 | 8,547,119 |
| Public works | 2,001,852 | - | - | - | - | 1,802 | 2,003,654 |
| Public safety | 1,074,785 | - | - | - | - | - | 1,074,785 |
| Culture and recreation | 476,603 | - | - | - | - | - | 476,603 |
| Health and welfare | 1,495,560 | - | - | - | 203,045 | 101,679 | 1,800,284 |
| Urban development | - | - | - | - | - | - | - |
| Capital outlays | - | 1,193,899 | - | 1,489,842 | - | 855,008 | 3,538,749 |
| Debt service: | | | | | | | |
| Principal | - | - | 746,908 | - | - | - | 746,908 |
| Interest | <u>-</u> | <u>-</u> | <u>405,744</u> | <u>-</u> | <u>-</u> | <u>-</u> | <u>405,744</u> |
| Total expenditures | <u>10,462,300</u> | <u>1,943,200</u> | <u>1,152,652</u> | <u>2,817,560</u> | <u>203,045</u> | <u>2,015,089</u> | <u>18,593,846</u> |
| Excess (deficiency) of revenues over expenditures | (61,583) | (724,330) | (592,237) | (2,694,072) | 43,393 | (212,158) | (4,240,987) |

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA, PUERTO RICO
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES
GOVERNMENTAL FUNDS (CONTINUED)
FISCAL YEAR ENDED JUNE 30, 2009**

| | <u>Major Funds</u> | | | | | | <u>Total Governmental Funds</u> |
|---|-----------------------------|---|-------------------------|---|---|---|---|
| | <u>General</u> | <u>Commonwealth Legislative Resolutions</u> | <u>Debt Service</u> | <u>Capital Improvement Loan</u> | <u>Housing Choice Voucher Sec 8 Program</u> | <u>Other Governmental Funds</u> | |
| Other financing sources (uses): | | | | | | | |
| Transfers in | \$ 123,804 | \$ - | \$644,938 | \$ - | \$ - | \$ 50 | \$ 768,792 |
| Transfers out | <u>(644,938)</u> | <u>-</u> | <u>(2,225)</u> | <u>(112,807)</u> | <u>-</u> | <u>(8,822)</u> | <u>(768,792)</u> |
| Total other financing sources (uses) | <u>(521,134)</u> | <u>-</u> | <u>642,713</u> | <u>(112,807)</u> | <u>-</u> | <u>(8,772)</u> | <u>-</u> |
| Net change in fund balance | (582,717) | (724,330) | 50,476 | (2,806,879) | 43,393 | (220,930) | (4,240,987) |
| Fund balances at beginning of year | <u>(2,935,814)</u> | <u>2,341,826</u> | <u>456,046</u> | <u>4,094,276</u> | <u>219,276</u> | <u>48,432</u> | <u>4,224,042</u> |
| Fund balances (deficit) at end of year | <u><u>\$(3,518,531)</u></u> | <u><u>\$1,617,496</u></u> | <u><u>\$506,522</u></u> | <u><u>\$ 1,287,397</u></u> | <u><u>\$262,669</u></u> | <u><u>\$(172,498)</u></u> | <u><u>\$ (16,945)</u></u> |

The accompanying notes are an integral part of this statement.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA, PUERTO RICO**

**RECONCILIATION OF STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN
FUND BALANCES OF GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES
FISCAL YEAR ENDED JUNE 30, 2009**

Net change in fund balances-total governmental funds: **\$ (4,240,987)**

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

Governmental funds reports capital assets outlays as expenditures.

However, in the Statement of Activities, the cost of those assets is
allocated over their estimated useful lives and reported as depreciation
expense:

| | | |
|---------------------------------|------------------|-----------|
| Expenditures for capital assets | \$ 3,538,749 | |
| Less: current year depreciation | <u>(728,809)</u> | 2,809,940 |

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

| | | |
|------------------------------------|----------------|---------|
| General obligation bonds and notes | 305,000 | |
| Other long term liabilities | <u>455,398</u> | 760,398 |

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

| | | |
|-----------------------|------------------|-------------------|
| Compensated absences | (28,742) | |
| Christmas bonus | 37,769 | |
| Judgements and Claims | (42,134) | |
| Other | <u>(77,769)</u> | <u>(110,876)</u> |

Change in net assets of governmental activities: **\$ (781,525)**

The accompanying notes are an integral part of this statement.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA, PUERTO RICO
Notes to Basic Financial Statements
June 30, 2009

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Municipality of Guánica of the Commonwealth of Puerto Rico (the “Municipality”) was founded in 1771. The Municipality is a local government with full legislative, fiscal and administrative powers to operate as a government under Law No. 81 of August 30, 1991, as amended, known as the *Autonomous Municipalities Act of the Commonwealth of Puerto Rico (Law No. 81)*.

The Municipality’s governmental system consists of executive and legislative branches. The Constitution of the Commonwealth of Puerto Rico (the “Commonwealth”) provides for the separation of powers of the executive, legislative and judicial branches. A Mayor, elected every four years by the citizens, exercises the executive power of the Municipality. The legislative power is exercised by the Municipal Legislature, which is also elected every four years. The General Justice Court System of the Commonwealth, which has jurisdiction over the Municipality, exercises the judiciary power.

The Municipality engages in a comprehensive range of services to the community such as housing, welfare, public safety, health, sanitation, education, culture, recreation, urban and economic development, and many other general and administrative duties.

a) Financial Reporting Entity

The accompanying basic financial statements include all departments, agencies and municipal entities that: (1) are under the legal and administrative control of the Mayor and (2) whose funds are under the legal custody and control of the Municipality’s Director of Finance and Budget, as prescribed by Law No. 81.

The Municipality’s management has considered all potential component units for which it may be financially accountable and other legally separate organizations for which the nature and significance of their relationship with the Municipality may be such that exclusion of their basic financial statements from those of the Municipality would cause the Municipality’s basic financial statements to be misleading or incomplete.

GASB Statement No. 14 - *The Financial Reporting Entity* (GASB No. 14), as amended by GASB Statement No. 39 – *Determining Whether Certain Organizations are Component Units* (GASB No. 39) set forth criteria to be considered in determining financial accountability. These criteria include appointing a voting majority of an organization’s governing body and (1) the ability of the Municipality to impose its will on that organization or (2) the potential for the organization to provide specific financial benefits to, or impose specific financial burdens on the Municipality. GASB Statement No. 39 provides additional guidance in determining whether certain organizations for which the primary government is not financially accountable should be reported as component units based on the nature and significance of their relationship with the primary government. Generally, GASB No. 39 requires reporting a component unit if an organization raise and holds economic resources for the direct benefit of a governmental unit.

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA, PUERTO RICO
Notes to Basic Financial Statements
June 30, 2009

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

b) Government-wide Financial Statements (GWFS)

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

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

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

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

- **Invested in capital assets, net of related debt** – These consist of capital assets, net of accumulated depreciation and amortization, reduced by the outstanding balances of bonds, notes and other debt that are attributed to the acquisition, construction or improvement of those assets. For the purposes of determining the outstanding debt attributed to capital assets, the total long-term debt related to the acquisition, construction or improvement of capital assets have been reduced by any related unspent debt proceeds and any related unamortized debt issuance costs.
- **Restricted net assets** – These consist of net assets restricted by external parties (such as creditors, grantors, contributors, laws or regulations of other governments, etc.), or net assets for which constraints are imposed by constitutional provisions or enabling legislation. Enabling legislation is defined as legislation that authorizes the Municipality to assess, levy, charge or otherwise mandate payment of resources (from external resource providers). Enabling legislation establishes restrictions if it includes a legally enforceable requirement that those resources be used only for the specific purposes stipulated in the legislation. The classification of restricted net assets identifies resources that have been received or earned by the Municipality with an explicit understanding between the Municipality and the resource providers that the resources would be used for specific purposes. Grants, contributions and donations are often given under those kinds of conditions. Bond indentures also often limit the use of bond proceeds to specific purposes.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA, PUERTO RICO
Notes to Basic Financial Statements
June 30, 2009

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

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

- **Unrestricted net assets** – These consist of net assets that are neither externally or legally restricted, nor invested in capital assets. However, unrestricted net assets often are designated to indicate that management does not consider them to be available for general operations. Unrestricted net assets often have constraints that are imposed by management, but can be removed or modified. When both restricted and unrestricted resources are available for use, it is the Municipality's policy to generally use restricted resources first, and then unrestricted resources as they are needed.

The accompanying statement of activities presents the results of the Municipality's operations by showing how the Municipality's net assets changed during the year ended June 30, 2009, using a net (expense) revenue format. This statement presents the cost of each function/program as well as the extent to which each of the Municipality's functions, programs or other services either contributes to or draws from the Municipality's general revenues (such as property taxes, municipal license taxes, construction excise taxes, etc.). A function/program describes a group of activities that are aimed at accomplishing a major service or regulatory responsibility. The functions/programs reported in the accompanying basic financial statements are: (1) general government, (2) public safety, (3) public works and sanitation, (4) culture and recreation, (5) health and welfare and (6) urban development. The governmental operations of the Municipality's departments and operational units are classified within the following functions/programs in the accompanying basic financial statements:

General government:

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

Public safety:

Department of municipal police
Department of emergency management

Public works and sanitation:

Department of public works
Department of sanitation

Culture and recreation:

Department of recreation and sports
Department of tourism

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA, PUERTO RICO
Notes to Basic Financial Statements
June 30, 2009

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

Health and welfare

Department of health

Department of elderly affairs

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

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

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

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA, PUERTO RICO
Notes to Basic Financial Statements
June 30, 2009

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

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

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

The Municipality has no fiduciary activities, which are those in which the Municipality would be holding or managing net assets for specific individuals or other external parties in accordance with trust agreements or other custodial arrangements. In addition, the Municipality has no operations or activities that are primarily financed and operated in a manner similar to private business enterprises, where the costs of providing goods or services to the general public is financed primarily through user charges.

c) Governmental Fund Financial Statements (GFFS)

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

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA, PUERTO RICO
Notes to Basic Financial Statements
June 30, 2009

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

- **General fund** – The general fund is the Municipality’s main operating and major fund, as defined below, used to account for all financial resources and governmental activities, except for financial resources required to be accounted for in another fund. It is presumed that the Municipality’s governmental activities have been reported in the general fund except for transactions for which one of the following compelling reasons has required the use of another fund: (1) legal requirements, (2) GAAP requirements or (3) the demands of sound financial administration requiring the use of a governmental fund other than the general fund.
- **Special revenue funds** – The special revenue funds are nonmajor funds, as defined below, used by the Municipality to account for revenues derived from grants or other revenue sources (other than major capital projects) that are either self-restricted by the Municipality or legally restricted by outside parties for use in specific purposes. The uses and limitations of each special revenue fund are specified by municipal ordinances or federal and state statutes. However, resources restricted to expenditure for purposes normally financed from the general fund are reported in the Municipality’s general fund provided that all applicable legal requirements are appropriately satisfied. In this case, a special revenue fund to account for such kind of transactions will be used only if legally mandated.
- **Debt service fund** – The debt service fund is a major fund, as defined below, used by the Municipality to account for the accumulation of resources for, and the payment of, principal and interest for: (1) bonds and notes for which debt service payments are legally mandated to be accounted for in a debt service fund and/or (2) general long-term debt for which the Municipality is being accumulating financial resources in advance, to pay principal and interest payments maturing in future years. Principal and accrued interest due on July 1 of the following fiscal year related to long-term debt for which debt service payments are accounted for in the debt service fund, are recorded as debt service fund’s liabilities at June 30, if resources are available at June 30 for its payment.

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

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

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

COMMONWEALTH OF PUERTO RICO
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1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

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

By definition, the Municipality's general fund is always considered a major governmental fund for financial reporting purposes. In addition, any other fund is considered a major fund for financial reporting purposes if its total assets, liabilities, revenues or expenditures of that individual governmental fund are at least 10 percent of the corresponding element total (assets, liabilities, revenues or expenditures) for all governmental funds or based on the Municipality's official's criteria, if the fund is particularly important to financial statement users. For the purposes of applying the aforementioned major fund criteria, no eliminations of interfund balances have been made. Total revenues for these purposes means all revenues, including operating and nonoperating revenues (net of allowances), except for other financing sources. Total expenditures for these purposes mean all expenditures, including operating and nonoperating expenditures, except for other financing uses.

Based on the aforementioned criteria, the Municipality's major governmental funds reported in the accompanying governmental fund financial statements are:

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

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

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

Capital Improvement Loan Fund: This fund is used to account for capital projects such as community facilities repairs, improvements of certain sport courts, and improvements to municipality roads.

Housing Choice Voucher Sec. 8 Program: This fund account for revenues related to federal program HUD Section 8. The purpose of the program is to provide rental assistance to vary low-income families to help afford decent, safe and sanitary housing.

COMMONWEALTH OF PUERTO RICO
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1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

d) Measurement Focus and Basis of Accounting

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

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

In a nonexchange transaction, the Municipality gives (or receives) value without directly receiving (or giving) equal value in return. This is different from an exchange transaction, in which each party receives and gives up essentially equal values. According current standards, the Municipality groups its nonexchange transactions into the following four classes in the accompanying basic financial statements: (a) derived tax revenues, (b) imposed nonexchange revenues, (c) government mandated nonexchange transactions, and (d) voluntary nonexchange transactions.

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

Government-mandated nonexchange transactions (such as grants and contributions) result when a government at one level (such as the federal or state government) provides resources to another government (such as the Municipality), and the provider government requires the recipient government to use those resources for a specific purpose or purposes established in the provider's enabling legislation. In these type of transactions, receivables and revenues are generally recorded as follows:

- For reimbursement-type (commonly known as “expenditure-driven awards”), receivables and revenues are recorded when all eligibility requirements imposed by the provider have been met. The Municipality must expend resources on the specific purpose or project before the provider reimburses any amounts. Revenue is, therefore, generally recognized as qualifying reimbursable expenditures are incurred.

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1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

- For other types of grants (mainly grants and contributions with purpose restrictions but with no time requirements), receivables and revenues are recorded when all applicable eligibility requirements are met. When the provider is a government (including the government of the United States of America) the applicable recognition period for both, the provider and the recipient, is the provider's fiscal year and begins on the first day of that year.

Voluntary nonexchange transactions (such as donations and certain grants and entitlements) result from legislative or contractual agreements, other than exchanges, entered into willingly by two or more parties. In these types of transactions, receivables and revenues are generally accounted for in the same manner as government-mandated nonexchange transactions discussed above.

Receipts of any type of revenue sources collected in advance for use in the following period are recorded as deferred revenues.

Events that are neither exchange nor nonexchange transactions are recorded when it is probable that a loss has been incurred and the amount of loss is reasonably estimable.

The measurement focus and the basis of accounting used in the accompanying GWFS differ significantly from the measurement focus and basis of accounting used in the preparation of the accompanying GFFS. Therefore, the accompanying GFFS include reconciliations to better identify the relationship between the GWFS and the GFFS.

Governmental fund financial statements – The accompanying GFFS are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are generally recognized as soon as they are both measurable and available. Revenues are generally considered to be available when they are collectible within the current year or soon enough thereafter to pay liabilities of the current year. For this purpose, the Municipality considers most revenues to be available if collected within 90 days after June 30, 2009, 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, 2009. The principal revenue sources considered susceptible to accrual include property taxes, municipal license taxes, intergovernmental grants and contributions and interest income. These principal revenue sources meet both measurability and availability criteria in the accompanying GFFS, except for amounts recorded as deferred revenues.

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

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1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

All revenues, expenses, gains, losses and assets resulting from nonexchange transactions are recorded in a similar manner to the GWFS, using the previously discussed criteria set forth by GASB No. 33 for nonexchange transactions, but subject to and limited by the availability criteria discussed above. Accordingly, municipal license tax receivables and revenues are generally recorded when the underlying exchange has occurred. Property tax receivables are also generally recorded in the period when an enforceable legal claim has arisen while property tax revenues (net of amounts considered not collectible) are also generally recorded in the period when resources are required to be used or the first period that the use of the resources is permitted. Receivables and revenues from reimbursement-type grants, contributions, donations and entitlements are also generally recorded as qualifying reimbursable expenditures are incurred, while receivables and revenues from other types of grants are recorded when all eligibility requirements imposed by the provider have been met.

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

Expenditures and related liabilities are generally recorded in the accompanying governmental fund financial statements in the accounting period in which the liability is incurred, as under the accrual basis of accounting, but only to the extent that they are normally expected to be liquidated with expendable financial resources.

Modifications to the accrual basis of accounting include:

- Employees' accumulated vacation, sick leave and compensatory time (compensated absences) is recorded as expenditure when consumed. The amount of the unpaid compensated absences has been reported only in the accompanying statements of net assets.
- Principal and interest on bonds and notes payable are recorded when they mature (when payment is due), except for principal and interest due in July 1 of the following fiscal year, which are recorded when resources are available in the debt service fund (generally June 30).
- Obligations under capital leases, amounts subject to claims and judgments under litigation and other long-term obligations are recorded only when they mature (when payment is due).

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

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

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

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1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

e) Unrestricted and Restricted Deposits

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

The Municipality follows the practice of pooling cash. The balance in the pooled cash account is available to meet current operating requirements. Under the laws and regulations of the Commonwealth, public funds deposited by the Municipality in commercial banks must be fully collateralized for the amounts deposited in excess of the federal depository insurance generally provided by the Federal Deposits Insurance Corporation (FDIC). All securities pledged as collateral are held by the Secretary of the Treasury of the Commonwealth, in the Municipality's name.

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

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

f) Unrestricted and Restricted Accounts Receivable

In the accompanying GWFS, receivables consist of all revenues earned but not collected at June 30, 2009. Major receivable balances for the governmental activities include property taxes and intergovernmental receivables.

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

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

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

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1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

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

g) Inventories

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

h) Deferred Charges

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

i) Capital Assets

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

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

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

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1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

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

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

| | <u>Years</u> |
|---|--------------|
| Land improvements | 20 |
| Buildings, structures and building improvements | 30 to 50 |
| Infrastructure | 20 to 50 |
| Licensed vehicles | 8 |
| Machinery and equipment, excluding those held under capital leases | 5 to 20 |

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

j) 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 revenues before allowable expenditure are incurred. 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 allowable expenditure are incurred.

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1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

k) Compensated Absences

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

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

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

l) Long-term Debt

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

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

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

m) Leases

The Municipality classifies its lease agreements either as operating or capital leases. Capital lease agreements are non-cancelable and involve, substance over form, the transfer of substantially all benefits and risks inherent in the ownership of the leased property, while operating leases do not involve such transfer. Accordingly, a capital lease involves the recording of an asset and a related lease liability at the inception of the lease. According to GAAP, the Municipality classifies a lease agreement as a capital lease if at its inception the lease meets one or more of the following four criteria:

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1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

- By the end of the lease term, ownership of the leased property is transferred to the Municipality.
- The lease agreement contains a bargain purchase option.
- The lease term is substantially equal (75% or more) to the estimated useful life of the leased property.
- At the inception of the lease, the present value of the minimum lease payments, with certain adjustments, is 90% or more of the fair value of the leased property.

Although the Municipality is prevented legally from entering into obligations extending beyond the current year budget, most capital lease agreements entered by the Municipality contain fiscal funding clauses or a cancellation clause that makes the continuation of the agreements subject to future appropriations. Leases that meet at least one of the aforementioned four criteria and have fiscal funding or cancellation clauses have been recorded as capital leases in the accompanying GWFS, since the likelihood of invoking the provision is considered to be remote. The Municipality's lease agreements do not include contingent rental payments nor escalation clauses.

In the GWFS, the obligation under capital leases is recorded at the lesser of the estimated fair value of the leased property or the present value of the minimum lease payments, excluding any portion representing executory costs and profit thereon to be paid by the lessor. A portion of each minimum lease payment is allocated to interest expense and the balance is applied to reduce the lease liability using the effective interest method.

In the GFFS, the net present value of the minimum lease payments at the inception of the capital lease is recorded simultaneously as (1) expenditure and (2) other financing source. Minimum lease payments are recorded as expenditures in the GFFS.

n) Accounting for Pension Costs

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

The Municipality accounts for pension costs from the standpoint of a participant in a multiple-employer cost-sharing plan. Accordingly, pension costs recognized in the accompanying basic financial statements are equal to the statutorily required contributions, with a liability recorded for any unpaid required contributions.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA, PUERTO RICO
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1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

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

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

The Municipality also obtains medical insurance coverage for its employees. The current insurance policies have not been canceled or terminated at June 30, 2009. In the past three years, the Municipality has not settled claims that exceeded insurance coverage.

p) Reservations of Fund Balances

Reservations of fund balances represent portions of fund balances that are legally segregated for specific future uses or are not appropriated for expenditure. The Municipality has the following types of reservations of fund balances:

- ***Encumbrances*** – Represent future expenditures under purchase orders, contracts and other commitments. These committed amounts represent reservations of unexpired appropriations and generally will become liabilities in future periods as the goods or services are received.
- ***Capital Projects*** – Represent the reservation of amounts to be used for future expenditures for capital projects under contracts and other commitments. These committed amounts generally will become liabilities in future periods as the projects are completed.
- ***Debt Service*** – Represent fund balances available to finance future debt service payments.

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1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

- ***Other Specified Purposes*** – Represent resources set aside for use in federal and state grant programs accounted for in the special revenue funds.

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.

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1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

s) Future Adoption of Accounting Pronouncements

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

| <u>Statement Number</u> | <u>Statement Name</u> | <u>Adoption Required in Fiscal Year</u> |
|-----------------------------|--|---|
| 51 | Pension Disclosures- an amendment of GASB Statements No. 25 and No. 27 | 2009-10 |
| 52 | Land and Other Real State Held as Investments By Endowments | 2009-10 |
| 53 | Accounting and Financial Reporting for Derivative Instruments | 2010-11 |
| 54 | Fund balance Reporting and Governmental Fund Type Definitions | 2011-12 |
| 55 | The Hierarchy of Generally Accepted Accounting Principles For State and local Governments | Immediately |
| 56 | Codification of Accounting and Financial Reporting Guidance | Immediately |

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

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2. CUSTODIAL CREDIT RISK - DEPOSITS

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

Under Commonwealth of Puerto Rico statutes, public funds deposited in commercial banks must be fully collateralized for the amount deposited in excess of federal deposit insurance. All securities pledged as collateral by the Municipality are held by the Secretary of Treasury of Puerto Rico in the Municipality's name. At year end the Municipality's bank balance in commercial banks amounts to \$1,368,399. Deposits in governmental banks (all of which are uninsured and uncollateralized are exposed to custodial risk. At year end the Municipality's bank balance in governmental banks amounts to \$3,124,921.

3. DUE FROM (TO) GOVERNMENTAL ENTITIES

A. Amounts due from governmental entities as of June 30, 2009 follows:

| | <i>Commonwealth Government</i> | <i>Federal Government</i> |
|---|------------------------------------|-------------------------------|
| Municipal Revenue Collection Center (CRIM) – property taxes (debt service fund) | \$ 5,150 | \$ - |
| Office of Commissioner of Municipal Affairs – CDBG | - | 507,193 |
| US Department of Housing and Urban Development – Section 8 | - | 4,433 |
| US Department of Commerce – EDA | - | 50 |
| Puerto Rico Police Department – Public Order Code | - | - |
| Others | 1,205 | - |
| Puerto Rico Electric Power Authority (PREPA) | <u>157,708</u> | <u>-</u> |
| | <u>\$164,063</u> | <u>\$511,676</u> |

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Notes to Basic Financial Statements
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3. DUE FROM (TO) GOVERNMENTAL ENTITIES, continued

B. Amounts due to other agencies as of June 30, 2009 follows:

| | Commonwealth Entities |
|--|----------------------------------|
| Puerto Rico Aqueduct and Sewer Authority (PRASA) | \$ 117,614 |
| Puerto Rico Telephone Company | 72,397 |
| Puerto Rico General Services Administration | 390,798 |
| Puerto Rico Employee Retirement System Administration | 390,073 |
| Puerto Rico Industrial Development Corporation (PRIDCO) | 161,847 |
| Unemployment | 150,980 |
| Other entities | 53,231 |
| | <u><u>\$1,336,940</u></u> |

4. INTERFUND TRANSACTIONS

a. Due from/to other funds:

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

| Receivable Fund | Payable Fund | Amount |
|--|--|----------------------------|
| General Fund | Major fund – State Legislative Joint Resolutions | \$ 395,791 |
| General Fund | Capital Improvement loan fund | 128,426 |
| General Fund | Other governmental funds –others | 745,563 |
| General Fund | Section 8 | 4,258 |
| General Fund | Major Fund – State Legislative Joint Resolutions | 200,576 |
| Other governmental funds –others | Major Fund – State Legislative Joint Resolutions | 204,541 |
| Major Fund – State Legislative Joint Resolutions | General Fund | 2,021,496 |
| Other governmental funds –others | CDR | 167,649 |
| Other governmental funds –others | Other minor funds | 5,681 |
| Total | | <u><u>\$ 3,873,981</u></u> |

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4. INTERFUNDS TRANSACTIONS, CONTINUED

b. Operating transfers:

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

5. CAPITAL ASSETS

Capital assets and depreciation as of and for the year ended June 30, 2009 is as follows:

| | <i>Balance , June 30, 2008</i> | <i>Increases</i> | <i>Decreases</i> | <i>Balance June 30, 2009</i> |
|--|------------------------------------|--------------------|------------------|----------------------------------|
| Government activities | | | | |
| Capital Assets not being depreciated: | | | | |
| Land | \$ 372,684 | \$ 221,000 | \$ - | \$ 593,684 |
| Construction in progress | <u>2,874,933</u> | <u>1,739,648</u> | <u>-</u> | <u>4,614,581</u> |
| Total Capital Assets not being depreciated: | <u>\$ 3,247,617</u> | <u>\$1,960,648</u> | <u>\$ -</u> | <u>\$ 5,208,265</u> |
| Capital Assets being depreciated: | | | | |
| Building, Structures and building improvements | \$10,281,994 | \$ - | - | \$10,281,994 |
| Infrastructure | 7,468,153 | 1,489,864 | - | 8,958,017 |
| Land improvements | 2,892,996 | - | - | 2,892,996 |
| Licensed vehicles | 1,908,210 | 26,452 | - | 1,934,662 |
| Machinery and equipment | 2,012,180 | 61,786 | - | 2,073,966 |
| Equipment under capital leases | <u>43,571</u> | <u>-</u> | <u>-</u> | <u>43,571</u> |
| Total Capital Assets being depreciated: | <u>\$24,607,104</u> | <u>\$1,578,102</u> | <u>\$ -</u> | <u>\$26,185,206</u> |
| Less accumulated depreciation for: | | | | |
| Building, Structures and building improvements | \$ 2,925,247 | \$ 207,395 | \$ - | \$ 3,132,642 |
| Infrastructure | 1,527,872 | 183,055 | - | 1,710,927 |
| Land improvements | 2,164,639 | 86,960 | - | 2,251,599 |
| Licensed vehicles | 1,209,925 | 118,842 | - | 1,328,767 |
| Machinery and equipment | 910,555 | 132,557 | - | 1,043,112 |
| Equipment under capital leases | <u>38,070</u> | <u>-</u> | <u>-</u> | <u>38,070</u> |
| Total accumulated depreciation | <u>\$ 8,776,308</u> | <u>\$ 728,809</u> | <u>\$ -</u> | <u>\$ 9,505,117</u> |
| Total capital assets, being depreciated, net | <u>\$15,830,796</u> | <u>\$ 849,293</u> | <u>\$ -</u> | <u>\$16,680,089</u> |
| Governmental activities capital assets, net | <u>\$19,078,413</u> | <u>\$2,809,941</u> | <u>\$ -</u> | <u>\$21,888,354</u> |

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA, PUERTO RICO
Notes to Basic Financial Statements
June 30, 2009

5. CAPITAL ASSETS, continued

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

| | |
|--------------------------------|------------------|
| General Government | \$ 151,499 |
| Public Safety | 101,398 |
| Public Works | 187,508 |
| Health and Welfare | 35,181 |
| Culture and education | 208,447 |
| Urban and economic development | <u>44,776</u> |
| | <u>\$728,809</u> |

6. DEFERRED REVENUES

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

| | <i>Revenues not available</i> | <i>Revenues received before allowable cost are incurred</i> |
|--|-----------------------------------|---|
| | <u> </u> | <u> </u> |
| EDA Fund | \$ - | \$ 28,463 |
| Unearned volume of municipal license taxes | 242,118 | - |
| Federal Emergency Management Agency | - | 123,305 |
| Sendec | - | 17,365 |
| Rural Development Corporation | - | 339,839 |
| Solid Waste Authority Fund | <u>-</u> | <u>4,067</u> |
| | <u>\$242,118</u> | <u>\$513,039</u> |

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA, PUERTO RICO
Notes to Basic Financial Statements
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7. LONG-TERM DEBT

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

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

In addition, before any new bonds or notes are issued, the revenues of the debt service fund should be sufficient to cover the projected debt service requirement. At June 30, 2009, the Municipality is in compliance with the debt limitation requirements.

Bonds and notes payable and other debt outstanding at June 30, 2009 are as follows:

Bonds

| | |
|--|-----------|
| \$375,000 series of 1992, payable in annual installments of \$25,000 to \$50,000 until July 1, 2009, interest from 5% to 7.81% | \$ 50,000 |
| \$530,000 series of 2002, payable in annual installments \$10,000 to \$40,000 until July 1, 2026, interest from 2.7% to 5.6% | 445,000 |
| \$1,310,000 series of 2005, payable in annual installments of \$35,000 to \$105,000 until July 1, 2025, interest from 4.23% to 5.33% | 1,200,000 |
| \$335,000 series of 2007, payable in annual installments of \$60,000 to \$80,000 until July 1, 2011, interest from 6.6% to 7.5% | 215,000 |
| \$710,000 series of 2008, payable in annual installments of \$10,000 to \$60,000 until July 1, 2032, interest from 7% to 7.5% | 700,000 |
| \$1,125,000 series of 1995, payable in annual installments of \$20,000 to \$110,000 until July 1, 2016 interest from 4.7% to 6.63% | 660,000 |
| \$135,000 series of 2000, payable in annual installments of \$10,000 to \$20,000 until July 1, 2009, interest from 5% to 7.81% | 20,000 |
| \$1,740,000 series of 2002, payable in annual installments of \$10,000 to \$130,000 until July 1, 2026, interest from 5% to 6% | 1,475,000 |
| \$1,270,000 series of 2008, payable in annual installments of \$15,000 to \$110,000 until July 1, 2032, interest from 7% to 7.5% | 1,270,000 |

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA, PUERTO RICO
Notes to Basic Financial Statements
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7. LONG-TERM DEBT, continued

| | |
|--|---------------------------|
| \$805,000 series of 2008, payable in annual installments of \$10,000 to \$70,000 until July 1, 2032, interest from 7% to 7.5% | 805,000 |
| \$1,210,000 series of 2008, payable in annual installments of \$85,000 to \$210,000 until July 1, 2017, interest from 7% to 7.5% | 1,210,000 |
| \$145,000 series of 2005, payable in annual installments of \$10,000 to \$20,000 until July 1, 2014, interest from 5% to 8% | <u>95,000</u> |
| Total bonds payable | <u><u>\$8,145,000</u></u> |

Loan for payment of legal settlement – On December 1, 2003, the Municipality obtained a loan from the Puerto Rico Treasury Department to pay a legal settlement related to the Federal Civil Case No. 01-2692 (JP). The face amount of the loan was \$2,000,000 at no interest. This note has an imputed interest rate of 3.00% and was originally recorded at its present value of \$1,635,177, net of an unamortized discount of \$364,823, at inception. \$1,374,775

Financing of the excess of property tax advances over collections – On November 4, 1999 the Municipality entered into a financing agreement with the Puerto Rico Treasury Department to pay a debt related to the excess of property tax advances over collections made by the Puerto Rico Treasury Department prior to the creation of CRIM in 1993. 370,911

The Municipality entered into a financing agreement with the Puerto Rico Department of Labor for a total amount of \$657,139 for unemployment benefits paid by the Commonwealth of Puerto Rico in behalf of the Municipality. The agreement is payable in monthly installments of \$15,059, including interest of 11.08% and due on October 5, 2010. 176,544

The Municipality entered into a financing agreement with the Puerto Rico Water and Sewer Authority for a total amount of \$60,000. The agreement is payable in monthly installments of \$5,000, due on October 1, 2009. 20,000

The Municipality entered into a financing agreement with Puerto Rico Water and Sewer Authority for a total amount of \$80,000. The agreement is payable in monthly installments of \$5,000 due on April 2010. 50,000

On October 22, 2003, the Municipality acquires a parcel of land from the Puerto Rico Land Authority in the amount of \$250,000 for which the Municipality issue a note payable. The note bears no interest and has an imputed interest rate of 6.00. The note was originally recorded at its present value of \$135,020, net of an unamortized discount of \$114,980, at inception. 118,064

\$1,061,453 note payable that represents a repayment agreement with GDB and CRIM to repay the excess of property taxes advances from fiscal years up to 2001. The repayment agreement is payable in annual aggregate principal installments of \$77,700 approximately, plus interest rate of 6.25% until July 1, 2032. 982,668

COMMONWEALTH OF PUERTO RICO
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Notes to Basic Financial Statements
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7. LONG-TERM DEBT, continued

Note payable of \$187,730 represents a financing agreement with CRIM to the repayment of catastral digitalization. The agreement is due in semester payment of \$17,805 until November 28, 2011 at interest rate of 6%. 48,452

Total notes payable \$3,141,414

Other Long-Term Debts

Note payable to FEMA – This amount represent final disallowed costs as determined by an audit performed by the Governor’s Authorized Representative (GAR) of FEMA funds related to Hurricane Georges. As of June 30, 2009, the outstanding balance amounts to \$750,467. The Municipality intends to pay the amount through a payment plan with FEMA which will be financed with unrestricted funds.

Compensated absences – Includes accrued vacations, sick leave benefits and other benefits with similar characteristics such as compensatory time, represents the Municipality’s commitment to fund such costs from future operations. As of June 30, 2009, the outstanding balance amounts to \$1,438,637. This amount will be repaid with unrestricted funds.

Other claims and judgments – Represent the final costs of legal cases paid subsequent to June 30, 2009 and other claims outstanding as of that date. The awarded amounts will be paid with unrestricted funds. As of June 30, 2009, the outstanding balance amounts to \$106,658.

The Municipality levies an annual special tax of 1.25% of the assessed value of real property. The proceeds of this tax are required to be credited to the Debt Service Fund for payment of general obligation bonds and notes of the Municipality. The property taxes are collected and retained by the CRIM.

| <u>Primary Government</u> | <u>Beginning Balance</u> | <u>Additions</u> | <u>Payments</u> | <u>Ending Balance</u> | <u>Due within one year</u> |
|--------------------------------------|--------------------------|------------------|------------------|-----------------------|----------------------------|
| Governmental Activities: | | | | | |
| Bonds payable | \$ 8,450,000 | \$ - | \$305,000 | \$ 8,145,000 | \$ 440,000 |
| Other Long- Term Liabilities: | | | | | |
| Treasury Department: | | | | | |
| Loan for payment of legal Settlement | 1,424,775 | - | 50,000 | 1,374,775 | - |
| Excess of property taxes | 449,165 | - | 78,254 | 370,911 | - |
| PR Labor Department | 357,257 | - | 180,713 | 176,544 | - |
| PR Land Authority | 118,064 | - | - | 118,064 | - |
| CRIM-Law 42 | 980,524 | - | 17,856 | 962,668 | 19,565 |
| CRIM-LIMS | 55,731 | - | 7,279 | 48,452 | 15,666 |
| CRIM-Delinquent accounts | 83,527 | - | 83,527 | - | - |
| CRIM-Excess of property tax advances | - | - | - | - | 70,000 |
| PR Water and Sewer Authority | 20,000 | 50,000 | - | 70,000 | - |
| Payable to FEMA | 750,467 | - | - | 750,467 | - |
| Compensated absences | 1,409,895 | 28,742 | - | 1,438,637 | - |
| Claims and judgments | 64,524 | 42,134 | - | 106,658 | - |
| Obligation under capital leases | - | - | - | - | - |
| Christmas bonus | <u>187,001</u> | <u>-</u> | <u>37,769</u> | <u>149,232</u> | <u>149,232</u> |
| Total other liabilities | <u>5,900,930</u> | <u>120,876</u> | <u>455,398</u> | <u>5,566,408</u> | <u>254,463</u> |
| Total noncurrent liabilities | <u>\$14,350,930</u> | <u>\$120,876</u> | <u>\$760,398</u> | <u>\$13,711,408</u> | <u>\$694,463</u> |

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA, PUERTO RICO
Notes to Basic Financial Statements
June 30, 2009

7. LONG-TERM DEBT, continued

The annual requirements for the amortization of bonds payable at June 30, 2009 are as follows:

| | <u>Bonds Payable</u> | |
|-----------|----------------------|--------------------|
| | <u>Principal</u> | <u>Interest</u> |
| 2010 | \$ 455,000 | \$ 422,239 |
| 2011 | 405,000 | 506,066 |
| 2012 | 445,000 | 478,421 |
| 2013 | 390,000 | 449,986 |
| 2014 | 420,000 | 395,822 |
| 2015-2019 | 2,065,000 | 1,701,678 |
| 2020-2024 | 1,555,000 | 1,073,102 |
| 2025-2029 | 1,445,000 | 561,064 |
| 2030-2034 | <u>855,000</u> | <u>166,815</u> |
| | <u>\$8,035,000</u> | <u>\$5,755,193</u> |

8. PROPERTY TAXES

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

The tax rates in force as of June 30, 2009 are 8.78% for real property (of which 8.58% is paid by the taxpayer and .20% is reimbursed by the Puerto Rico Treasury Department) and 6.58% for personal property (of which 6.38% is paid by the taxpayer and .20% is reimbursed by the Puerto Rico Treasury Department). For both tax rates 1.03% belongs to the Commonwealth and 7.75% and 5.75%, respectively, belongs to the Municipality. Of the portion belonging to the Municipality, 6% on real property and 4% on personal property represents the Municipality's portion which is appropriated for general purposes and accounted in the general fund. The remaining portion of 1.75% on both tax rates belonging to the Municipality is restricted for debt service and accounted in the debt service fund.

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

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8. PROPERTY TAXES, continued

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

9. SALES AND USE TAX

On July 4, 2006 the Commonwealth Legislature approved Act No. 117 (“Act 117”) which amends the Puerto Rico Internal Revenue Code of 1994 to provide, among other things, for a sales and use tax of 5.5% to be imposed by the Commonwealth Government. Act 117 also authorizes each municipal government to impose a municipal sales and use tax of 1.5% This municipal sales and use tax has in general the same tax base and limitations (except for unprocessed foods) as those provided by the Commonwealth’s sales and use tax.

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

On July 29, 2007 the Commonwealth Legislature approved Act No. 80 (“Act 80”) which amend Act No. 117 of July 4, 2006 to impose to all the Municipalities of Puerto Rico a uniform municipal sales and use tax of 1.5%. Effective August 1, 2007 1% of the 1.5% is collected by the Municipalities and the remaining .5% of the 1.5% is collected by the Puerto Rico Department of Treasury (PRDT). Act 80 also provides for restrictions on the use of the sales tax, which is required be invested in solid waste and recycling programs, capital improvements and health and public safety costs.

Amount collected by the PRDT (the remaining .5% of the 1.5%) is deposited in accounts or special funds in the Governmental Development Bank of Puerto Rico (“GDB”), subject to restrictions imposed and distributed as follows:

- .2% of the .5% will be deposited in a “Municipal Development Fund” to finance costs as restricted by the Act,
- .2% of the .5% will be deposited in a “Municipal Redemption Fund” to finance loans to Municipalities subject to restrictions imposed by the Act and,
- .1% of the .5% will be deposited in a “Municipal Improvement Fund” to finance capital improvement projects; these funds will be distributed based on legislation from the Commonwealth’s Legislature

COMMONWEALTH OF PUERTO RICO
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10. MUNICIPAL LICENSE TAXES

The Municipality is authorized by Law No. 81 to impose and collect municipal license taxes on all trade or business activities operated by any natural or legal person within the territorial area of Guánica. This is a self-assessed tax generally based on the business volume measured by gross sales. The Municipality establishes the applicable tax rates. At June 30, 2005, the municipal tax rates imposed by the Municipality were 1.50% for financing institutions and 0.50% for other types of taxpayers. Any taxpayers that have been granted with partial tax exemptions under any of the incentive tax laws of the Commonwealth ultimately pay municipal license taxes at reduced tax rates, generally between 60% and 90% under standard rates.

Each taxpayer must assess his/her corresponding municipal license tax by declaring his/her volume of business through a tax return to be filed every April 15 based on the actual volume of business generated in the preceding calendar year. Taxpayers with a sales volume of \$1 million or more must include audited financial statements with their tax returns. The tax can be paid by the taxpayer in two equal installments due on July 15 and January 15, subsequent to the filing of the declaration. The first installment of the tax covers the six-month period ended December 31, subsequent to the filing date of the declaration, while the second installment of the tax covers the six-month period ended June 30 of the subsequent calendar year. If a taxpayer elects to pay the tax in full on the filing date of the declaration (generally April 15), a 5% discount is granted automatically on the total tax amount due.

Any municipal license taxes collected in advance (that is, pertaining to a future period) are recorded as deferred revenues. Deferred municipal license tax revenues recorded in the accompanying GWFS and GFFS amounted to \$242,118 at June 30, 2009, which represents municipal licenses collected in advance for the taxable year 2008-2009.

11. INTERGOVERNMENTAL REVENUES

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

| | <u>Amount</u> |
|---|--------------------|
| Amount of municipal equalization fund and subsidy send by CRIM | \$4,262,353 |
| Compensation in lieu of tax from the Puerto Rico Electric Power Authority (PREPA) | 1,415,082 |
| Reimbursement from Commonwealth Government - Christmas Bonus expenditures | 149,232 |
| State Grant from PR Health Department | <u>1,393,590</u> |
| Total | <u>\$7,220,257</u> |

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA, PUERTO RICO
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12. EMPLOYEES RETIREMENT SYSTEM

Description of the Plan

Employees of the Municipality participate in the Employee's Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS). The ERS is cost-sharing multiple-employer defined benefit pension plan sponsored by the Government under the Act No. 447, approved on May 15, 1951, as amended. ERS covers all regular employees of the Government and its instrumentalities and of certain municipalities and components units not covered by their own retirement systems.

Participation is mandatory except for members of the Legislature, Government Secretaries, Head of Agencies and Public Instrumentalities, Assistants to the Governor, the Comptroller of the Puerto Rico, Gubernatorial Board and Committee appointees and Experimental Service Station employees. ERS provides retirement, death and disability benefits. Disability retirement benefits are available to members for occupational and non-occupational disabilities. Retirement benefits depend upon age at retirement and number of years of credited service. Benefits vest after ten years of plan participation.

Members who have attained at least 55 years of age and have completed at least 25 years of creditable service or members who have attained at least 58 years of age and have completed at least 10 years of creditable service are entitled to an annual benefit, payable monthly for life. The amount of the annuity shall be 1.5% of the average salary, as defined, multiplied by the number of years of creditable service up to 20 years, plus 2% of the average salary, as defined, multiplied by the number of years of creditable service in excess of 20 years. In no case will the annuity be less than \$200 per month.

Participants who have completed at least 30 years of creditable service are entitled to receive the Merit Annuity. Participants who have not attained 55 years of age will receive up to a maximum of 65% of the average salary, as defined, or if they have attained 55 years of age will receive up to a maximum of 75% of the average salary, as defined. Disability retirement benefits are available to members for occupational disability up to a maximum benefit of 50% of the average salary, as defined. However, for non-occupational disability, a member must have at least 10 years of creditable services.

The contribution requirements for both employees and employers are established by law and are not actuarially determined. Employees are required to contribute 5.775% for the first \$550 of monthly salary plus 8.275% for the excess of this amount, or on the alternative, 8.275% of their monthly gross salary. The Municipality is required by Act No. 447 to contribute 9.275% of its employees' gross salaries.

Act No. 1 of 1990 made certain amendments applicable to new participants joining the ERS effective April 1, 1990. These changes consist principally of the establishment of contributions at 8.275% of their monthly gross salary, an increase in the retirement age to 65, a decrease in the annuity benefit to 1.5% of the average salary, as defined, for all years of creditable services, a decrease in the maximum disability, and death benefits annuities from 50% to 40% of average salary, as defined, and the elimination of the Merit Annuity for participants who have completed 30 years of creditable services.

Law Number 305 was enacted on September 24, 1999, amended the Act Number 447 for the purpose of establishing a new program (System 2000). System 2000 became effective on January 1, 2000. Employees participating in the current system (ERS) as of December 31, 1999, may elect either to stay in the defined-benefit plan or transfer to the new program. Persons joining the government on or after January 1, 2000, will only be allowed to become members of System 2000.

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12. EMPLOYEES RETIREMENT SYSTEM, continued

System 2000 is a hybrid defined contribution plan, also known as a cash balance plan. Under this new plan there will be a pool of pension assets, which will be invested by the System, together with those of the current defined-benefit plan. Benefits at retirement age will not be guaranteed by the Government. The annuity will be based on a formula which assumes that each year the employees' contribution (with a minimum of 8.275% up to a maximum of 10%) of their monthly salary, and will be invested in an account which will either: (a) earn a fixed rate based on the two-year Constant Maturity Treasury Note or, (b) earn a rate equal to 75% of the return of the System's investment portfolio (net of management fees), or (c) earn a combination of both alternatives. Participants receive periodic account statements similar to those of defined contribution plans showing their accrued balances. Disability pensions are not being granted under System 2000. The employers' contributions (9.275% of the employees' salary) will be used to fund the current plan.

If at time of retirement accumulated benefits amount to \$10,000 or less may elect to receive a lump sum distribution up to the accumulated benefits. Under the new program the retirement age is reduced from 65 to 60 for those employees who joined the current plan on or after April 1, 1990.

Funding Policy

The authority under which the funding policy and the obligations to contribute to the ERS and System 2000 by the plans' members, employers and other contributing entities (state of municipal contributions), are established or may be amended by law.

Contribution requirements are established by law and are as follows:

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

Annual Contribution

Total employee contributions to the above-mentioned plans during the year ended June 30, 2009, amounted to approximately \$58,557 – Law No. 477 and \$148,450 System 2000. The Municipality's contributions during those years are recognized as total pension expenditures/expenses in the category of administration as follow:

These amounts represented the 100% of the required contribution for year 2008-2009. Additionally, changes made in the types and amounts of benefits offered by special laws and costs of living adjustments, led to a one-time recommended contribution to fund the retroactive adjustment related to the changes.

The Employee's Retirement System of the Government of Puerto Rico provides additional information of the ERS and System 2000. They issue a publicly available financial report that includes financial statements and required supplementary information for ERS, as a component unit of the Government. That report may be obtained by writing to the Administration at PO Box 42003, Minillas Station, San Juan, PR 00940-2003.

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13. RISK MANAGEMENT

The Risk Management Division of the Municipality's Legal Department is responsible of assuring that the Municipality's property is property insured. Annually, the Risk Management Division compiles the information of all property owned and its respective market value. After evaluating this information, the Risk Management Division submits the data regarding the Municipality's properties to the Area of Public Insurance at the Department of the Treasury of the Commonwealth of Puerto Rico who is responsible for purchasing all property and casualty insurance policies of all municipalities.

14. CONTINGENCIES

- a. The Municipality receives Federal Grants for specific purposes that are subject to review and audit by the grantor agencies. Although such audits could generate expenditure disallowances under the terms of the grants, management believes that any required reimbursements would not be material.

The Municipality is a defendant and/or co-defendant in various lawsuits which claims for actual damages. Some of these lawsuits are covered by insurance. The Municipality's management and outside counsels believe that is probable that any potential liability that might exist, if any, in excess of the insurance, will not affect significantly the financial position of the Municipality.

15. COMMITMENTS

The Municipality of Guánica had several outstanding or planned construction projects as of June 30, 2009. These projects are evidenced by contractual commitments with contractors. The construction projects are commitments of the Capital Projects' funds that amounted to approximately \$2.1 million.

COMMONWEALTH OF PUERTO RICO
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16. FUND DEFICITS

The Municipality has accumulated deficits in the following individual funds:

| | |
|--|---------------------------------|
| Major governmental fund – General Fund | <u>\$(3,518,531)</u> |
| Non-major governmental funds: | |
| Law 52 & 82 | (548,664) |
| ADFAN | <u>(41,173)</u> |
| | <u>(589,837)</u> |
| | <u>\$(4,108,368)</u> |

The budget project does not address the cumulative general fund deficit. The non-major governmental fund deficits result from the accrual of expenditures without accruing intergovernmental revenues for reimbursement of expenditures. As requires by current standards, the Municipality recorded intergovernmental revenues for reimbursement-based (expenditure-driven) grants on fund statements when all applicable eligibility requirements have been met and the resources are available. These deficits will be covered with future budgetary appropriations of the general fund, if necessary.

17. ACCOUNTING CHANGES AND RESTATEMENTS

A. Governmental Fund Financial statements

The following restatements have been made in the governmental fund financial statements, which are reported as an adjustment to the beginning fund balances:

| <u>Description</u> | <u>General Fund</u> |
|--|---------------------------------|
| Fund balance, beginning | \$(2,765,507) |
| Treasury Department debt | <u>(170,307)</u> |
| Fund balance, beginning as restated | <u>\$(2,935,814)</u> |

B. Governmental Wide Financial Statements

The following restatements have been made in the governmental wide financial statements, which are reported as an adjustment to the beginning net assets:

| <u>Description</u> | <u>Total</u> |
|--|-------------------------------|
| Net assets, beginning | \$9,431,832 |
| Treasury Department debt | <u>(170,307)</u> |
| Net assets, beginning as restated | <u>\$9,261,525</u> |

END OF NOTES

REQUIRED SUPPLEMENTARY INFORMATION

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA, PUERTO RICO
BUDGETARY COMPARISON SCHEDULE - GENERAL FUND
FISCAL YEAR ENDED JUNE 30, 2009**

| | <u>Budgeted amounts</u> | | Actual Amounts (Budgetary Basis) | Variance with Final Budget Positive (Negative) |
|---|-------------------------|-------------------|---|---|
| | <u>Original</u> | <u>Final</u> | <u>(See Note A)</u> | |
| Revenues: | | | | |
| Taxes: | | | | |
| Property taxes | \$ 1,081,120 | \$ 1,081,120 | \$ 1,154,052 | \$ 72,932 |
| Municipal license taxes | 360,000 | 360,000 | 393,471 | 33,471 |
| Sale and use tax | 240,000 | 240,000 | 275,367 | 35,367 |
| Intergovernmental | 7,557,516 | 7,557,516 | 7,220,257 | (337,259) |
| Licenses, permits and other local taxes | 1,036,000 | 1,036,000 | 907,463 | (128,537) |
| Fees, fines and charges for services | 45,000 | 45,000 | 209,215 | 164,215 |
| Interest | 34,000 | 34,000 | 212,801 | 178,801 |
| Other | <u>153,500</u> | <u>153,500</u> | <u>28,091</u> | <u>(125,409)</u> |
| Total revenues | <u>10,507,136</u> | <u>10,507,136</u> | <u>10,400,717</u> | <u>(106,419)</u> |
| Expenditures: | | | | |
| Current: | | | | |
| General government | 5,924,909 | 6,255,712 | 5,408,866 | 846,846 |
| Public works and sanitation | 2,105,167 | 2,029,178 | 1,994,681 | 34,497 |
| Public safety | 943,349 | 838,407 | 1,072,908 | (234,501) |
| Culture and recreation | 569,242 | 502,653 | 473,760 | 28,893 |
| Health and welfare | <u>954,328</u> | <u>871,046</u> | <u>1,494,757</u> | <u>(623,711)</u> |
| Total expenditures | <u>10,496,995</u> | <u>10,496,996</u> | <u>10,444,972</u> | <u>52,024</u> |
| Excess (deficiency) of revenues over expenditures | 10,141 | 10,140 | (44,255) | (54,395) |
| Other financing sources (uses): | | | | |
| Transfers in | - | - | 123,804 | 123,804 |
| Transfers (out) | <u>-</u> | <u>-</u> | <u>(644,938)</u> | <u>(644,938)</u> |
| Total other financing sources (uses): | <u>-</u> | <u>-</u> | <u>(521,134)</u> | <u>(521,134)</u> |
| Excess (deficiency) of revenues and other financing sources over expenditures and other financing uses | <u>\$ 10,141</u> | <u>\$ 10,140</u> | <u>\$ (565,389)</u> | <u>\$ (575,529)</u> |

The accompanying notes to required supplemental information are an integral part of this schedule.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA, PUERTO RICO**

**NOTES TO REQUIRED SUPPLEMENTARY INFORMATION -
BUDGETARY COMPARISON SCHEDULE – GENERAL FUND**

June 30, 2009

NOTE A – BUDGET PROCESS AND BUDGETARY BASIS OF ACCOUNTING

The Municipal budget is prepared for the General Fund following the requirements of the Autonomous Municipal Law of 1981, as amended. It is developed utilizing elements of performance-based program budgeting and zero-based budgeting and includes estimates of revenues and other sources for ensuing fiscal year under laws existing at the time the budget is prepared.

Budget amendments are approved by the Municipal Legislature. Certain budget transfers within the limitations and restrictions of the Municipal Law can be approved by the Mayor or by the Municipal Legislature. The budget comparison schedule provides information about the original budget, the amended budget and the actual results, under the budgetary basis of accounting.

The budgetary basis of accounting is different from GAAP. Revenues are generally recorded when cash is received and expenditures are generally recorded when the related expenditure is incurred or encumbered. The encumbrances (that is, purchase orders, contracts) are considered expenditures when a commitment is made. On a GAAP basis, encumbrances outstanding at year end are reported in the governmental funds statements as a reservation of fund balance since they do not constitute expenditures or liabilities while on a budgetary basis encumbrances are recorded as expenditures of current year. Encumbrance appropriations lapse one year after the end of the fiscal year. Unencumbered appropriations are lapsed at year end. The legal level of budgetary control (the level at which expenditures may not legally exceed appropriations) is at the function level.

The presentation of the budgetary data excludes other appropriations such as capital projects, debt service and special revenue funds because projects are funded on a multi-year nature, generally requiring several years to complete or effective budgetary control is alternatively achieved through general obligation bond indentures and legal and contractual grant agreement provisions.

NOTE B - BUDGET TO GAAP RECONCILIATION

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF GUANICA, PUERTO RICO**

**NOTES TO REQUIRED SUPPLEMENTARY INFORMATION -
BUDGETARY COMPARISON SCHEDULE - GENERAL FUND
June 30, 2009**

NOTE B - BUDGET TO GAAP RECONCILIATION - Continued

| | |
|--|---------------------------|
| Deficiency of revenues and other financing sources over expenditures and other financing uses (budgetary basis) | \$(565,389) |
| Budget to GAAP differences: | |
| Timing differences: | |
| Current year encumbrances recorded as expenditures for budgetary reporting purposes: | 13,316 |
| Prior year encumbrances recorded as expenditures for financial reporting purposes: | <u>(30,644)</u> |
| Net change in fund balance (GAAP basis): | <u>\$(582,717)</u> |