

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

MUNICIPIO DE ISABELA
AUDITORIA 2003-2004
30 DE JUNIO DE 2004



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INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the **Municipality of Isabela, Puerto Rico (Municipality)**, as of and for the fiscal year ended June 30, 2004, which collectively comprise the **Municipality's** basic financial statements as listed in the Table of Contents. These financial statements are the responsibility of the **Municipality's** management. Our responsibility is to express an opinion on these basic combined 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 basic financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the basic financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall basic financial statements presentation. We believe that our audit provide a reasonable basis for our opinion.

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**, as of June 30, 2004, and the respective changes in financial position, for the fiscal year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated January 17, 2005 on our consideration of the **Municipality's** internal control over financial reporting on our test of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis and budgetary comparison information on pages 4 through 16, and 34 and 35, 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.

INDEPENDENT AUDITORS' REPORT

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

CPA Diaz Martinez, PSC
CPA DIAZ-MARTINEZ, PSC
Certified Public Accountants & Consultants
License Number 12, expires on December 1, 2007

Caguas, Puerto Rico
January 17, 2005



**Commonwealth of Puerto Rico
MUNICIPALITY OF ISABELA**

MANAGEMENT DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2004

The following discussion and analysis of the Municipality of Isabela's financial performance provides an overview of the Municipality's financial activities for the fiscal period ended June 30, 2004. Please read it in conjunction with the financial statements which follow this section.

FINANCIAL HIGHLIGHTS

Highlights for Government-wide Financial Statements

The government-wide financial statements report information about the Municipality as a whole using the economic resources measurement focus and accrual basis of accounting:

- The assets of the Municipality, on a government-wide basis, exceeded its liabilities at the close of fiscal year 2004 by \$30,191,893 (net assets).
- Revenues (not including special items) increased by \$8,847,189 (48%) and expenses increased \$573,735 (3.7%) in comparison with year 2003, as restated.
- Net change in net assets amounted to \$12,016,538, an increase of 65% with respect to prior year (2003) net change, as restated.
- The Municipality reported special items revenue for \$1,016,046 mainly from tax amnesty and legal claim settlements for 2004.
- The Municipality accounted as part of its revenues \$4,452,516 from donated assets (including infrastructure) received from the Central Government developed and constructed projects or facilities, \$350,000 from a landfill waste disposal grant with Autoridad de Desperdicios Sólidos (ADS) and \$700,000 for a federal grant expenses reimbursements of a 2001-2003 water front project.

Highlights for Fund Financial Statements

The fund financial statements provide detailed information about the Municipality's most significant funds using the current financial resources measurement focus and modified accrual basis of accounting:

- At the close of the current fiscal year, the Municipality's governmental funds reported combined ending fund balances of \$11,211,420, an increase of \$6,047,791 in comparison with the prior year, as restated. Approximately 42% (or \$4,691,394) of the total combined fund balances is unreserved.
- The General Fund reported an excess of revenues, other financing sources and special items over expenditures and other financing uses of \$6,145,886 and an unreserved fund balance of \$4,691,394. Unreserved fund balances increased \$3,958,015 from prior year, as restated.
- Management has designated \$2,286,999 for future special activities in the general fund for which \$2,182,920 is for community assistance and construction projects at the management discretion. Such funds have been assigned from general funds excess of revenues in current and prior years, as approved by municipal legislature.

**Commonwealth of Puerto Rico
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MANAGEMENT DISCUSSION AND ANALYSIS

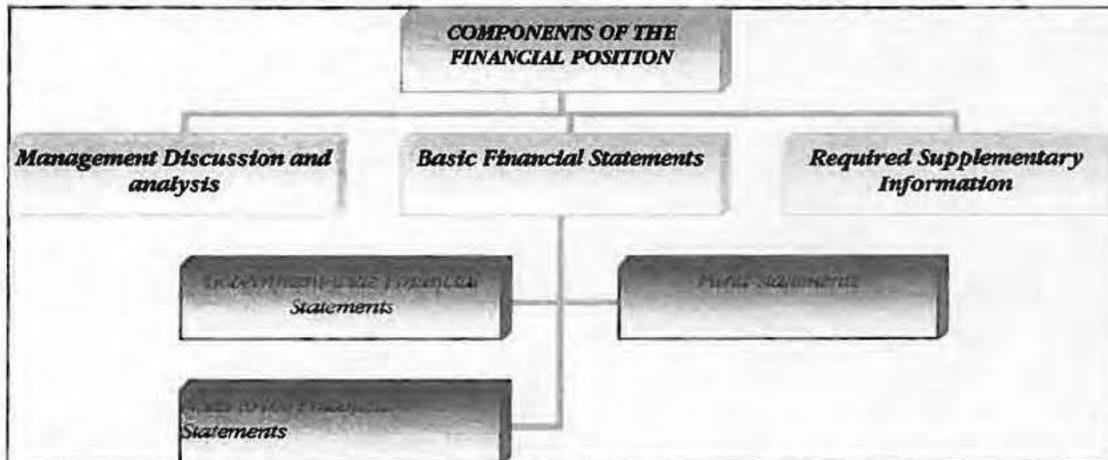
Fiscal year ended June 30, 2004

General Financial Highlights

- The investment in net capital assets as of June 30, 2004 was \$26,419,265 (net of related debt).
- Long term debt decreased to \$12,933,231, approximately decrease of 2.8% (\$361,070) with respect to prior year balance, as restated.
- Other long term debt increases and net reductions from adjustments amounted to \$609,188 and \$87,765, respectively. Such adjustments represent the recognition of other long term debts as reported by the Central Government agencies to the municipality.
- On a budgetary basis, actual revenues exceeded actual expenditures by \$2,185,476, net of \$1,201,482 internally designated funds for future expenditures and transfers out.
- Revenues increase was mainly due to a \$700,000 federal agency expense reimbursement, a \$329,503 increase in municipal property tax collections, \$299,623 in collections from a tax amnesty and \$704,558 from a legal claim settlement of revenues in lieu of taxes.

OVERVIEW OF THE FINANCIAL STATEMENTS

The Municipality's basic financial statements comprise three components: (1) management discussion and analysis (presented here), (2) basic financial statements, and (3) required supplementary information.



The Municipality's basic financial statements consist of two kinds of statements, each with a different view of the Municipality's finances. The government-wide financial statements provide both long-term and short-term information about the Municipality's overall financial status. The fund financial statements focus on major aspects of the Municipality's operations, reporting those operations in more detail than the government-wide statements:

**Commonwealth of Puerto Rico
MUNICIPALITY OF ISABELA**

MANAGEMENT DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2004

Basic Financial Statements

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

The government-wide statements report information about the Municipality as a whole using accounting methods similar to those used by private-sector businesses. They are prepared using the flow of economic resources measurement focus and the accrual basis of accounting. The first government-wide statement – the statement of net assets – presents information on all of the Municipality’s assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in the Municipality’s net assets are an indicator of whether its financial health is improving or deteriorating. Other non-financial factors such as the condition of the Municipality’s roads and other infrastructure may need to be considered to assess the overall health of the Municipality. The second statement – the statement of activities – presents information showing how the net assets changed during the year. All of the current year’s revenues and expenses are taken into account in the statement of activities regardless of when cash is received or paid.

The government-wide statements reports as governmental activities the municipality’s basic services such as public works and sanitation; public safety, culture and recreation, housing, welfare, and community development; education and general administration. These activities are primarily financed through property taxes, other local taxes and intergovernmental revenues. Included in the governmental activities are the governmental funds.

- ***Fund Financial Statements***

The fund financial statements provide more detailed information about the Municipality’s most significant funds. Funds are accounting devices that the Municipality uses to keep track of specific sources of funding and spending for particular purposes. Some funds are required by Federal and Commonwealth regulations, as well by bond covenants.

The Municipality’s basic services are included in governmental funds, which are used to account for essentially the same functions reported as governmental activities in the government-wide statements. However, unlike the government-wide statements, the governmental funds are prepared using the flow of current financial resources measurement focus and the modified accrual basis of accounting. Under this approach the financial statements focus on near-term inflows and outflows of external resources, as well on balances of expendable resources available at year end. Consequently, the governmental fund statements provide a detailed short-term view that helps the reader determine whether there are more or fewer financial resources that can be spent in the near future to finance the Municipality’s programs. Because this information does not encompass the additional long-term focus of the government-wide statements, additional information is provided on a subsequent page that explains the relationship (or differences) between the government-wide and fund statements.

The governmental fund statements focus on major funds. The Municipality’s major funds are the general fund (which accounts for the main operating activities of the Municipality) and funds that complies with a minimum criterion (percentage of the assets, liabilities, revenues or expenditures). Funds that do not comply with this criterion are grouped and presented in a single column as other governmental funds.

**Commonwealth of Puerto Rico
MUNICIPALITY OF ISABELA**

MANAGEMENT DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2004

- *Notes to the financial statements*

The basic financial statements also include notes to explain information in the financial statements and provide more detailed data.

Required supplementary information

The statements and notes are followed by the required supplementary information that contains the budgetary comparison schedule for the General Fund.

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE

Net Assets

The following table presents a summary of the Statements of Net Assets as of June 30, 2004 and 2003:

TABLE 1

Summary Statement of Net Assets As of June 30,		
	Governmental Activities	
	2004	(As restated) 2003
Assets		
Current and other assets	\$ 18,877,259	\$ 12,568,027
Capital assets	27,862,510	22,921,596
Total assets	\$ 46,739,769	\$ 35,489,623
Liabilities		
Current and other liabilities	\$ 3,614,645	\$ 4,629,155
Long term liabilities	12,933,231	12,685,113
Total liabilities	16,547,876	17,314,268
Net assets		
Invested in capital assets, net of related debt	26,419,265	21,045,596
Restricted	9,529,845	7,023,263
Unrestricted (deficit)	(5,757,217)	(9,893,504)
Total net assets	\$ 30,191,893	\$ 18,175,355

Net assets (assets over liabilities) may serve over time as a useful indicator of a government's financial position. Net assets for the year increased 72% with respect to prior year. The most significant change was a reduction in unrestricted deficit of \$4,136,287 due to positives changes in net assets related to unrestricted operation, an increase in total assets due to a sustained and positive trend in surpluses and capital infrastructure asset donations from Central Government.

**Commonwealth of Puerto Rico
MUNICIPALITY OF ISABELA**

MANAGEMENT DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2004

The largest portion of the Municipality's net assets reflects its investment in capital assets (e.g., land, buildings, equipment, and infrastructure) for \$32,221,366; less accumulated depreciation (\$4,358,856) and less any related outstanding debt (\$1,443,245) used to acquire those assets. The Municipality uses these assets to provide services to its citizens and consequently, these assets are not available for future spending. The resources needed to repay the debt related to these capital assets must be provided from other sources, because capital assets are not generally liquidated for the purpose of retiring debt.

Restricted net assets represent resources that are subject to external restrictions on how they may be used.

Unrestricted net assets are the part of the net assets that can be used to finance day-to-day operations without constraints established by debt covenants, enabling legislation or other legal requirements.

As of June 30, 2004 the Municipality presented an unrestricted net assets deficit of \$5,757,217. This deficit primarily arise from long term obligations such as compensated absences \$1,385,268, the estimated municipal solid waste landfill future closing cost \$3,722,789 and debts to CRIM (Central Municipal Revenue Collection Agency) \$748,669 for which the Municipality did not provide funding in previous budgets. Historically, such obligations have been budgeted on a pay as you go basis without providing funding for their future liquidation. In addition, operational loans and certain general obligation bonds do not have a related capital asset to be reported as invested in capital assets, net of related debt section of net assets. Therefore, are reported as part of the unrestricted net assets section.

**Commonwealth of Puerto Rico
MUNICIPALITY OF ISABELA**

MANAGEMENT DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2004

Changes in net assets

The following table summarizes the changes in net assets for the years ended June 30, 2004 and 2003:

TABLE 2

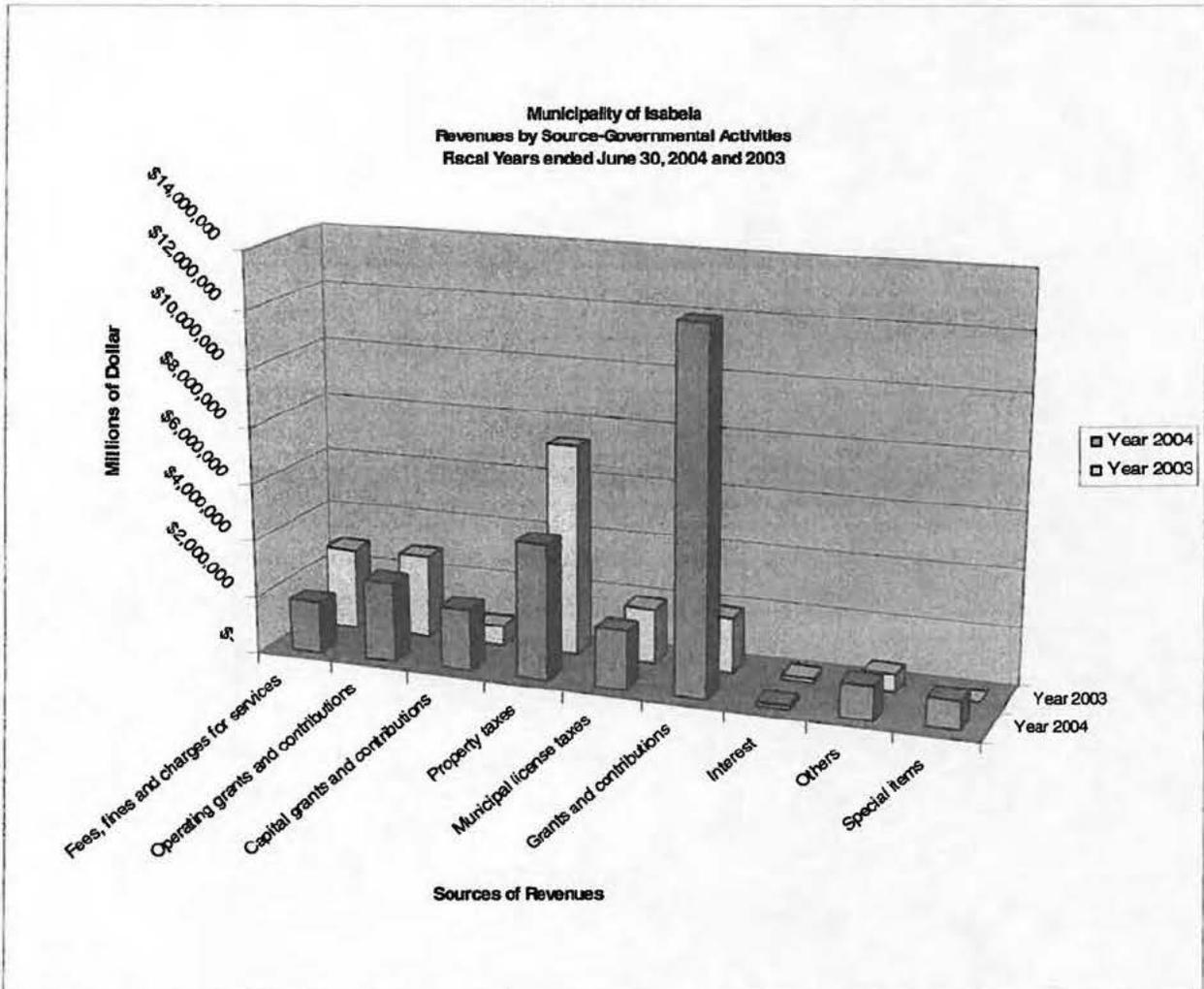
Summary of Changes in Net Assets As of June 30,		
	Governmental Activities	
	2004	(As restated) 2003
Program revenues:		
Fees, fines and charges for services	\$ 1,787,468	\$ 2,861,054
Operating grants and contributions	2,757,403	2,916,224
Capital grants and contributions	2,136,049	713,100
General revenues:		
Property taxes	4,711,064	7,406,242
Municipal license taxes	2,057,207	1,933,105
Grants and contributions not restricted to specific programs	12,564,014	1,929,686
Interest	176,373	145,114
Others	1,167,619	605,483
Total revenues	\$ 27,357,197	\$ 18,510,008
Expenses:		
General government	\$ 5,613,090	\$ 6,304,844
Public safety	799,840	1,040,173
Public works and sanitation	3,461,606	2,602,185
Health	2,542,610	3,615,806
Housing, welfare and community development	1,839,645	1,022,914
Culture and recreation	913,705	596,370
Education	856,873	259,255
Interest on long term debt	329,336	341,423
Total expenses	\$ 16,356,705	\$ 15,782,970
Special items	1,016,046	-
Change in net assets	12,016,538	2,727,038
Net assets-beginning of year (As restated)	18,175,355	15,448,317
Net assets-end of year	\$ 30,191,893	\$ 18,175,355

**Commonwealth of Puerto Rico
MUNICIPALITY OF ISABELA**

MANAGEMENT DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2004

FIGURE 1

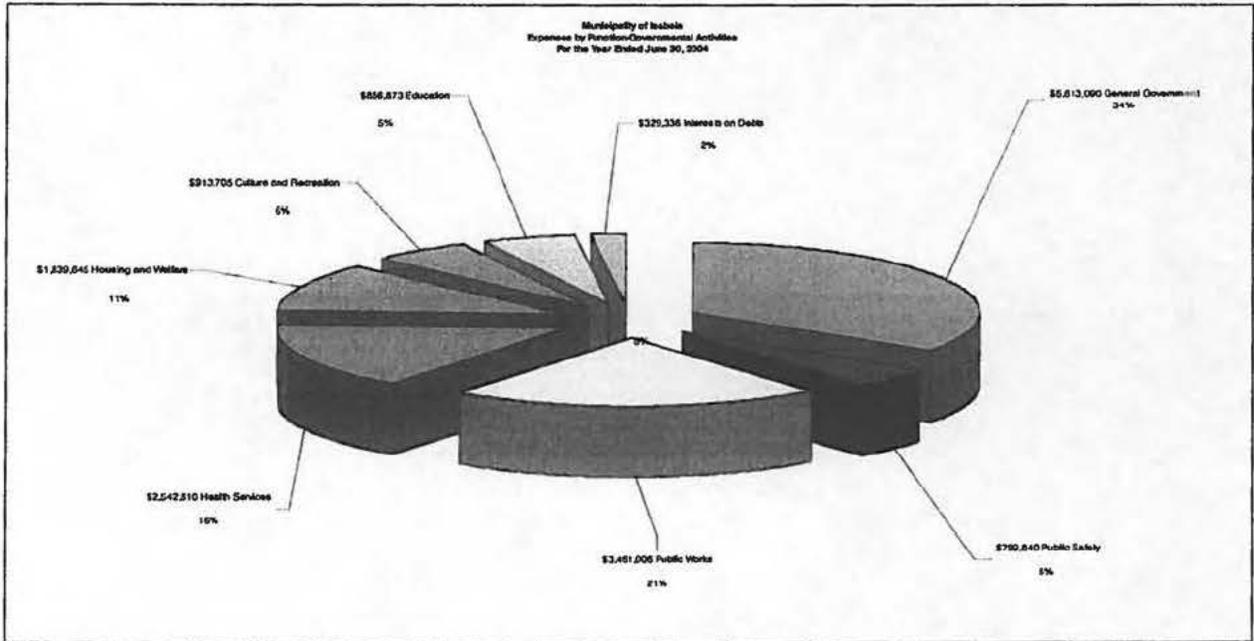


Commonwealth of Puerto Rico
MUNICIPALITY OF ISABELA

MANAGEMENT DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2004

FIGURE 2



**Commonwealth of Puerto Rico
MUNICIPALITY OF ISABELA**

MANAGEMENT DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2004

Approximately 9.7% of the Municipality's revenues came from grants and contributions, 16.6% from property taxes, 6.3% from fees and charges for services and 44.0% from unrestricted grants. The Municipality's expenses cover a range of services. The largest expenses are general government with 34.3%, public works and sanitation representing approximately 21.2% and health services provided with an outpatient health facility known as CIMA. Program revenues of the Municipality covered 48% of total expenses.

With respect to prior year, revenues increased by approximately \$8,847,189 or 48%, excluding revenues on special items of \$1,016,046. Significant increases includes grants and contribution with 55.1%, due to the donation of capital assets and infrastructure constructed by the Central Government (\$4,452,516), additional grant from Administración de Desperdicios Sólidos de P.R.(ADS) for a waste management landfill project, increase in collections of construction permits with a 11.5% or \$483,489 and property taxes with due mainly to an increase in collections and additional revenues due to reimbursement of \$700,000 from EDA for the Isabela Water Front Project.

Expenses increased 3.64% or \$573,735 in comparison with 2003 year, as amended. Such increase excludes a loss of \$251,298 on the disposition of capital asset that was presented as a special item category. Significant increases were registered on housing and welfare with 79.8% due to increases in state legislative grants expenses and donations incurred for the benefit of the community. As part of the housing, welfare and community development activities includes welfare expenses related to donations and others financed with external grants such as Section 8 Voucher and CDBG. An increase of 23.1% in Education is mainly due to the operation of the newly Head Start Program of \$516,814. Public works and sanitation increased due to additional capital assets maintenance and other non-capitalize costs, including motor pool expenses.

Changes in net assets for the year 2004 include additional resources from special items in the amount of \$1,016,046. These special items include \$526,786 for a property tax amnesty and \$704,558 of a legal case settlement from the Puerto Rico Electric Power Authority, a component unit of the Commonwealth of Puerto Rico and losses on disposal of assets of \$251,298.

As noted previously the increase in revenues over the increase in expenses, caused an increase of 65% in the net change in net assets with respect to prior year net change.

The following table focuses on the cost of each of the Municipality's largest programs as well as each program's net cost (total cost less fees generated by the programs and program-specific intergovernmental aid):

TABLE 3

Net Cost of Municipality's Governmental Activities				
Fiscal years ended June 30,				
Functions/Programs	Total Cost of Services		Net Cost of Services	
	2004	2003	2004	2003
General government	\$ 5,613,090	\$ 6,304,844	\$ 3,028,656	\$ 3,079,940
Public works and sanitation	3,461,606	2,602,185	3,109,286	1,266,701
Health	2,542,610	3,615,806	2,542,610	3,615,806
Housing, welfare and community development	1,839,645	1,022,914	231,528	(443,260)
Culture and recreation	913,705	596,370	913,705	596,370
Other	1,986,049	1,640,851	(150,000)	1,248,858
	\$ 16,356,705	\$ 15,782,970	\$ 9,675,785	\$ 9,364,415

**Commonwealth of Puerto Rico
MUNICIPALITY OF ISABELA**

MANAGEMENT DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2004

Some of the cost of governmental activities in 2004 was paid by those who directly benefited from the programs (\$1,787,468) and other governments and organizations that subsidized certain programs with grants and contributions (\$2,757,403 and \$2,136,049, respectively). The \$9,675,785 net cost of services was fully covered by other general revenues including property and municipal license taxes.

FINANCIAL ANALYSIS OF THE MUNICIPALITY'S FUNDS

Governmental funds

The focus of the Municipality's governmental funds is to provide information on near-term inflows, outflows and balances of resources available for spending. Such information is useful in assessing the Municipality's financing requirements. In particular, unreserved fund balance may serve as a useful measure of a Municipality's net resources available at the end of a fiscal year. For the Fiscal year ended June 30, 2004, the governmental funds reported combined ending fund balances of \$11,211,420, a net increase of \$6,047,791 in comparison with the prior year, as restated. This increase was caused primarily by a net change in the general fund of \$6,145,886; \$157,166 increase in the debt service fund and a decrease of (\$255,261) in the other governmental funds. Of total combined fund balances, \$4,691,394 (41.8%) constitutes unreserved fund balance. The remainder of fund balance is reserved to indicate that is not available for new spending.

The general fund is the operating fund of the Municipality. Unreserved fund balance of the general fund represents approximately 46% of total ending general fund balance. For the year ended June 30, 2004, the fund balance of the general fund increased by \$6,145,886 when compared with the prior year, as restated. The principal components of the net increases of \$3,867,982 in revenues in the general fund are an increase of \$7,291,923 in intergovernmental assistance and a decrease in other revenues of \$3,423,941. The net decrease in expenditures of \$758,927 was due to a decrease of \$294,350 in the general government expenditures, a decrease in capital outlay of \$1,121,356; and an increase in other expenditures of \$656,779 in repairs and maintenance of roads, structures and equipment.

GENERAL FUND BUDGETARY HIGHLIGHTS

The general fund original budget for the fiscal period 2003-2004 presented an increase of less than 1.0% with respect to prior year budget. Amendments to the original budget are approved by the Municipal Legislature. During the fiscal year budget revenues were increased by \$2,313,360 due to additional collections of property taxes, construction permits and of others revenues. Budget expenditures were increased by \$2,313,320, including therein a \$1,210,045 transfer out to general funds special designated activities. Actual revenues were greater than the revised budgeted revenues by \$1,245,631 (net). The most significant variance is in fees, fines and charges for services, \$1,060,083.

A positive variance of \$930,255 between revised budget and actual expenditures was due mainly to a net decrease of \$387,153 in general government, \$209,809 in public works and sanitation expenditures and \$185,734 in public safety. The Municipality reported less expenditure than appropriations in those functions on payments for unemployment and general insurance, professional and nonprofessional services, utilities and the administration of the Municipal landfill. Actual revenues exceeded actual expenditures by \$2,185,476.

**Commonwealth of Puerto Rico
MUNICIPALITY OF ISABELA**

MANAGEMENT DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2004

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital assets

At the end of the fiscal year, the Municipality has invested \$27,862,510 (net of accumulated depreciation) in a broad range of capital assets, including buildings, parks, roads, bridges, land and equipment. This amount represents a net increase of \$4,940,911 or approximately 21.6% over the prior year, as restated.

TABLE 4

	Capital Assets, net As of June 30,	
	Governmental Activities	
	2004	(As restated) 2003
Non-depreciable assets:		
Land	\$ 3,668,589	\$ 1,829,943
Construction in progress	3,181,224	46,960
Depreciable assets:		
Buildings	8,241,705	8,409,410
Buildings and buildings improvements	424,949	428,546
Infrastructure	8,527,490	8,319,320
Vehicles, machinery and equipment	3,818,553	3,887,420
Total	\$ 27,862,510	\$ 22,921,599

The Municipality acquired a total of \$1,836,646 of land during the fiscal year 2003-2004 as follows:

- "Plaza de Recreo Land Acquisition" - \$138,800
- "Barrio Mora Land Acquisition for Coliseo Municipal" - \$737,000
- "Picadero Municipal Land Acquisition" - \$255,000
- "Vertedero Municipal Land Acquisition" - \$159,523

**Commonwealth of Puerto Rico
MUNICIPALITY OF ISABELA**

MANAGEMENT DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2004

The Municipality reported additions of \$3,134,264 in construction in progress, \$1,838,646 for land acquisitions and \$621,539 in infrastructure during the year. These additions are composed mainly of capital improvements and donations from construction contractors of municipal, Central Government donations, donations of recreational areas, parks streets and roads. Some of these improvements and donations are detailed as follows:

- “Villa Pesquera Business Center Improvements” - \$873,067
- “Plaza de Recreo Land Acquisition” - \$138,800
- “Barrio Mora Land Acquisition for Coliseo Municipal” - \$737,000
- “Plaza Recreo Building” - \$921,650
- “Plaza del Mercado Facilities” - \$367,415
- “Soterrado Eléctrico del Centro del Pueblo” - \$2,138,038
- “Picadero Municipal Land Acquisition” - \$255,000
- “Mejoras al la Villa de Pescadores” - \$107,243
- Vertedero Municipal Land Acquisition - \$159,523

The Municipality’s fiscal year 2005 consolidated capital budget calls for a significant amount of projects including construction of “Plaza de Mercado \$550,000, facilities for “El Picadero Municipal” with a budget of \$1,600,000, improvements of recreational parks at various wards and rural areas for \$2,711,231. These projects will be financed through Federal and Commonwealth grants, funds from the Commonwealth Legislature, general obligation bonds and Municipal funds. More detailed information about the Municipality’s capital assets is presented in Note 6 to the financial statements.

Long term debt

At year-end, the Municipality had \$12,933,231 in general and special bonds and notes, an increase of 2% with respect to prior year. The following is a summary of the Municipality’s outstanding debt as of June 30, 2004 and 2003:

TABLE 5

Outstanding Long-term Debt		
As of June 30,		
	Governmental Activities	
	2004	(As restated) 2003
General and special obligation bonds and notes	\$ 6,693,363	\$6,726,000
Note payable to CRIM – LIMS	416,394	459,327
Note Payable to CRIM – prior years delinquent accounts	332,275	471,071
Solid waste landfill	3,722,789	3,543,449
Compensated absences	1,385,268	1,485,266
Christmas Bonus	324,219	-
P.R. Water Sewer Authority	58,923	-
Total	\$ 12,933,231	\$ 12,685,113

**Commonwealth of Puerto Rico
MUNICIPALITY OF ISABELA**

MANAGEMENT DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2004

The increase in the general and special obligation bonds and others debts is due to the recording of debts with Municipal Revenue Collection Center (CRIM) for old tax liens accounts repurchased and refinanced with third parties, the Christmas bonus accrual of \$324,219, the issuance of payment plan (debt refinancing) with the P.R. Water and Sewer Authority for \$58,923 and the recording of a past digitalization debt assumed by the municipality in behalf of CRIM LIMS Agreement for \$416,394. More detailed information about the Municipality's long term liabilities is presented in Notes 7 and 8 to the financial statements.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

The Municipality's selected and appointed officials considered many factors when setting the fiscal year 2004-2005 budget. One of these factors is the economy. Among economic areas considered are the population growth estimates, personal income, housing statistics and unemployment rates. The Municipality's unemployment rate now stands at 12.8%, which compares with the Commonwealth rate of 12.4%.

The Municipality applied a conservative approach in development budget estimates. Amounts available for appropriations in the General Fund for the fiscal year 2005 are \$11,249,218, an increase of approximately 11.25% with respect to prior year estimates. Budgeted expenditures are expected to rise accordingly to the increase of budgeted revenues. Among planned projects, this budget included an increase in salaries to employees of approximately \$704,412, the creation of two municipal departments for approximately \$449,506, increase of medical plans benefits and an increase from \$750 to \$1,000 in Christmas bonus to all Municipal employees. If these estimates are realized, the Municipality's budgetary general fund balance is expected to increase by approximately \$881,000 by the close of 2005 fiscal year.

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 demonstrate the Municipality's accountability for the money it receives. If you have questions about this report or need additional information, contact the Municipality's Director of Finance CPA Jason D. León at P.O. Box 507, Isabela, Puerto Rico 00602.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO

STATEMENT OF NET ASSETS

JUNE 30, 2004

	<u>GOVERNMENTAL ACTIVITIES</u>
ASSETS:	
Cash and Investments.....	\$ 9,058,221
Receivables:	
Federal Grant	3,058,938
Others.....	666,468
Commonwealth Government.....	1,056,970
Restricted Assets:	
Cash	3,217,625
Cash with Fiscal Agent	1,615,161
Deferred Charges.....	28,920
Inventories and Supplies	<u>174,956</u>
Capital Assets (Notes 1 & 6):	
Land, Improvements, and Construction in Progress.....	6,849,813
Other Capital Assets, Net of Depreciation].....	<u>21,012,697</u>
Total Capital Assets.....	<u>27,862,510</u>
TOTAL ASSETS	<u>46,739,769</u>
LIABILITIES:	
Accounts Payable and Accrued Liabilities.....	1,123,827
Interest Payable	153,194
Due to:	
Commonwealth Government.....	573,543
Federal Government.....	12,722
Deferred Revenues:	
Municipal Licenses Taxes.....	1,608,525
Federal Grants.....	40,964
Other.....	101,870
Long-Term Liabilities (Note 7):	
Due within One Year	1,122,005
Due in More than One Year.....	<u>11,811,226</u>
Total Liabilities	<u>16,547,876</u>
NET ASSETS	
Invested in Capital Assets, Net of Related Debt.....	26,419,265
Restricted for:	
Capital Projects.....	7,833,003
Debt Service	1,468,887
Other Specific Purposes	227,955
Unrestricted (Deficit).....	<u>(5,757,217)</u>
TOTAL NET ASSETS	<u>\$30,191,893</u>

See accompanying Notes to Basic Financial Statements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO

STATEMENT OF ACTIVITIES

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

FUNCTIONS/PROGRAMS	EXPENSES	PROGRAM REVENUES			NET (EXPENSE) REVENUE
		CHARGES FOR SERVICES	OPERATING GRANTS AND CONTRIBUTIONS	CAPITAL GRANTS AND CONTRIBUTIONS	
Governmental Activities:					
General Government.....	\$ 5,613,090	\$ 1,435,148	\$ 1,149,286	\$ -	(\$ 3,028,656)
Public Safety.....	799,840	-	-	2,136,049	1,336,209
Public Works and Sanitation.....	3,461,606	352,320	-	-	(3,109,286)
Health.....	2,542,610	-	-	-	(2,542,610)
Housing, Welfare and Community Development.....	1,839,645	-	1,608,117	-	(231,528)
Culture and Recreation.....	913,705	-	-	-	(913,705)
Education.....	856,873	-	-	-	(856,873)
Interest on Long-Term Debt.....	329,336	-	-	-	(329,336)
Total Governmental Activities.....	<u>\$16,356,705</u>	<u>\$ 1,787,468</u>	<u>\$ 2,757,403</u>	<u>\$ 2,136,049</u>	<u>(9,675,785)</u>
General Revenues:					
Property Taxes.....					4,711,064
Municipal License Taxes.....					2,057,207
Grants and Contributions not Restricted to Specific Programs....					12,564,014
Interest.....					176,373
Other.....					1,167,619
Special Items:					
Property Taxes – Amnesty.....					562,786
Loss on Disposition of Capital Assets.....					(251,298)
Legal Case Settlement – PREPA.....					704,558
Total General Revenues and Special Items.....					<u>21,692,323</u>
CHANGE IN NET ASSETS.....					12,016,538
Net Assets – Beginning of Year, as Restated (Note 15).....					<u>18,175,355</u>
NET ASSETS – ENDING OF YEAR.....					<u>\$30,191,893</u>

See accompanying Notes to Basic Financial Statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO**

BALANCE SHEET – GOVERNMENTAL FUNDS

JUNE 30, 2004

	GENERAL	CDBG FUND	DEBT SERVICE FUND	OTHER GOVERNMENTAL FUNDS	TOTAL GOVERNMENTAL FUNDS
ASSETS					
Cash and Investments (Note 1).....	\$ 8,442,117	\$ 2,198	\$ -	\$ 613,976	\$ 9,058,221
Receivables, net:					
Federal Grants.....	-	2,998,976	-	59,962	3,058,938
Other.....	518,877	-	48,620	32,471	599,968
Due from Commonwealth Government.....	1,056,970	-	-	-	1,056,970
Due from Other Funds.....	385,560	-	-	-	385,560
Inventories and Supplies.....	174,956	-	-	-	174,956
Restricted Assets:					
Cash.....	3,217,625	-	-	-	3,217,625
Cash with Fiscal Agents.....	2,800	-	1,571,397	40,964	1,615,161
Total Assets.....	<u>13,798,905</u>	<u>3,001,104</u>	<u>1,620,017</u>	<u>747,373</u>	<u>19,167,399</u>
LIABILITIES AND FUND BALANCES					
Accounts Payable and Accrued Liabilities.....	767,270	333,086	-	121,207	1,221,563
Matured Bonds and Interest Payable.....	-	-	837,635	-	837,635
Due to Commonwealth Government.....	475,807	-	-	-	475,807
Due to Federal Government.....	12,722	-	-	-	12,722
Due to Other Funds.....	-	112,610	-	272,950	385,560
Deferred Revenues:					
Municipal License Taxes.....	1,608,525	-	-	-	1,608,525
Property Taxes.....	95,336	-	-	-	95,336
Federal Grants.....	-	2,555,408	-	40,964	2,596,372
Other.....	722,459	-	-	-	722,459
Total Liabilities.....	<u>3,682,119</u>	<u>3,001,104</u>	<u>837,635</u>	<u>435,121</u>	<u>7,955,979</u>
Fund Balances:					
Reserve For:					
Encumbrances.....	439,040	-	-	-	439,040
Debt Service.....	-	-	782,382	-	782,382
Capital Projects.....	4,858,819	-	-	211,830	5,070,649
Other Specific Purposes.....	127,533	-	-	100,422	227,955
Unreserved					
Designated for Future Expenditures.....	2,286,999	-	-	-	2,286,999
Undesignated.....	2,404,395	-	-	-	2,404,395
Total Fund Balances.....	<u>10,116,786</u>	<u>-</u>	<u>782,382</u>	<u>312,252</u>	<u>11,211,420</u>
TOTAL LIABILITIES AND FUND BALANCES.....	<u>\$13,798,905</u>	<u>\$ 3,001,104</u>	<u>\$ 1,620,017</u>	<u>\$ 747,373</u>	<u>\$19,167,399</u>

See accompanying Notes to Basic Financial Statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO**

**RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET
TO THE STATEMENT OF NET ASSETS**

JUNE 30, 2004

Total Fund Balances – Governmental Funds (Page 19)		\$11,211,420
Amounts reported for Governmental Activities in the Statement of Net Assets (Page 17) are different because:		
Capital Assets used in governmental activities are not financial resources and therefore are not reported in the funds.....		27,862,510
Other Assets used in governmental activities are not financial resources and therefore are not reported in the funds		
Deferred Charges		28,920
Other Assets are not available to pay for current-period expenditures and therefore are deferred in the funds:		
Municipal Revenue Collection Center	\$ 95,336	
Business Permits Receivable	120,000	
Christmas Bonus.....	150,589	
Grants from PR Department of Recreation and Sports	66,500	
Grants from Solid Waste Authority of Puerto Rico.....	350,000	
Federal Grants – CDBG.....	<u>2,555,408</u>	3,337,833
Interest liabilities are not due and payable in the current period and therefore are not reported in the funds.....		(20,559)
Some Long-Term Liabilities are not due and payable in the current period and therefore are not reported in the funds. Those liabilities consist of:		
General Obligation Bonds and Notes	5,988,363	
Compensated Absences.....	1,385,268	
Municipal Solid Waste Debt.....	3,722,789	
Note payable to Municipal Revenue Collection Center for Financing of Delinquent Accounts	332,275	
Christmas Bonus.....	324,219	
Note Payable to Puerto Rico Aqueduct and Sewer Authority (PRASA)	58,923	
Note Payable to Municipal Revenue Collection Center – LIMS.....	<u>416,394</u>	<u>(12,228,231)</u>
Total Net Assets of Governmental Activities (Page 17).....		<u>\$30,191,893</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO**

**STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE –
GOVERNMENTAL FUNDS**

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

	GENERAL	CDBG FUND	DEBT SERVICE FUND	OTHER GOVERNMENTAL FUNDS	TOTAL GOVERNMENTAL FUNDS
REVENUES					
Property Taxes	\$ 3,771,159	\$ -	\$ 1,036,507	\$ -	\$ 4,807,666
Municipal License Taxes	2,057,207	-	-	-	2,057,207
Intergovernmental:					
Commonwealth Government.....	10,650,665	-	-	277,894	10,928,559
Federal Government.....	-	1,613,101	-	899,131	2,512,232
Fees, Fines and Charges for Service.....	2,314,558	-	-	-	2,314,558
Interest.....	151,715	-	10,718	-	162,433
Other.....	13,940	-	-	-	13,940
Total Revenues.....	<u>18,959,244</u>	<u>1,613,101</u>	<u>1,047,225</u>	<u>1,177,025</u>	<u>22,796,595</u>
EXPENDITURES					
Current:					
General Government	6,231,924	162,411	-	-	6,394,335
Public Safety.....	761,238	-	-	66,812	828,050
Public Works and Sanitation.....	2,152,711	-	-	51	2,152,762
Culture and Recreation.....	666,474	-	-	93,116	759,590
Health	2,553,086	-	-	-	2,553,086
Housing, Welfare and Community Development.....	1,425,082	126,600	-	417,950	1,969,632
Education.....	-	-	-	854,357	854,357
Capital Outlay	248,461	1,324,090	-	-	1,572,551
Debt Service:					
Principal	-	-	733,976	-	733,976
Interest.....	-	-	303,438	-	303,438
Total Expenditures.....	<u>14,038,976</u>	<u>1,613,101</u>	<u>1,037,114</u>	<u>1,432,286</u>	<u>18,121,777</u>
OTHER FINANCING SOURCES (USES)					
Proceeds – Note Payable PRASA.....	105,629	-	-	-	105,629
Transfers – In.....	9,898	-	54,250	-	64,148
Transfers – Out.....	(54,250)	-	(9,898)	-	(64,148)
Total Other Financing Sources and Uses	<u>61,277</u>	<u>-</u>	<u>44,352</u>	<u>-</u>	<u>105,629</u>
Special Items:					
Property Taxes – Amnesty	459,783	-	103,003	-	562,786
Case Settlement – PREPA.....	704,558	-	-	-	704,558
Total Special Items.....	<u>1,164,341</u>	<u>-</u>	<u>103,003</u>	<u>-</u>	<u>1,267,344</u>
Net Change in Fund Balances.....	6,145,886	-	157,166	(255,261)	6,047,791
Fund Balance – Beginning, as Restated (Note 15)	3,970,900	-	625,216	567,513	5,163,629
FUND BALANCES – ENDING	<u>\$10,116,786</u>	<u>\$ -</u>	<u>\$ 782,382</u>	<u>\$ 312,252</u>	<u>\$11,211,420</u>

See accompanying Notes to Basic Financial

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO**

**RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES
IN FUND BALANCE OF GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES**

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

Net Change in Fund Balances – Total Governmental Funds (Page 21)		\$ 6,047,791
Amounts reported for Governmental Activities in the Statement of Activities (Page 18) are different because:		
Governmental funds report capital 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. In the current period, these amounts are:		
Expenditures for Capital Assets.....	\$ 1,412,687	
Current Year Depreciation	<u>(672,994)</u>	739,693
Governmental funds only report the proceeds received in the disposal of assets. In the Statement of Activities, a gain or loss is reported for each disposal. Thus, the change in net assets differs from the change in fund balance by the cost of the disposed asset.....		(251,298)
Revenues in the Statement of Activities that do not provide current financial resources are not reported as revenues in the governmental funds:		
Municipal Revenue Collection Center.....	95,336	
Business Permits Receivable	120,000	
Christmas Bonus.....	150,589	
Grants from PR Department of Recreation and Sports	66,500	
Grants from Solid Waste Authority of Puerto Rico.....	350,000	
Donated Capital Assets	<u>4,452,516</u>	5,234,941
Revenues reported in governmental funds which are not reported as revenues in the Statement of Activities:		
Municipal Revenue Collection Center.....	(191,938)	
Christmas Bonus.....	(118,949)	
CDBG revenues.....	<u>(363,452)</u>	(674,339)
Proceeds from note payable to Puerto Rico Aqueduct and Sewer Authority (PRASA) is an other financing source in the governmental funds, but an increase of long-term liabilities in the Statement of Activities		(105,629)
Expenditures reported in governmental funds which are not reported as expenses in the Statement of Activities:		
Mature bonds principal payments (net change).....	(200,000)	
Other Long-Term Liabilities.....	<u>438,087</u>	238,087
Repayment of long-term debt is an expenditure reported in the governmental funds, but reduces long-term liabilities in the Statement of Activities:		
General and Special Obligations	728,945	
Other	<u>466,333</u>	1,195,278
Some expenses reported in the Statement of Activities do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds.		
Compensated Absences.....	100,000	
Municipal Solid Waste Landfill	(179,349)	
Christmas Bonus.....	(324,219)	
Accrued Interest (net change).....	802	
Amortization of Deferred Charges	<u>(5,220)</u>	(407,986)
Change in Net Assets of Governmental Activities (Page 18)		<u>\$12,016,538</u>

See accompanying Notes to this financial statement.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO**

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The **Municipality of Isabela, Puerto Rico (Municipality)** was founded in the year 1819, and operates as a governmental unit of the Commonwealth of Puerto Rico, under the Law Number 81 of August 30, 1991, known as "Autonomy Municipalities Law of the Commonwealth of Puerto Rico". The governmental system of the **Municipality** is composed of the executive and legislative bodies. The Mayor is the Chief Executive Officer and is elected every four years in the general elections of the Commonwealth of Puerto Rico. The legislative body consists of 14 Legislators also elected in the general elections of Puerto Rico for a four-year period.

The **Municipality** provides services such as: health, public works, sanitation, aids and services to low-income and elderly citizens, public safety, housing and urban development, culture and recreation, planning, zoning and other general and administrative services.

The accounting policies of the **Municipality** conform to accounting principles generally accepted in the United States of America as applicable to governmental units. The following is a summary of the more significant of such policies.

The accompanying basic financial statements of the **Municipality** have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) as prescribed by the Governmental Accounting Standards Board (GASB). The GASB is the standard-setting body for governmental accounting and financial reporting. The GASB periodically updates its codification of the existing Governmental Accounting and Financial Reporting Standards which, along with subsequent GASB pronouncements (Statements and Interpretations) constitutes GAAP for governmental units.

In June 1999, the GASB issued Statement Number 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*. This statement establishes new financial reporting requirements for state and local governments. The **Municipality** adopted the provisions of GASBS No. 34 as well as other statements referred to below as of July 1, 2002. They require new information and restructure much of the information that governments have presented in the past.

Comparability with reports issued in prior years is affected. With the implementation of GASBS No. 34, the **Municipality** has prepared required supplementary information titled Management's Discussion and Analysis, which precedes the basic financial statements.

As previously mentioned, other GASB Statements and Interpretations were required to be implemented in conjunction with GASBS No. 34. Therefore, the **Municipality** has implemented the following GASB Statements in the fiscal year 2002-2003: GASBS No. 37, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments: Omnibus*, GASBS No. 38, *Certain Financial Statement Note Disclosures*, GASBS No. 39, *Determining Whether Certain Organizations Are Component Units*, GASBS No. 41, *Budgetary Comparison Schedules - Perspective Differences*, and GASBS Interpretation No. 6, *Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements*.

The accompanying basic financial statements present the financial position and the results of operations of the **Municipality** and its various funds and fund types. The basic financial statements are presented as of June 30, 2004, and for the fiscal year then ended. The more significant of these accounting policies are described below and, where appropriate, subsequent pronouncements will be referenced.

A. Financial Reporting Entity

The accompanying basic financial statements include all departments and organizations units whose funds are under the custody and control of the **Municipality**. In evaluating the **Municipality** as a reporting entity, management has addressed all the potential component units. The decision to include a potential component unit in the reporting entity was made by applying the provisions of GASBS No. 14, as amended by GASBS No. 39.

The basic criteria for including a potential component unit within the reporting entity is if potential component units are financially accountable and other organizations for which the nature and significance of their relationship with the entity are such that exclusion would cause the **Municipality's** financial statements to be misleading or incomplete. The GASB has 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) 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**.

The relative importance of each criteria must be evaluated in light of specific circumstances in order to determine which components units are to be included as part of the reporting entity. Our specific evaluations of the criteria applicable to the **Municipality** indicate no organizations meet the criteria to be included as component units. Accordingly, these basic financial statements present only the **Municipality** as the reporting entity.

These financial statements present the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information of the **Municipality**, as of June 30, 2004, and the respective changes in financial position, where applicable, thereof for the fiscal year then ended.

B. Measurement Focus and Basis of Accounting

Government-wide Financial Statements

The government-wide financial statements (**the Statement of Net Assets and the Statement of Activities**) are reported using the economic resources measurement focus and the accrual basis of accounting. Revenue is recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grant and similar items are recognized as revenue as soon as all eligibility requirements have been met.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(continuation)

B. Measurement Focus and Basis of Accounting (continuation)

Governmental Fund Financial Statements

The governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recorded when susceptible to accrual; as soon as it is both measurable and available. "Available" means collectible within the current period or soon enough thereafter, normally within sixty (60) days, to be used to pay liabilities of the current period. Expenditures are generally recognized when the related liability is incurred.

The exception to this general rule is the principal and interest on general obligation long-term debt and compensated absences, if any, are recognized when due.

In applying the "susceptible to accrual" concept to intergovernmental revenues (federal grants) pursuant to GASBS No. 33, *Accounting and Financial Reporting for Nonexchange Transactions* (the **Municipality** may act as either provider or recipient), the provider should recognize liabilities and expenses and the recipient should recognize receivables and revenue when the applicable eligibility requirements including time requirements, are met. Resources transmitted before the eligibility requirements are met should, under most circumstances, be reported as advances by the provider and deferred revenue by the recipient.

There are essentially two types of revenue. For the majority of grants, moneys must be expended by the **Municipality** on the specific purpose or project before any amounts will be reimbursed. Revenue is, therefore, recognized as expenditures are incurred to the extent available. For the other revenue, moneys are virtually unrestricted and are generally revocable only for failure to comply with prescribed compliance requirements. These resources are reflected as revenue at the time of receipt or earlier if the susceptible to accrual criteria is met. Expenditures are generally recorded when a liability is incurred, as under accrual accounting. Modifications to the accrual basis of accounting include the following:

- Employee's vested annual vacation and sick leave is recorded as expenditure when utilized. The amount of accumulated annual vacation and sick leave unpaid at June 30, 2004, has been reported only in the government-wide financial statements.

C. Financial Statement Presentation

The basic financial statements include both government-wide (based on the **Municipality** as a whole) and fund financial statements. While the previous financial reporting model emphasized fund types (the total of all funds of a particular type), in the new financial model the focus is on either the **Municipality** as a whole, or major individual funds (within the basic financial statements). Both the government-wide and fund financial statements (within the basic financial statements) categorize primary activities as either governmental or business type.

Government-wide Financial Statements

The government-wide financial statements (the **Statement of Net Assets** and the **Statement of Activities**) report information of all the activities of the **Municipality**. For most part, the effect of interfund activity has been removed from these government-wide financial statements. Governmental activities, which normally are supported by taxes and intergovernmental revenues, are reported separately from business-type activities, which rely to a significant extent on fees and charges for support.

The focus of the **Statement of Net Assets** is designed to be similar to bottom line results for the **Municipality** and its governmental activities. This statement, for the first time, combines and consolidates governmental fund's current financial resources (short-term spendable resources) with capital assets and long-term obligations.

The **Statement of Net Assets** presents the reporting entities' assets and liabilities, with the difference reported as net assets. Net assets are reported in three categories:

- **Invested in Capital Assets, Net of Related Debt** – These consists of capital assets, net of accumulated depreciation and amortization and reduced by outstanding balances for bonds, notes, and other debt that are attributed to the acquisition, construction, or improvement of those assets.
- **Restricted Net Assets** – These result when constraints placed on net assets use are either externally imposed by creditors, grantors, contributors, and the like, or imposed by law through constitutional provisions or enabling legislation.
- **Unrestricted Net Assets** – These consist of net assets which do not meet the definition of the two preceding categories. 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 on resources that are imposed by management, but can be removed or modified.

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

The **Statement of Activities** is focused on both the gross and net costs per functional category. The statement reduces gross expenses (including depreciation) by related program revenues, operating and capital grants. This is intended to summarize and simplify the user's analysis of cost of various governmental services.

Governmental Fund Financial Statements

The fund financial statements (the **Balance Sheet**, the **Statement of Revenues, Expenditures, and Changes in Fund Balances**, the **Statement of Net Assets**) are, in substance, very similar to the financial statements presented in the previous financial reporting model. Emphasis here is on the major funds in the governmental category. Non-major funds are summarized into a single column.

continue

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(continuation)

C. Financial Statement Presentation (continuation)

Traditional users of governmental financial statements will find the Fund Financial Statements presentation more familiar. The focus is on Major Funds, rather than the previous financial model's fund types. The Governmental Major Fund Statements are presented on current financial resources and modified accrual basis of accounting.

This is the manner in which these funds are normally budgeted. This presentation deemed most appropriate to (a) demonstrate legal and covenant compliance, (b) demonstrate the source and use of liquid resources, and (c) demonstrate how the Municipality's actual experience conforms to the budgeted fiscal plan.

Since the governmental fund statements are presented in different measurement focus and basis of accounting than the government-wide statements, reconciliation is presented and separate explanation for each differences.

The Municipality reports its financial position (**Balance Sheet**) and results of operations (**Statement of Revenues, Expenditures and Changes in Fund Balance**) in funds, which are considered separate accounting entities. The operations of each fund are accounted for within a set of self-balancing accounts. Fund accounting segregates funds according to their intended purpose and is used to aid management in demonstrating compliance with legal, financial, and contractual provisions.

The new model as defined in GASBS No. 34 established criteria (percentage of the assets, liabilities, revenues, or expenditures/expenses of either fund category in the governmental fund) for the determination of major funds. The non-major funds are combined in a single column in the fund financial statements. The Municipality reports the following major fund:

General Fund – This is the general operating fund of the Municipality. It is used to account for all financial resources, except those required to be accounted for in another fund.

Debt Service Fund – This is used to account for the accumulation of resources for, and the payment of long-term debt principal and interests

Community Development Block Grant Program Fund (CDBG) – This is the fund used to account for all the transactions of the State Community Development Block Grant Program. The primary objectives of this program is to development of viable communities by providing decent housing, a suitable living environment and expanded economic opportunities, principally for persons of low and moderate income.

GASBS No. 34 eliminates the presentation of Account Groups, but provides for these records to be maintained and incorporates the information into the Governmental column in the government-wide **Statement of Net Assets**.

D. Budgetary Data

The Municipality's annually adopts the Budget Resolution for all operating funds of the Municipality except for certain restricted accounts of Proprietary Funds and Special Revenue Funds. Budgetary control is legally maintained at the fund level. The budget is prepared using the modified accrual basis of accounting with encumbrance included as budgetary basis expenditures. The Municipality's Budget Resolution provides transfer authority (1) to the Mayor and the Management and Budget Director, within and between departments and funds, as long as the total budget of the Municipality (net of interfund transfers) is not increased; (2) to the Management and Budget Director to implement grant budgets as the grant applications are accepted by the Municipality; and (3) to the Management and Budget Director to amend (re-appropriate) each new year's budget, to the extent of outstanding encumbrances, and/or unexpended project/grant appropriations at year end. Municipality's Legislature action is required for (1) use of the budgeted Legislature contingency, and (2) the approval of a supplemental appropriation(s). During the year, several supplemental appropriations were necessary.

The budget columns (original and final budgets) of the Budgetary Comparison – General Fund reflect the original budget and the amended budget (which have been adjusted for legally authorized revisions of the annual budgets during the year). Appropriations, except remaining project appropriations, encumbrances, and unexpended grant appropriations, lapse at the end of each fiscal year.

Amendments to the budget, including transfers, require the approval of the Municipal Legislature. Unencumbered appropriations lapse at the end of the next fiscal year. The Municipality follows these procedures, in accordance with law, in order to establish the budgetary data reflected in the basic financial statements:

1. Prior of May 15 of each fiscal year, the Mayor submits to the Municipal Legislature a proposed budget for the fiscal year commencing the following July 1 in addition of a budget message.
2. The budget document is available for public inspection prior to its approval by the Municipal Legislature.
3. The Commissioner of Municipal Affairs examines the budget to verify if it complied with the law's standards and sends it to the Mayor for any comments or recommendation before the limited date establishes by the Law.
4. Prior to June 13, the annual budget is legally enacted through passage of the annual appropriation ordinance.
5. If a budget is not adopted prior to the end of the end of the fiscal year, the annual budget for the preceding fiscal year, as approved by the Municipal Legislature and the Mayor, is automatically renewed for the ensuing fiscal year until a new budget is approved. This permits the Municipality to continue making payments for its operating and other expenses until the new budget is approved.

continue

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO**

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

**NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(continuation)**

D. Budgetary Data (continuation)

6. Subsequent to the enactment of the annual appropriation ordinance, the Municipal Legislature has the authority to make necessary amendments made during the fiscal year and are reflected in the budget information included in the Budgetary Comparison Schedule – General Fund.

Since the budgetary basis differs from accounting principles generally accepted in the United States of America (GAAP), actual amounts for the General Fund in the accompanying Budgetary Comparison Schedule, is presented on the budgetary basis to enhance comparability.

The principal differences between the budgetary and GAAP bases are the following:

1. Encumbrances are recorded as expenditures under the budgetary basis and as a reserve of fund balances under GAAP.
2. The non-exonerated portion of the property tax advances are presented as revenue in the budgetary basis and as other financing sources under GAAP (See Note 9).
3. Interfund transactions of the General Funds are not included in the budgetary basis.
4. Certain accrued liabilities and other debts are not included in the budgetary basis.
5. Certain revenues susceptible to accrual, i.e., both measurable and available, are not included in the budgetary data.

All encumbrance appropriations in the operating budget lapse at the end of the fiscal year. Property taxes collected during the current year by the Municipal Revenue Collection Center (Fiscal Agent) are presented as revenues in the accounting basis but are not considered in the budgetary schedule.

The special funds of the Special Revenue Fund have not been included in the budgetary comparison because balances are not budgeted. Also the budget prepared for the Federal Finance Awards Programs included in the Capital Projects and Special Revenue Funds is based on a program period which is not necessarily a year. Accordingly, it's not practical to present an annual comparison of budget for such programs.

E. Cash, Cash Equivalent and Investment

The Director of Finance of the **Municipality** is responsible for investing the available resources in certificates of deposit and other short-term investments. Investments are made from the available combined funds of the **Municipality** and, accordingly, it is not practical to disclose certificates of deposit and other short-term investments individually by fund in the combined financial statements. Interest earned on certificates of deposit and other short-term investments are recognized as revenue in the General Fund. Cash in the Special Revenue, Debt Service and

Capital Project Funds are restricted; accordingly, resources available were not used for pool investments.

Cash with fiscal agent represents property tax collections retained by the Municipal Revenues Collection Center and undisbursed proceeds of certain bonds, loans or grants which are maintained in a cash custodian account by the Government Development Bank of the Commonwealth of Puerto Rico.

Cash balance recognized in the Debt Service Fund is restricted for the payment of the **Municipality's** obligations, and others are restricted for specific projects, such as the acquisition or construction of permanent improvements. This sinking fund is maintained by the Governmental Development Bank of Puerto Rico, agency which acts as the insurer and payer of the **Municipality's** bonds and notes issued in accordance with law.

F. Receivable

Receivable are stated nets of estimated allowances for uncollectible accounts, which are determined upon past collection experience and current economic conditions. Receivable from Federal Government represents amounts owed to the **Municipality** for reimbursement of expenditures incurred pursuant to federally funded programs.

G. Inventories

The General, Special Revenue and Capital Project Funds, purchases office and printing supplies, gasoline, oil and other expendable supplies held for consumption. The cost of purchases is recorded as expenditure in the appropriate fund and the inventory is not recorded in the basic financial statements. Only inventory medicine and medical supplies of the Isabelina Advance Medical Center in the amount of \$174,956 are included in the financial statements.

H. Capital Assets

Property, plant and equipment purchased or acquired is carried at historical cost or estimated historical cost. Contributed assets are recorded at fair market value as of the date received. The **Municipality's** capitalization levels are \$500 on personal property. For improvements other than buildings, the capital outlay must be greater than \$10,000, extend the estimated useful life for ten years, and be greater than 10% of the original cost of the asset. Other costs incurred for repairs and maintenance is expensed as incurred.

Depreciation on all assets is provided on the straight-line basis over the following estimated useful lives: **(See Table 1)**

TABLE 1	
CAPITAL ASSETS	YEARS
Buildings	50
Improvement Other Than Buildings	50
Infrastructure	10-50
Vehicles	5
Machinery and Equipment	5-10

continue

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO**

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

**NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(continuation)**

I. Compensated Absences

The **Municipality** accrues accumulated unpaid vacation and sick leave and associated employee-related costs when earned (or estimated to be earned) by the employee. The **Municipality's** employees are granted 30 days of vacations and 18 days of sick leave annually. Vacations may be accumulated up to a maximum of sixty (60) days and sick leave up to a maximum of ninety (90) days. In the event of employee resignation, the employee is paid for accumulated vacation days up to the maximum allowed. Separation from employment prior to use of all or part of the sick leave terminates all rights for compensation, except for employees with ten years of service who are entitled to sick leave pay up to the maximum allowed. The **Municipality** accrued a liability for compensated absences, which meet the following criteria:

1. The **Municipality's** obligation relating to employee's rights to receive compensation for future absences is attributable to employee's services already rendered.
2. The obligation relates to rights that vest or accumulate.
3. Payment of the compensation is probable.
4. The amount can be reasonably estimated.

In accordance with the above criteria and requirements as established by GASBS No. 16; the **Municipality** has accrued a liability for compensated absences, which has been earned but not taken by **Municipality's** employees. For the government-wide statements, the current portion is the amount estimated to be used in the following year. For the governmental funds statements, all of the compensated absences are considered long-term and therefore, are not a fund liability and represents a reconciling item between the fund level and government-wide presentations (see Note 7).

J. Insurance

The **Municipality** has insurance coverage for its public facilities, primarily to provide protection from catastrophic losses. Also, principal officials of the **Municipality** are covered under various surety bonds. The Secretary of the Treasury Department of the Commonwealth of Puerto Rico is the agent commissioned to place all of the **Municipality's** insurance coverage. Corresponding premiums payable are withheld by the Municipal Revenue Collection Center from quarterly advances of annual property tax and subsidy sent to the **Municipality**.

K. Interfund Transactions

Interfund transactions are reflected as loans, reimbursements or transfers. Loans are reported as receivables and payables as appropriate and are subject to elimination upon consolidation. Reimbursements occur when one fund incurs a cost, charges the appropriate benefiting fund and reduces its related cost as a reimbursement. All other interfund transactions are treated as transfers. Transfers between governmental funds are netted as part of the reconciliation to the government-wide

columnar presentation. The **Municipality** has the following types of transactions among funds:

Interfund Transfers – Legally required transfers that are reported when incurred as transfers-in by the recipient fund and as transfers-out by the disbursing fund, with receivables and payables presented as amounts due to and due from other funds. Advances between funds are also presented as amounts due to and due from other funds. However, these transfers and related amounts receivables and payables are considered internal balances and activities that have been eliminated in the government-wide financial statements.

L. Reservations of Fund Balance – Governmental Funds

The governmental fund financial statements present fund balance reserves for those portions of fund balance (1) not available for appropriation for expenditures or (2) legally segregated for a specific future use. The reserves for related assets such as inventories and prepayments are examples of the former. Reserves for debt service and other specific purposes are examples of the latter.

M. Claims and Judgments

The estimated amount of the liability for claims and judgments, if any, which is due on demand, such as from adjudicated or settled claims, is recorded in the General Fund. The Long-Term Liabilities includes an amount estimated as a contingent liability or liabilities with a fixed or expected due date, which will require future available financial resources for its payment.

N. Use of Estimates

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

NOTE 2 CASH, CASH EQUIVALENTS AND INVESTMENTS

Investments consist of certificates of deposit. The **Municipality's** cash, cash equivalent and investments at year-end were entirely covered by the Federal Deposit Insurance Corporation (FDIC) coverage, up to a maximum of \$100,000 in each bank, and the excess by collateral provided by the banks and held by the Department of the Treasury pursuant the applicable laws and regulations. Cash with fiscal agent is maintained in interest bearing accounts in the Government Development Bank of Puerto Rico and is not collateralized.

Puerto Rico laws authorize governmental entities to invest in direct obligations or obligations guaranteed by the federal government or the Commonwealth of Puerto Rico. The **Municipality** is also allowed to invest in bank acceptances, other bank obligations and certificates of deposit in financial institutions authorized to do business under the federal and Commonwealth laws.

continue

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO**

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

NOTE 2 CASH, CASH EQUIVALENTS AND INVESTMENTS
(continuation)

During the year, the **Municipality** invested its funds in interest bearing bank accounts and short-term certificates of deposit. As June 30, 2004, the market value of investments recorded in General Fund approximated its carrying value as follow: (See Table 2)

CERTIFICATE OF DEPOSIT ISSUED BY	PRINCIPAL NUMBER	INTEREST AMOUNT	RATE	TABLE 2 EXPIRATION DATE
Popular Bank of Puerto Rico ...	1110000023	\$1,031,537	1.80%	08-07-04
Popular Bank of Puerto Rico ...	1110000025	469,860	1.80%	08-09-04
Popular Bank of Puerto Rico ...	1110000026	313,535	1.80%	08-09-04
Popular Bank of Puerto Rico ...	1110000027	1,735,841	1.60%	09-07-04
Popular Bank of Puerto Rico ...	1110000031	207,132	1.80%	12-09-04
Popular Bank of Puerto Rico ...	1110000032	209,617	1.80%	12-09-04
Popular Bank of Puerto Rico ...	1110000033	1,000,000	1.60%	09-13-04
Popular Bank of Puerto Rico ...	1110000034	301,180	1.55%	09-13-04
Popular Bank of Puerto Rico ...	1110000035	700,000	1.80%	12-15-04
TOTAL		<u>\$5,968,702</u>		

NOTE 3 OTHERS RECEIVABLES

As of June 30, 2004, this amount consist of the following: (See Table 3)

TABLE 3	AMOUNT
Levy – Villa Pesquera Apartment	\$101,870
PR Treasury Department	107,660
Patents	7,671
Construction Taxes	120,000
Plaza del Mercado	4,128
Other (Special Funds)	11,530
Interests	15,429
Christmas Bonus	<u>150,589</u>
TOTAL	<u>\$518,877</u>

NOTE 4 INTERFUND TRANSFER AND BALANCES

A. INTERFUND TRANSFERS

Transfers are indicative of funding for capital projects or debt service, and subsidies of various operations. (See Table 4)

INTERFUND TRANSFERS WITHIN THE GOVERNMENTAL FUNDS			TABLE 4
SOURCES	TRANSFER TO	AMOUNT	PURPOSE
Debt Service Fund	General Fund	\$ 9,898	Interests
General Fund	Debt Service	<u>54,250</u>	Debt payment
TOTAL		<u>\$64,148</u>	

B. INTERFUND RECEIVABLE AND PAYABLE BALANCES

Interfund receivables and payables at June 30, 2004 are summarized as follows: (See Table 5)

INTERFUND RECEIVABLE	INTERFUND PAYABLE	TABLE 5 AMOUNT
General Fund	SBGP	\$112,610
General Fund	Other Governmental Fund	<u>272,950</u>
TOTAL		<u>\$385,560</u>

NOTE 5 DUE TO COMMONWEALTH GOVERNMENT

As of June 30, 2004, balance due to Commonwealth of Puerto Rico's entities of the General Fund for services rendered to the **Municipality**, consists of the following: (See Table 6)

TABLE 6	AMOUNT
Department of Labor	\$435,253
PR Aqueduct and Sewer Authority	<u>40,554</u>
Total Due to Governmental Units	<u>\$475,807</u>

continue

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO**

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

NOTE 6 CAPITAL ASSETS

Capital Assets activities for the fiscal year ended June 30, 2004 was as follows: (See Table 7)

TABLE 7	BALANCE JULY 1, 2003	ADJUSTMENTS	ADDITIONS	RETIREMENTS	BALANCE JUNE 30, 2004
Non-Depreciable Capital Assets:					
Land.....	\$ 1,537,443	\$ 292,500	\$ 1,838,646	\$ -	\$ 3,668,589
Construction in Progress	-	46,960	3,134,264	-	3,181,224
Total Non-Depreciable Capital Assets.....	1,537,443	339,460	4,972,910	-	6,849,813
Depreciable Capital Assets:					
Buildings	9,331,733	(14,800)	-	-	9,316,933
Buildings Improvements	-	428,546	-	-	428,546
Infrastructure.....	9,411,504	-	621,539	(282,046)	9,750,997
Machinery and Equipment.....	5,732,520	(112,856)	270,754	(15,341)	5,875,077
Total Depreciable Capital Assets.....	24,475,757	300,890	892,293	(297,387)	25,371,553
Less Accumulated Depreciation:					
Buildings	(907,787)	264	(167,705)	-	(1,075,228)
Buildings Improvements	-	-	(3,597)	-	(3,597)
Infrastructure.....	(1,092,182)	(2)	(170,767)	39,444	(1,223,507)
Machinery and Equipment.....	(1,810,528)	78,284	(330,925)	6,645	(2,056,524)
Total Accumulated Depreciation.....	(3,810,497)	78,546	(672,994)	46,089	(4,358,856)
Total Depreciable Capital Assets (Net).....	20,665,260	379,436	219,299	(251,298)	21,012,697
CAPITAL ASSETS, NET	\$22,202,703	\$ 718,896	\$ 5,192,209	(\$ 251,298)	\$27,862,510

Depreciation expenses were charged to governmental functions/programs as follows: (See Table 8)

TABLE 8	AMOUNT
General Government	\$ 42,575
Public Safety	63,015
Public Works and Sanitation.....	389,476
Health.....	1,831
Culture and Recreation.....	159,402
Housing, Welfare and Community Development.....	14,179
Education.....	2,516
Total Depreciation Expenses	\$672,994

NOTE 7 GENERAL LONG-TERM DEBTS

A. GENERAL AND SPECIAL OBLIGATIONS PAYABLE

The principal long-term obligations of the Municipality are general and special obligations notes issued to finance the construction and improvements of public facilities and purchase of equipment. The Municipality's obligations long-term debt retirements are appropriated and paid from resources accumulated in the Debt Service Fund (See Note 8). The special obligations long-term notes retirements are paid through retention made by the Municipal Revenue Collection Center from

monthly advance of annual property tax and subsidy send to the Municipality.

General and Special obligations payable as of June 30, 2004, are comprised of the following individual issues:

DESCRIPTION	AMOUNT
General Obligations:	
\$305,000, Series 2000, for construction purposes, payable in semiannual installments ranging from \$20,000 to \$40,000, excluding interests at 2.6%, through July 1, 2010.....	\$ 235,000
\$525,000, Series 1996, for construction purposes, payable in semiannual installments ranging from \$13,000 to \$36,000, excluding interest at 4.50%, through January 1, 2021 (Water and Waste Disposal Loans and Grants)	433,713
\$410,000, Series 1999, for construction purposes, payable in annual installments ranging from \$11,000 to \$29,000, excluding interests at 4.50%, through January 1, 2024 (Water and Waste Disposal Loans and Grants)	384,650
\$3,455,000, Series 2001, for operational purposes, payable in semiannual installments ranging from \$45,000 to \$299,000, excluding interests 5.0% through July 1, 2026.....	3,355,000

continue

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO**

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

NOTE 7 GENERAL LONG-TERM DEBTS (continuation)

DESCRIPTION	AMOUNT
\$985,000, Series 2001, for equipment, payable in semiannual installments ranging from \$170,000 to \$230,000, excluding interests from 2.8% to 3.21%, through July 1, 2006.....	\$ 635,000
\$1,510,000, Series 2001, for equipment payable in semiannual installments ranging from \$20,000 to \$65,000, excluding variable interests from 4.375% to 8.0%, through July 1, 2015.....	575,000
Total General Obligations.....	<u>5,618,363</u>

Special Obligations:

\$505,000, Series 1993, for operational purposes, payable in semiannual installments ranging from \$20,000 to \$65,000, excluding variable interests from 4.375% to 8.00%, through July 1, 2009.....	285,000
\$1,160,000, Series 1999, for construction purposes, payable in semiannual installments ranging from \$80,000 to \$155,000, excluding interests at 7.08%, through July 1, 2009.....	790,000
Total Special Obligations.....	<u>1,075,000</u>
Total General and Special Obligations.....	<u>\$6,693,363</u>

The annual requirements to amortize the general and special obligations outstanding as of June 30, 2004 are as follows (See Table 9):

YEAR ENDING JUNE 30,	PRINCIPAL PAYMENT	INTEREST PAYMENT	TOTAL PAYMENT
2005	\$ 705,000	\$ 136,878	\$ 841,878
2006	795,000	333,237	1,128,237
2007	531,000	347,793	878,793
2008	322,000	320,452	642,452
2009	344,000	299,098	643,098
2010-2015	986,000	1,216,625	2,202,625
2016-2021	942,000	937,155	1,879,155
2022-2027	1,231,713	573,630	1,805,343
2028-2033	836,650	125,805	962,455
TOTAL	<u>\$ 6,693,363</u>	<u>\$ 4,290,673</u>	<u>\$10,984,036</u>

B. OTHER LONG-TERM DEBTS

Following are the Other Long-Term Debts (See Table 10):

DESCRIPTION	BALANCE JULY 1, 2003	NEW ISSUES	RETIREMENTS AND ADJUSTMENT *	BALANCE JUNE 30, 2004
Landfill.....	\$4,000,000	\$ 179,340	(\$ 456,551)	\$3,722,789
Property Taxes - MRCC.....	-	-	332,275	332,275
Christmas Bonus.....	-	324,219	-	324,219
PR Aqueduct and Sewer Authority....	-	105,629	(46,706)	58,923
MRCC-LIMS.....	-	-	416,394	416,394
Compensated Absences.....	1,718,445	-	(333,177)	1,385,268
TOTAL.....	<u>\$5,718,445</u>	<u>\$ 609,168</u>	<u>(\$ 87,765)</u>	<u>\$6,239,868</u>

* As adjusted (see Note 15)

C. CHANGES IN GENERAL LONG-TERM DEBTS

The following is a summary of changes in long-term debts for the year ended June 30, 2004: (See Table 11)

DESCRIPTION	BALANCE JULY 1, 2003	NEW ISSUES	RETIREMENTS AND ADJUSTMENT	BALANCE JUNE 30, 2004	AMOUNTS DUE WITHIN ONE YEAR	AMOUNTS DUE AFTER NEXT YEAR
General.....	\$ 6,208,000	\$ -	(\$ 587,637)	\$ 5,618,363	\$ 585,000	\$ 5,033,363
Special.....	1,225,000	-	(150,000)	1,075,000	150,000	925,000
Others Debts.....	5,718,445	609,168	(87,765)	6,239,868	387,005	5,852,863
TOTAL.....	<u>\$13,149,445</u>	<u>\$ 609,168</u>	<u>(\$ 825,402)</u>	<u>\$12,933,231</u>	<u>\$ 1,122,005</u>	<u>\$11,811,226</u>

NOTE 8 DEBT RETIREMENT

Revenues of the debt service fund consists of the ad-valorem property taxes which are recognized as revenue when collected from taxpayers and reported by the Municipal Revenue Collection Center of the Commonwealth of Puerto Rico to the Municipality (See Note 9).

These property taxes are accumulated by the Municipal Revenue Collection Center in costs of the general obligations bonds issued by the Municipality (See Note 7). Payments are made to the Government Development Bank of the Commonwealth of Puerto Rico from such accumulated funds by the Municipal Revenue Collection Center of Puerto Rico.

NOTE 9 PROPERTY TAXES

The Municipal Revenue Collection Center of the Commonwealth of Puerto Rico is responsible for the assessment of all real and personal property located within the Municipality and for the levy, administration and collection of the corresponding tax contribution.

The property tax contribution is levied each year over the appraised value of the property at the beginning of the calendar year. The real property assessment is based on the current value existing in the year 1957 and the personal property at the current value at the date of the assessment.

The tax rate per annum is 7.53% for real property and 5.83% for personal property of which 1.03% of both belong to the Commonwealth of Puerto Rico and 6.00% and 4.00%, respectively, belongs to the Municipality. From the portion belonging to the Municipality, 6.00% and 4.00%, respectively, represents the Municipality's basic tax rate that is appropriated for general purposes and therefore accounted for through the general fund.

The remaining portion belonging to the Municipality of 1.50% represents the ad-valorem property taxes withheld by the Municipal Revenue Collection Center of the Commonwealth of Puerto Rico and restricted for debt service, which is accounted for through the debt service fund (See Note 8). The Municipality has reached the maximum statutory tax rate limit for the basic tax while there is no limitation for the ad-valorem tax rate.

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**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO**

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

NOTE 9 PROPERTY TAXES (continuation)

The Commonwealth of Puerto Rico grants complete real property tax exoneration on the first \$15,000 has assessed valuation on residential units occupied by their owners. However, the **Municipality** receives the full amount levied, except for residential units assessed at less than \$3,500 on which a complete exemption is granted. The Municipal Revenue Collection Center, instead of the property taxpayer, becomes the source of payment in these cases.

The **Municipality** grants a complete exemption from personal property taxes up to an assessment value of \$50,000, to retailers with an annual net sales volume of less than \$150,000. The Municipal Revenue Collection Center advances to the **Municipality**, on monthly payments, 100% of the contribution assessed over property for each fiscal year. In accordance to Law, these advances will be contributions by the Municipal Revenue Collection Center from taxpayers. The Municipal Revenue Collection Center periodically informs to the **Municipality** the amounts collected from taxpayers and applied to outstanding advances.

The **Municipality** records as revenue in the general fund the property tax contribution when received from monthly advances from Municipal Revenue Collection Center.

Due to the fact that collections of property tax are applied to the advances of property tax paid by the Municipality Revenue Collection Center, the amortization of the advance at end of year was not available due to that is in process of verification by external auditors. As of June 30, 2004, the Debt Service Fund presented a receivable of \$48,620 for the collection of additional property taxes during the next 60 days after end of year.

NOTE 10 VOLUME OF BUSINESS TAX

The volume of business tax is levied each year based on the prior year's gross revenues for all commercial and industrial organizations doing business in the **Municipality** and which are not totally or partially exempt from this tax under the Industrial Incentives Laws of the Commonwealth of Puerto Rico. All taxpayers are required to file their declarations by April 23 of each year. The tax rates are as follows:

- a. 1.50% for financial institutions and savings and loan associations.
- b. 0.40% for all other organizations with volume of sales less than \$200,000 and 0.50% for volume of sales in excess of \$200,000.

Taxes are payable in two equal semi-annual installments on July 1 and January 1 following the date of levy. If they are paid with declaration, the taxpayer is granted a 5% of discount. Collections of taxes during current fiscal year, applicable to the next fiscal year, are recorded as deferred revenues in the General Fund.

NOTE 11 INTERGOVERNMENTAL REVENUES

Intergovernmental revenues consist primarily of funds received from the Commonwealth of Puerto Rico, "in lieu of tax" payments from the quasi-public corporation, Puerto Rico Electric Power Authority, and federal financial assistance received from federal government.

Grants and subsidies received from the Commonwealth of Puerto Rico and federal agencies include, among others, a general subsidy for urban development and capital improvements. Intergovernmental revenues are accounted for through the General Fund except for those directly related to urban development and capital improvements, which are accounted for through the Special Revenue and the Capital Project Funds. Federal Financial Assistance is recorded in the Special Revenue Fund.

NOTE 12 EMPLOYEE'S RETIREMENT PLAN

The Employee's Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS) is the administrator of a cost-sharing multiple-employer retirement system established by the Commonwealth of Puerto Rico. The ERS was created under the Act 447, approved on May 15, 1951, as amended, and became effective on January 1, 1952. ERS covers all regular employees of the Commonwealth of Puerto Rico 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.

The **Municipality** adopted the requirements of GASBS No. 25 for all the career employees that are covered under the Commonwealth of Puerto Rico Employee's Retirement System, a multiple-employer public employee retirement system, established by State Laws.

Under the plan, the employees and employer portions are contributed, for which, the employee amount is withheld from salaries. Covered employees are required by Commonwealth statute 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 all salary. The **Municipality** contributes to the system 9.275% of the participating employee's salaries.

Law Number 305 of September 24, 1999, amends the Act Number 447 that establish a savings program. All employees active in the system as of December 31, 1999 may elect to transfer from defined contribution programs to the new savings program (a defined contribution plan). Employees in the savings program may now contribute from a minimum of 8.275% up to a maximum of 10% of their monthly salary, and will 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.

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**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO**

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

NOTE 12 EMPLOYEE'S RETIREMENT PLAN (continuation)

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.

The pension benefit for participants who retire with less than 30 years of service is computed at the rate of 1½% of their average compensation of each year of credit service for the remaining years. The System also provides for death and disability benefits and the assets of the System pertaining to the participant employees.

A variety of significant actuarial assumptions are used to determine the standard measure of the pension benefit obligation and these assumptions are summarized below:

- a. The present value of the future pension payments was computed by using a discount of 9%.
- b. Future pension payments reflect an assumption of a 6% salary increase.

All employees that do not elect to transfer for the new program and who at the time of employment are 55 years old or less are eligible to participate in the System. Pension benefits for participants with 30 years of service are as follows (See Table 12)

YEARS OF SERVICE	PARTICIPANT'S AGE	PENSION BENEFITS	TABLE 12
30 or more	55 or less	65% of the average of the three years of highest salary during the employee's service period.	
30 or more	58 or more	75% of the average of the three years of highest salary during the employee's service period.	
30 or more	65 or more	75% of the average of the three years of highest salary during the employee's service period (employees started working after April 1, 1990).	

The amount of the total pension benefit obligation is based on a standardized measurement established by GASBS No. 27, *Financial Reporting for Defined Benefit Pension Plans and Notes Disclosure for Defined Contributions Plans*. The standardized measurement is the actuarial present value of estimated defined pension benefits, adjusted for the effects of projected salary increases and step-rate benefits, estimated to be payable in the future as a result of employee services performed to date. The measure is intended to help users assess the System's funding status on a going-concern basis, assess progress made in accumulating sufficient assets to pay benefits when due, and make comparisons among other public retirement systems. The measure is independent of the actuarial funding method used to determine contributions to the plan.

The membership of retirees and beneficiaries currently receiving benefits and terminated employees entitled to benefits, but not yet receiving benefits, and active employees and the distribution of active employees between vested and non-vested is not readily available.

Contributions in 2004 and prior years were made based on percentages established by the law. Such percentage has not been based on actuarial studies, as required by accounting principles generally accepted in the United States of America. An actuarial compilation of the annual contribution applicable to the **Municipality** has not been prepared. Accordingly, the accounts by which the actual contributions differ from the required actuarial contributions are not known.

The total pension expenditures recorded in the category of administration for the Fiscal Year Ended June 30, 2004 was approximately **\$268,248**. All employees who at the time of employment are 55 years old or less are eligible to participate in the System. No benefit is payable if the participant receives a refund of his accumulated contributions.

The historical trend information regarding the accumulation of assets and pension benefit obligation in the ERS is not available. For the ten-year trend information, refer to the separately issued financial statements of the ERS as of and for the fiscal year ended June 30, 2004. The P.R. Retirement Plan Administration provides additional information of the ERS. They issue a publicly available financial report that includes financial statements and required supplementary information for ERS, as a component unit of the Commonwealth of Puerto Rico. That report may be obtained by writing to the Administration at PO Box 42003, Minillas Station, San Juan, PR 00940.

NOTE 13 ESTIMATED MUNICIPAL SOLID WASTE LANDFILL CLOSING COSTS

State and Federal laws and regulations require the **Municipality** to place a final cover on its landfill when closed and perform certain maintenance and monitoring function at the landfill site for thirty years after closure. In addition to the operating expenditures related to current activities of the landfill, an expense provision and related liability are being recognized based on futures closure and post-closure care costs that will be incurred near or after the date the landfill no longer accepts waste. The **Municipality** has performed a study of the activities that need to be implemented at

the **Municipality's** landfill to comply with applicable laws and regulations. As result of this study, the **Municipality** has recognized an estimated liability for future closure and post-closure care costs.

The recognition of this liability is based on the amount of the landfill used during the year. The estimated liability for landfill closure and post-closure care costs has a discounted balance of \$3,722,789 (based on a 6% discount rate) as of June 30, 2004, which is based on 87% usage of the landfill. It is estimated that an additional \$800,000 will be recognized as closure and post-closure care expenditures between the date of the balance sheet and the date the landfill is expected to be filled to capacity (December 2008). The estimated total current costs of the landfill closure and post-closure care (\$4,160,000) is based on the amount that would be paid if all the equipment, facilities and services required to close, monitor and maintain the landfill were acquired as of June 30, 2004. However, the actual cost of closure and post-closure care may be higher due to inflation, changes in technology, or changes in landfill laws and regulations. As of June 30, 2004 the **Municipality** has not made contributions to finance closure and post-closure care costs.

continue

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO**

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

NOTE 14 CONTINGENCIES

A. CLAIMS AND JUDGMENTS

The **Municipality** is, at present, a defendant in a number of legal matters that arise from alleged improper application of policies and negligence in the ordinary course of the **Municipality's** activities. The legal counsel of the **Municipality** has advised that at this stage in the proceedings of lawsuits he cannot offer an opinion as to the probable outcome.

In addition, the **Municipality** is a defendant or co-defendant in several legal proceedings, which are in discovery stage. Certain of these claims are covered by insurance. Legal counsel with the information currently available can not determine the final outcome of these claims.

B. FEDERAL GRANTS

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

NOTE 15 ACCOUNTING CHANGES, CHANGES IN REPORTING ENTITY AND RESTATEMENTS

During fiscal year 2002-2003, the **Municipality** implemented several new accounting standards and an interpretation issued by GASB. As part of the implementation of the new standards, during the current fiscal year 2003-2004, the **Municipality** continued the documentation of capital assets not previously reported and the inventory of infrastructure.

The other adjustment corresponded to the receivable and payables not previously identified.

Table 13 reconciles the June 30, 2003 Net Assets/Fund Balance, as previously reported to Beginning Net Assets/Fund Balance as restated, July 1, 2003.

NOTE 16 FUTURE ADOPTION OF ACCOUNTING PRONOUNCEMENT

The Governmental Accounting Standards Board (GASB) issued GASBS No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*, which is effective for fiscal year beginning after December 15, 2004. Early application is encouraged. The **Municipality** has not adopted the requirement of this statement. Other two pronouncements are issued (GASBS Nos. 43 and 44), but do not apply to the **Municipality**.

Table 13		
Governmental-Wide		NET ASSETS
Net Assets, as Previously Reported,		
June 30, 2003.....		\$18,072,778
Adjustment to Accounts Payable.....	(617,907)	
Adjustment to Accounts Receivable.....	2,415	
Property Tax Doubtful Accounts.....	(471,071)	
Municipal Solid Waste Landfill Debt.....	456,551	
Compensated Absences.....	233,179	
MRCC - LIMS Debt.....	(459,327)	
Deferred Revenue - Farmer Home.....	208,701	
Deferred Charges 2003.....	31,140	
Adjustment to Capital Assets.....	718,896	
Beginning Net Assets, as Restated, July 1, 2003.....		<u>\$18,175,355</u>
Governmental Fund	GENERAL FUND	OTHER FUNDS
Fund Balance, as Previously Reported,		
June 30, 2003.....	\$ 4,336,843	\$ 509,683
Adjustment to Accounts Payable.....	(487,307)	57,830
Adjustment to Accounts Receivable.....	121,364	-
Beginning Fund Balance, as Restated,		
July 1, 2003.....	<u>\$ 3,970,900</u>	<u>\$ 567,513</u>

END OF NOTES

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO**

**REQUIRED SUPPLEMENTARY INFORMATION
BUDGETARY COMPARISON SCHEDULE – GENERAL FUND**

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

	<u>BUDGET AMOUNTS</u>		<u>ACTUAL AMOUNTS (BUDGETARY BASIS) (SEE NOTE A)</u>	<u>VARIANCE WITH FINAL BUDGET POSITIVE (NEGATIVE)</u>
	<u>ORIGINAL</u>	<u>FINAL</u>		
REVENUES:				
Property Taxes	\$ 3,650,964	\$ 3,775,779	\$ 3,950,588	\$ 174,809
Municipal License Taxes	1,583,990	1,952,236	2,057,207	104,971
Intergovernmental.....	4,214,252	5,400,076	5,232,245	(167,831)
Fees, Fines and Charges for Service.....	494,600	1,114,475	2,174,558	1,060,083
Interests	53,500	51,800	44,099	92,299
Miscellaneous	<u>2,400</u>	<u>18,700</u>	<u>-</u>	<u>(18,700)</u>
Total Revenues (Inflows).....	<u>9,999,706</u>	<u>12,313,066</u>	<u>13,558,697</u>	<u>1,245,631</u>
EXPENDITURES:				
General Government	4,971,666	5,919,376	5,532,223	387,153
Public Safety.....	918,579	943,424	757,690	185,734
Public Works and Sanitation.....	2,182,944	2,231,420	2,021,611	209,809
Culture and Recreation.....	510,166	717,300	666,474	50,826
Health	572,686	575,086	552,952	22,134
Housing, Welfare and Community Development	<u>780,865</u>	<u>802,415</u>	<u>727,816</u>	<u>74,599</u>
Total Expenditures (Outflows)	<u>9,936,906</u>	<u>11,189,021</u>	<u>10,258,766</u>	<u>930,255</u>
Excess of Revenues Over Expenditures.....	<u>62,800</u>	<u>1,124,045</u>	<u>3,299,231</u>	<u>2,175,886</u>
Other Financing Sources (Uses):				
Transfer-in	62,800	87,027	87,027	-
Transfer-out	<u>-</u>	<u>(1,210,032)</u>	<u>(1,201,482)</u>	<u>8,550</u>
Other Financing Sources (Uses).....	<u>-</u>	<u>(1,123,005)</u>	<u>(1,114,455)</u>	<u>8,550</u>
BUDGETARY FUND BALANCE, JUNE 30, 2004.....	<u>\$ -</u>	<u>\$ 1,040</u>	<u>\$ 2,185,476</u>	<u>\$ 2,184,436</u>

See accompanying Notes to Required Supplementary Information.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO**

**BUDGETARY COMPARISON SCHEDULE – GENERAL FUND
NOTE TO REQUIRED SUPPLEMENTARY INFORMATION**

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

NOTE A Explanation of Differences between Budgetary Inflows and Outflows and GAAP Revenues and Expenditures

Actual Amounts (Budgetary Basis) “Available for Appropriation” from the Budgetary Comparison Schedule (See Page 34).....	\$ 2,185,476
Budget to GAAP Timing Differences:	
Non budgeted funds recorded as revenues for financial reporting purposes	6,139,003
Non budgeted funds recorded as expenditures for financial reporting purposes.	(3,932,110)
Non budgeted transfers in	1,660,141
Non budgeted transfers out	(599,936)
Revenues recorded for financial reporting purposes but not in budgetary basis.....	462,615
Revenues recorded in budgetary basis but not for financial reporting purposes.....	(60,000)
Expenditures recorded for financial reporting purposes but not in budgetary basis	(132,591)
Expenditures recorded in budgetary basis but not for financial reporting purposes.....	146,133
Current year encumbrances recorded as expenditures for budgetary reporting purposes	<u>179,060</u>
Net Change in Fund Balance (See Page 21)	<u>\$ 6,047,791</u>

END OF THIS SECTION

PART II

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
AND REPORTS REQUIRED BY GOVERNMENT AUDITING
STANDARDS AND OMB CIRCULAR A-133**

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO**

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

FEDERAL GRANTOR / PASS THROUGH GRANTOR / PROGRAM OR CLUSTER TITLE	FEDERAL CFDA NUMBER	PASS-THROUGH ENTITY IDENTIFYING NUMBER	FEDERAL EXPENDITURES
U.S. Department of Agriculture:			
Pass-Through PR Department of Education:			
Child and Adult Care Food Program.....	10.558	N/AV	<u>\$ 19,477</u>
U.S. Department of Housing and Urban Development:			
Direct Programs:			
Section 8 Housing Choice Vouchers Program	14.871	N/A	391,881
Indirect Programs:			
Pass-Through State -- Office of the Commissioner of Municipal Affairs			
State Block Grant Program (SBGP)	14.228	01-FD-32 00-FD-32 99-FD-32 98-FD-32 97-FD-32 96-FD-32 95-FD-32 94-AF-FD-32	<u>1,613,101</u>
Total U.S. Department of Housing and Urban Development ...			<u>2,004,982</u>
U.S. Department of Justice:			
Pass Through PR Department of Justice:			
Local Law Enforcement Block Grant	16.592	N/AV	<u>59,073</u>
U.S. Department of Transportation -- National Highway Traffic Safety Administration:			
Pass Through PR Department of Transportation -- (Traffic Safety Commission):			
State and Community Highway Safety	20.660	N/AV	<u>7,739</u>
U.S. Department of Health and Human Services:			
Head Start Program	93.600	N/A	516,814
Pass Through Administration of Children and Families:			
Child Care and Development Block Grant.....	93.575	N/A	<u>190,473</u>
Total U.S. Department of Health and Human Services			<u>707,287</u>
TOTAL EXPENDITURES OF FEDERAL AWARDS			<u>\$2,798,558</u>

The accompanying Notes to Schedule of Expenditures of Federal Awards are an integral of this Schedule.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO**

NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

NOTE 1 GENERAL

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activities of the **Municipality of Isabela, Puerto Rico**. The information in this Schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this Schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements. The **Municipality** reporting entity is defined in Note (1) (A) to the basic financial statements. All federal financial awards received directly from federal agency as well as federal financial awards passed-through other government agencies are included on the Schedule.

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

NOTE 3 FEDERAL CFDA NUMBER

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

NOTE 4 PASS-THROUGH GRANTOR'S NUMBER

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

NOTE 5 LOAN OUTSTANDING

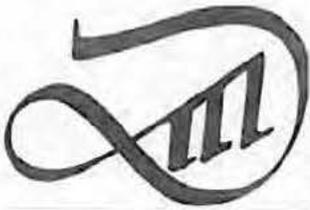
In determining the value of total noncash awards expended for loans and loan guarantees, the balances of loans from previous years must be included if the federal government imposes continuing compliance requirements. OMB Circular A-133 does not specifically define the term continuing compliance requirements. Therefore, it is a matter of judgment as to whether continuing compliance requirements are significant enough to require inclusion of prior-year loan or loan guarantee balances. The **Municipality of Isabela, Puerto Rico** had the following outstanding balance at June 30, 2004 for Water and Waste Disposal Loans Programs. For these loans the grantor does not impose continuing compliance requirements, as described on the OMB Circular A-133. Therefore, the prior year balances are not considered expenditures on the Schedule of Expenditures of Federal Awards. The amount presented in the Schedule, represent federal expenditures according to modified accrual basis of accounting (see Note 2). The loans outstanding balances were included in the Long-Term Liabilities of the Statement of Net Assets.

PROGRAM TITLE	FEDERAL CFDA NUMBER	AMOUNT OUTSTANDING
Water and Waste Disposal Loans and Grants	10.770	\$384,650
Water and Waste Disposal Loans and Grants	10.770	433,713

NOTE 6 MAJOR PROGRAMS

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

END OF NOTES



INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS REQUIRED BY GOVERNMENT AUDITING STANDARDS

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

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of **Municipality of Isabela, Puerto Rico (Municipality)**, as of and for the fiscal year ended June 30, 2004, which collectively comprise the **Municipality's** basic financial statements and has issued our report thereon dated January 17, 2005. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the **Municipality's** internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control would not necessarily disclose all matters in the internal control over financial reporting that might be material weakness. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

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

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS REQUIRED BY GOVERNMENT AUDITING STANDARDS

Page 2

This report is intended solely for the information and use of the management, the Honorable Mayor and Members of the Municipal Legislature, Office of the Commissioner of Municipal Affairs, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

CPA Diaz-Martinez, PSC
CPA DIAZ-MARTINEZ, PSC
Certified Public Accountants & Consultants
License Number 12, expires on December 1, 2007

Caguas, Puerto Rico
January 17, 2005





INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM AND INTERNAL CONTROL OVER COMPLIANCE REQUIRED BY OMB CIRCULAR A-133

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

Compliance

We have audited the compliance of the **Municipality of Isabela, Puerto Rico (Municipality)** with the types of compliance requirements described in the *U. S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the fiscal year ended June 30, 2004. The **Municipality's** major federal programs are identified in the summary of auditors' result section of the accompanying Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the **Municipality's** management. Our responsibility is to express an opinion on the **Municipality's** compliance based on our audit.

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

In our opinion, the **Municipality** complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the fiscal year ended June 30, 2004. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying Schedule of Findings and Questioned Costs as items 04-III-02 through 04-III-11.

Internal Control Over Compliance

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

INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM AND INTERNAL CONTROL OVER COMPLIANCE REQUIRED BY OMB CIRCULAR A-133

Page 2

We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect the **Municipality's** ability to administer a major federal program in accordance with applicable requirements of laws, regulations, contracts and grants. Reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs as item 04-III-01 through 04-III-07.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that none of the reportable conditions described above is a material weakness.

This report is intended solely for the information and use of the management, the Honorable Mayor and Members of the Municipal Legislature, Office of the Commissioner of Municipal Affairs, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

CPA Diaz-Martinez, PSC
CPA DIAZ-MARTINEZ, PSC
Certified Public Accountants & Consultants
License Number 12, expires on December 1, 2007

Caguas, Puerto Rico
January 17, 2005



PART III
FINDINGS AND QUESTIONED COSTS

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO**
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004

SECTION I – SUMMARY OF AUDITORS' RESULTS

Financial Statements

Type of auditors' report issued: Unqualified Opinion Qualified Opinion
 Adverse Opinion Disclaimer Opinion

Internal control over financial reporting:

● Reportable condition(s) identified? Yes None Reported

● Material weakness(es) identified? Yes No

Noncompliance material to financial statements noted? Yes No

Federal Awards

Internal control over major programs:

● Reportable condition(s) identified? Yes None Reported

● Material weakness (es) identified? Yes No

Type of auditors' report issued on compliance for Major Programs: Unqualified Opinion Qualified Opinion
 Adverse Opinion Disclaimer Opinion

Any audit finding disclosed that are required to be reported in accordance with Section 510 (a) of Circular A-133? Yes No

Identification of Major Programs:

CFDA NUMBER	NAME OF FEDERAL PROGRAM OR CLUSTER
14.228	State Block Grant Program (SBGP)
14.871	Section 8 Housing Choice Vouchers
93.600	Head Start Program

Dollar threshold used to distinguish between Type A and Type B Programs: \$300,000

Auditee qualified as low-risk auditee? Yes No

continue

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

SECTION II – FINANCIAL STATEMENT FINDINGS

NO MATTER IS REPORTED.

continue

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING	NUMBER 04-III-01
FEDERAL PROGRAM	HEAD START PROGRAM (CFDA 93.600) U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES
REQUIREMENT	INTERNAL CONTROL
NONCOMPLIANCE	ALLOWABLE COST/COST PRINCIPLES
CONDITION	It was noted in our tests of Municipality's internal control over disbursement process, that supporting documents related to thirteen (13) issued checks were not stamped as paid, there was one (1) disbursement voucher without purchase order, five (5) vouchers did not have the invoices, and ten (10) vouchers did not have a receiving report.
CRITERIA	Code of Federal Regulations, 45 CFR, Part 74, Subpart C, Section 74.21(b)(3), state that recipients' financial management systems shall provide for effective control over and accountability for all funds, property and other assets. Additionally, regulation states that recipients shall adequately safeguard all such assets and assure they are used solely for authorized purposes.
CAUSE	There are no adequate internal control procedures implemented to assure this compliance.
EFFECT	Liabilities could be paid twice by the Municipality . The Municipality is not in compliance with Code of Federal Regulations, 45 CFR, Part 74, Subpart C, Section 74.21(b)(3).
RECOMMENDATION	Municipality should implement adequate procedures to ensure that all supporting documents of all disbursement transactions are stamped as paid in order to assure compliance with this requirement.
QUESTIONED COSTS	None
MANAGEMENT RESPONSE	The Finance Department Director was instructed to verify the deficiencies related to the disbursement vouchers and orient each employee who contributed to this finding, of the importance of properly authorizing and canceling such documents.

continue

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING	NUMBER 04-III-02
FEDERAL PROGRAM	STATE BLOCK GRANT PROGRAM (CFDA NO. 14.228) U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT PASS-THROUGH STATE – OFFICE OF COMMISSIONER OF MUNICIPAL AFFAIRS
REQUIREMENT	COMPLIANCE AND INTERNAL CONTROL
NONCOMPLIANCE	ALLOWABLE COST/COST PRINCIPLES
CONDITION	It was noted in our tests of Municipality's internal control over disbursement process, that supporting documents related to thirteen (13) issued checks were not stamped as paid.
CRITERIA	Code of Federal Regulations, 24 CFR, Part 24, Subpart C, Section 84.21(b)(3), state that recipients' financial management systems shall provide for effective control over and accountability for all funds, property and other assets. Additional, regulation states that recipients shall adequately safeguard all such assets and assure them are used solely for authorized purposes.
CAUSE	There are no adequate internal control procedures implemented to assure this compliance.
EFFECT	Liabilities could be paid twice by the Municipality . The Municipality is not in compliance with Code of Federal Regulations, 24 CFR, Part 24, Subpart C, Section 84.21(b)(3).
RECOMMENDATION	Municipality should implement adequate procedures to ensure that all supporting documents of all disbursement transactions are stamped as paid in order to assure compliance with this requirement.
QUESTIONED COSTS	None
MANAGEMENT RESPONSE	Finance Director established strict procedures to ensure that all vouchers and receiving reports are processed, authorized and cancelled according to generally accepted accounting principles and regulations.

continue

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING	NUMBER 04-III-03
FEDERAL PROGRAM	HEAD START PROGRAM (CFDA NO. 93.600) U.S. DEPARTMENT OF HEALTH AND HUMAN RESOURCES
REQUIREMENT	COMPLIANCE AND INTERNAL CONTROL
NONCOMPLIANCE	DAVIS-BACON ACT
CONDITION	During our test we noted that the Municipality did not perform interviews to ensure that contractors paid prevailing wages according to Department of Labor.
CRITERIA	Davis-Bacon Act, as amended (40 USC 276a – 276a-7).
CAUSE	Municipality did not establish a process that ensures contractors paid prevailing wages as required by the act.
EFFECT	Municipality is not in compliance with Davis-Bacon Act (40 USC 276a – 276a-7).
RECOMMENDATION	We recommend management to develop a monitoring system that includes obtaining prevailing wage rates from the Department of Labor, the assignment of specific responsibility to one municipal employee to monitor contractors and subcontractors for compliance, obtaining contractor's payrolls and perform the interviews to contractor's and subcontractor's laborers accordingly to the established requirements.
QUESTIONED COSTS	None
MANAGEMENT RESPONSE	Copy of the contractor's payroll was presented to the auditor. A procedure will be established for future reference.

continue

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING	NUMBER 04-III-04
FEDERAL PROGRAM	SECTION 8 HOUSING CHOICE VOUCHER PROGRAM (CFDA NO. 14.871) U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
REQUIREMENT	COMPLIANCE AND INTERNAL CONTROL
NONCOMPLIANCE	ELIGIBILITY TEST
CONDITION	During our Participant Files Test we noted that two (2) participant files did not have evidence of the HUD-approved release and consent forms submitted by the family as required by federal regulation.
CRITERIA	Code of Federal Regulations, 24 CFR, Subpart F, Section 5.617 (b) stated that as a condition of admission to, or continued occupancy of, any assisted unit, the Municipality shall require the family head and other such family members as it designated, on 24 CFR, Subpart B, Section 5.230 (a), to execute a HUD-approved release and consent form authorizing any depository or private source of income, or any federal, state or local agency, to furnish or release to the Municipality and to HUD such information as the Municipality and HUD determines to be necessary. Also it is stated on 24 CFR, Subpart K, Section 982.516 (g).
CAUSE	Municipality does not have consent forms that authorize the collection of income information from State Wages Information Collection Agencies (SWICA), and wages, net earnings from self-employment, payments of retirement income, and unearned income as referenced at 26 U.S.C. 6103. In addition, the consent form may authorize the collection of other information from applicants and participants to determine eligibility or level of benefits.
EFFECT	Municipality is not in compliance with 24 CFR, Subpart F, Section 5.617(b); Subpart B, Section 5.230(a); and Subpart K, Section 982.516 (g).
RECOMMENDATION	We recommend management to require each member of the family of an assistance applicant or participant who is at least 18 years of age, and each family head and spouse regardless of age, to sign a release form.
QUESTIONED COSTS	None
MANAGEMENT RESPONSE	On December 1, 2003, the Municipality appointed a Housing Inspector. Instructions were given in order to perform the required housing inspections prospectively from the date of his appointment. The Municipality continues to inspect and review all findings in the assigned housing units.

continue

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING	NUMBER 04-III-05
FEDERAL PROGRAM	SECTION 8 HOUSING CHOICE VOUCHER PROGRAM (CFDA NO. 14.871) U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
REQUIREMENT	COMPLIANCE AND INTERNAL CONTROL
NONCOMPLIANCE	ELIGIBILITY TEST
CONDITION	During our Participant Files Test we noted that Municipality did not assure that participants submit a third parties verifications regarding the family income and the family composition.
CRITERIA	Code of Federal Regulations, 24 CFR, Subpart K, Section 982.516 (a)(2) stated that the Municipality must obtain and document in the tenants' file third party verification of the following factors, or must document in the tenant file why third party verification was not available: (i) reported family annual income, (ii) the value of assets, (iii) expenses related to deductions from annual income and (iv) other factors that affect the determination of adjusted income.
CAUSE	Municipality does not maintain tenants' files as required by federal regulations in order to verify the information provided by the applicant or participants regarding the family income and the family composition.
EFFECT	Municipality is not in compliance with 24 CFR, Subpart K, Section 982.516 (a)(2).
RECOMMENDATION	We recommend management to implement the necessary procedures in order to comply with program regulations.
QUESTIONED COSTS	None
MANAGEMENT RESPONSE	Pending the Corrective Action Plan.

continue

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING	NUMBER 04-III-06
FEDERAL PROGRAM	SECTION 8 HOUSING CHOICE VOUCHER PROGRAM (CFDA NO. 14.871) U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
REQUIREMENT	COMPLIANCE AND INTERNAL CONTROL
NONCOMPLIANCE	ELIGIBILITY TEST
CONDITION	During our Participant Files Test we noted that seven (7) participants' files did not have evidence of the Certificate of No Penal Record submitted by the family.
CRITERIA	Code of Federal Regulations, 24 CFR, Subpart L, Section 982.553 (a)(1-2) stated that at any time, the PHA may deny assistance to an applicant, or terminate assistance to a participant family if any member of the family commits a drug-related criminal activity; or violent criminal activity.
CAUSE	Municipality did not assure that all participants submit a Certificate of No Penal Record.
EFFECT	Is not possible for the Municipality to determine if the participant incur in this activities that can affect its eligibility.
RECOMMENDATION	We recommend management to require each member of the family of an assistance applicant or participant who is at least 18 years of age to submit a Certificate of No Penal Record.
QUESTIONED COSTS	None
MANAGEMENT RESPONSE	Pending the Corrective Action Plan.

continue

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING	NUMBER 04-III-07
FEDERAL PROGRAM	STATE BLOCK GRANT PROGRAM (CFDA NO. 14.228) U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT PASS-THROUGH STATE – OFFICE OF COMMISSIONER OF MUNICIPAL AFFAIRS
REQUIREMENT	COMPLIANCE AND INTERNAL CONTROL
NONCOMPLIANCE	PROCUREMENT STANDARDS
CONDITION	The model for construction contracts used by the Municipality did not contain the clause detailed for compliance with the provisions for Energy Policy and Conservation Act as required by the program regulation.
CRITERIA	Code of Federal Regulations, Subpart C, 24 CFR Section 85.36 (i) (1-13) stated that subgrantee's contract must contain provision in paragraph (i) of this Section. Federal agencies are permitted to require changes, remedies, changed conditions, access and records retention, suspension of work, and other clauses approved by the Office of Procurement Policy.
CAUSE	Federal Program and Finance Departments did not maintain appropriate procurement standard procedures, in order to assure that contractor complies with some requirements.
EFFECT	Municipality is not in compliance with Subpart C, 24 CFR, Section 85.36 (i) (1-13) of OMB Common Rules.
RECOMMENDATION	We recommend management to update contract model according with the federal requirement.
QUESTIONED COSTS	None
MANAGEMENT RESPONSE	Pending the Corrective Action Plan.

continue

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING	NUMBER 04-III-08
FEDERAL PROGRAM	HEAD START PROGRAM (CFDA 93.600) U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES
REQUIREMENT	COMPLIANCE
NONCOMPLIANCE	SPECIAL TESTS AND PROVISIONS
CONDITION	During our test we noted that the records of the employees did not have evidence of a signed declaration that includes the required information related to child abuse.
CRITERIA	Code of Federal Regulations, 45 CFR, Part 1301, Subpart D, Section 1301.31, (c) (1-3) state that the Personnel policies must require that all prospective employees must sign a declaration prior to employment which lists: (1) All pending and prior criminal arrests and charges related to child sexual abuse and their disposition; (2) Convictions related to other forms of child abuse and/or neglect; and (3) All convictions of violent felonies.
CAUSE	Personnel Department did not assure that all prospective employees sign the required declarations.
EFFECT	Municipality is not in compliance with Code of Federal Regulations, 45 CFR, Part 1301, Subpart D, Section 1301.31, (c) (1-3).
RECOMMENDATION	We recommend to management to implement internal control procedures in order to comply with this requirement.
QUESTIONED COSTS	None
MANAGEMENT RESPONSE	The declaration will be included in the Personnel policies accordingly with the Code of Federal Regulations.

continue

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING	NUMBER 04-III-09
FEDERAL PROGRAM	SECTION 8 HOUSING CHOICE VOUCHER PROGRAM (CFDA NO. 14.871) U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
REQUIREMENT	COMPLIANCE AND INTERNAL CONTROL
NONCOMPLIANCE	SPECIAL TESTS AND PROVISIONS
CONDITION	During our Participant Files Test we noted that fourteen (14) tenant's files do not documented the determination that the rent to owner is reasonable in accordance with the Municipality's administrative plan initially and during the contract term.
CRITERIA	Code of Federal Regulations, 24 CFR, Subpart D, Section 982.158 (f) (7) stated that the Municipality must maintain records to document the basis for the Municipality's determination that the rent to owner is a reasonable rent (initially and during the term of the HAP contract).
CAUSE	Municipality does not implement procedures in order to document the reasonable rent to owner.
EFFECT	Municipality is not in compliance with 24 CFR, Subpart D, Section 982.158 (f) (7).
RECOMMENDATION	We recommended management to document the basis for the determination that the rent to owner is a reasonable rent (initially and during the term of the HAP contract).
QUESTIONED COSTS	None
MANAGEMENT RESPONSE	At the present, Municipality management is documenting the reasonable rent at the moment of the inspection. The Municipality management is in the process of modifying the Administrative Plan for the Section 8 program. In February of 2005, the Municipality will be holding public hearings in order to establish an alternative rent reasonable test per sector or community.

continue

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO**
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING	NUMBER 04-III-10
FEDERAL PROGRAM	SECTION 8 HOUSING CHOICE VOUCHER PROGRAM (CFDA NO. 14.871) U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
REQUIREMENT	COMPLIANCE
NONCOMPLIANCE	SPECIAL TESTS AND PROVISIONS
CONDITION	During our Participant Files Test we noted that two (2) participants' files do not have evidence of an initial unit inspection and eleven (11) do not have evidence of a periodic unit inspection.
CRITERIA	Code of Federal Regulations, 24 CFR, Subpart D, Section 982.405 (a) stated that the Municipality must inspect the unit leased to a family prior to the initial term of the lease, at least annually during assisted occupancy, and at other times as needed, to determine if the unit meets the Housing Quality Standards.
CAUSE	Municipality does not conduct initial and periodic inspections as required by the federal regulation.
EFFECT	Municipality is not in compliance with 24 CFR, Subpart D, Section 982.405 (a) and Section 982.305 (b)(1)(I).
RECOMMENDATION	We recommend management to conduct the Housing Quality Standards Inspections as established under federal regulation.
QUESTIONED COSTS	None
MANAGEMENT RESPONSE	Municipality corrected the situation on the spot and faxed to auditor, document was misplaced. The Municipality will correct immediately this situation.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING	NUMBER 04-III-11
FEDERAL PROGRAM	SECTION 8 HOUSING CHOICE VOUCHER PROGRAM (CFDA NO. 14.871) U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
REQUIREMENT	COMPLIANCE
NONCOMPLIANCE	SPECIAL TESTS AND PROVISIONS
CONDITION	During our verification of units with failed Housing Quality Standards Inspections we noticed that in ten (10) participant's files was no evidence of a unit inspection report or other verification documenting that any PHA required repairs were completed.
CRITERIA	Code of Federal Regulations, 24 CFR, Subpart I, Section 982.404 stated that the Municipality must not make any housing assistance payments for a dwelling unit that fails to meet the Housing Quality Standards, unless the responsible person (owner and/or participant) correct the defect within the period specified by the Municipality and the Municipality verifies the correction.
CAUSE	Municipality does not verified the correction of the Housing Quality Standards deficiencies; therefore, the Municipality fails to take prompt and vigorous action to enforce the owner and/or participants obligations.
EFFECT	Municipality is not in compliance with 24 CFR, Subpart I, Section 982.404.
RECOMMENDATION	We recommend to management to implement internal control procedures to establish a correction time period to assure that the units Housing Quality Standards deficiencies were corrected during the specified period established by the federal regulation.
QUESTIONED COSTS	None
MANAGEMENT RESPONSE	Municipality corrected the situation on the spot and faxed to auditor, document was misplaced. The Municipality will correct immediately this situation.

END OF SCHEDULE

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO**

SCHEDULE OF PRIOR AUDIT'S FINDINGS AND QUESTIONED COSTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

(1) Audit Findings that have been Fully Corrected:

FISCAL YEAR 2003

Finding Number 03-III-04 **Special Tests and Provisions- Evidence of revision of the allowable utility schedule.**

CFDA Number 14.871

Questioned Cost NONE

Auditee Comments System and procedures corrected.

Finding Number 03-III-07 **Special Tests and Provisions- Municipality did not perform supervisory quality control HQS Inspections.**

CFDA Number 14.871

Questioned Cost NONE

Auditee Comments System and procedures corrected.

FISCAL YEAR 2002

Finding Number 02-III-01 **Allowable Costs/ Cost Principles- Missing documents on vouchers payments.**

CFDA Number 14.228

Questioned Cost NONE

Auditee Comments System and procedures corrected.

Finding Number 02-III-08 **Special Tests and Provisions- Evidence of revision of the allowable utility schedule.**

CFDA Number 14.871

Questioned Cost NONE

Auditee Comments System and procedures corrected.

Finding Number 02-III-11 **Special Tests and Provisions- Municipality did not perform supervisory quality control HQS Inspections.**

CFDA Number 14.871

Questioned Cost NONE

Auditee Comments System and procedures corrected.

continue

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO**

SCHEDULE OF PRIOR AUDIT'S FINDINGS AND QUESTIONED COSTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

(2) Audit Findings not Corrected or Partially Corrected:

FISCAL YEAR 2003

Finding Number	03-III-01	Allowable Cost/Cost Principles- Missing and not cancelled documents on vouchers payments.
CFDA Number	14.228	
Questioned Cost	None	
Auditee Comments	On January 29, 2004 Mr. Jason D. León, Finance Director, established strict procedures to ensure that invoices and disbursements are processed, authorized, and cancelled according to government accounting rules and regulations.	
Finding Number	03-III-02	Eligibility – Missing documentation (HUD-approved release and consent forms).
CFDA Number	14.871	
Questioned Cost	None	
Auditee Comments	The Federal Grants Office Director (FGOD) instructed the official in charge of the Section 8 Housing Choice Voucher Program to use a release and consent form approved by the U.S. department of Housing and Urban Development local office for approval. Each family member of an assistance applicant or participant who is at least 18 years of age, and each family head and spouse regardless of age will be required to sign the release and consent forms.	
Finding Number	03-III-03	Special Tests and Provisions- Evidence of the determination of the reasonableness of the rent paid to the owners.
CFDA Number	14.871	
Questioned Cost	None	
Auditee Comments	Municipality did not properly document the reasonable rent test performed. Since, December 1, 2003, the Housing Inspector implemented the Rent Reasonableness Form to improve the documentation of the procedures performed.	
Finding Number	03-III-05	Special Tests and Provisions- Missing inspection reports.
CFDA Number	14.871	
Questioned Cost	None	
Auditee Comments	Mr. Miguel Serrano was appointed as Housing Inspector effective December 1, 2003. We estimate that in approximately an eight month period the annual housing inspections, the rent reasonableness and the HQS will be revised and inspected for each unit.	

continue

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO**

SCHEDULE OF PRIOR AUDIT'S FINDINGS AND QUESTIONED COSTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

(2) Audit Findings not Corrected or Partially Corrected: (continuation)

Finding Number 03-III-06 **Special Tests and Provisions- Missing verification documenting that any PHA-required repairs were completed.**

CFDA Number 14.871

Questioned Cost None

Auditee Comments To adhere to Housing Quality Enforcement Standards, we have implemented a form that will help us successfully achieve the program goals.

FISCAL YEAR 2002

Finding Number 02-III-03 **Eligibility – Missing documentation (HUD-approved release and consent forms).**

CFDA Number 14.871

Questioned Cost None

Auditee Comments Federal Grants Office Director (FGOD) has been instructed and is in process to request to all participants, on a case by case basis, the update and completion of forms, and to include these in the participant files in accordance with Subpart F, Section 5.617(b); Subpart B, Section 5.230(a); and Subpart K, Section 982.516 (g). The program documents (forms) filling and correction is expected to be completed by April 30, 2003. FGOD will submit on a monthly basis progress reports to the Internal Auditor, Finance Director, Municipal Legislature and Mayor on the program special provisions performance and correction of findings mentioned on items 6, 7, 8 and 9 starting on April 2003.

Finding Number 02-III-07 **Special Tests and Provisions – Evidenced of the determination of the reasonable of the rent paid to the owners.**

CFDA Number 14.871

Questioned Cost None

Auditee Comments Federal Grants Office Director (FGOD) has been instructed and is in process to include documentation of the rent to be pay to owners in accordance to federal regulations by May 30, 2003.

Finding Number 02-III-09 **Special Tests and Provisions – Missing inspection reports.**

CFDA Number 14.871

Questioned Cost None

Auditee Comments Specific instructions have been addressed to the FGOD in order to comply with Section 982.158(d) to perform required HQS inspections and re-inspections on a regularly basis. HQS inspections to the program files commenced during second half of the fiscal year. Also municipal internal auditor will be assigned to audit this area and to test program personnel compliance with Sections 982.158(d). FGOD will submit on a monthly basis progress reports to the Internal Auditor, Finance Director, Municipal Legislature and Mayor on the program special provisions performance and correction of findings mentioned on items 3, 4 and 5 [Refer to Sections 928.54(b), 982.405(b) and 982.404].

continue

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

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

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

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

**RETURN
TO**

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

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

<p>1. Fiscal period ending date for this submission</p> <table border="1"> <tr> <td>Month</td> <td>Day</td> <td>Year</td> </tr> <tr> <td align="center">06</td> <td align="center">/ 30</td> <td align="center">/ 2004</td> </tr> </table> <p>Fiscal Period End Dates Must Be In 2004, 2005, or 2006</p>	Month	Day	Year	06	/ 30	/ 2004	<p>2. Type of Circular A-133 audit</p> <p>1 <input checked="" type="checkbox"/> Single audit 2 <input type="checkbox"/> Program-specific audit</p>
Month	Day	Year					
06	/ 30	/ 2004					

<p>3. Audit period covered</p> <p>1 <input checked="" type="checkbox"/> Annual 2 <input type="checkbox"/> Biennial 3 <input type="checkbox"/> Other - <input type="text"/> Months</p>	<p>4. FEDERAL GOVERNMENT USE ONLY Date received by Federal clearinghouse</p>
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5. Auditee Identification Numbers

<p>a. Primary Employer Identification Number (EIN)</p> <table border="1"> <tr> <td>6</td><td>6</td><td>-</td><td>0</td><td>4</td><td>3</td><td>3</td><td>7</td><td>9</td><td>6</td> </tr> </table>	6	6	-	0	4	3	3	7	9	6	<p>b. Are multiple EINs covered in this report? 1 <input type="checkbox"/> Yes 2 <input checked="" type="checkbox"/> No</p> <p>c. If Part I, Item 5b = "Yes," complete Part I, Item 5c on the continuation sheet on Page 4.</p>
6	6	-	0	4	3	3	7	9	6		

<p>d. Data Universal Numbering System (DUNS) Number</p> <table border="1"> <tr> <td><input type="text"/></td><td>-</td><td><input type="text"/></td><td><input type="text"/></td><td><input type="text"/></td><td><input type="text"/></td> </tr> </table>	<input type="text"/>	-	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<p>e. Are multiple DUNS covered in this report? 1 <input type="checkbox"/> Yes 2 <input checked="" type="checkbox"/> No</p> <p>f. If Part I, Item 5e = "Yes," complete Part I, Item 5f on the continuation sheet on Page 4.</p>
<input type="text"/>	-	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>		

6. AUDITEE INFORMATION

a. Auditee name MUNICIPALITY OF ISABELA	
b. Auditee address (Number and street) APARTADO 507	
City ISABELA	
State PR	ZIP + 4 Code 0 0 6 6 2 -
c. Auditee contact Name CARLOS DELGADO ALTIERI	
Title MAYOR	
d. Auditee contact telephone (787) 872 - 2100	
e. Auditee contact FAX () -	
f. Auditee contact E-mail	

7. AUDITOR INFORMATION (To be completed by auditor)

a. Auditor name CPA DIAZ MARTINEZ, PSC	
b. Auditor address (Number and street) P.O. BOX 8369	
City CAGUAS	
State PR	ZIP + 4 Code 0 0 7 2 6 - 8 3 6 9
c. Auditor contact Name JOSE E. DIAZ MARTINEZ	
Title PRESIDENT	
d. Auditor contact telephone (787) 746 - 0510	
e. Auditor contact FAX (787) 746 - 0525	
f. Auditor contact E-mail CPADIAZMARTINEZ@HOTMAIL.COM	

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

Signature of certifying official <i>Carlos Delgado Altieri</i>	Date Month Day Year 02 / 02 / 05
Printed Name of certifying official HON. CARLOS DELGADO ALTIERI	
Printed Title of certifying official MAYOR	

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

Signature of auditor <i>CPA Diaz-Martinez, PSC</i>	Date Month Day Year 01 / 31 / 05
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PART II FINANCIAL STATEMENTS (To be completed by auditor)

1. Type of audit report

Mark either: 1 Unqualified opinion OR any combination of: 2 Qualified opinion 3 Adverse opinion 4 Disclaimer of opinion

2. Is a "going concern" explanatory paragraph included in the audit report? 1 Yes 2 No

3. Is a reportable condition disclosed? 1 Yes 2 No - SKIP to Item 5

4. Is any reportable condition reported as a material weakness? 1 Yes 2 No

5. Is a material noncompliance disclosed? 1 Yes 2 No

PART III FEDERAL PROGRAMS (To be completed by auditor)

1. Does the auditor's report include a statement that the auditee's financial statements include departments, agencies, or other organizational units expending \$500,000 or more in Federal awards that have separate A-133 audits which are not included in this audit? (AICPA Audit Guide, Chapter 12) 1 Yes 2 No

2. What is the dollar threshold to distinguish Type A and Type B programs? (OMB Circular A-133 § 520(b)) \$ 300,000

3. Did the auditee qualify as a low-risk auditee? (§ 530) 1 Yes 2 No

4. Is a reportable condition disclosed for any major program? (§ 510(a)(1)) 1 Yes 2 No - SKIP to Item 6

5. Is any reportable condition reported as a material weakness? (§ 510(a)(1)) 1 Yes 2 No

6. Are any known questioned costs reported? (§ 510(a)(3) or (4)) 1 Yes 2 No

7. Were Prior Audit Findings related to direct funding shown in the Summary Schedule of Prior Audit Findings? (§ 315(b)) 1 Yes 2 No

8. Indicate which Federal agency(ies) have current year audit findings related to direct funding or prior audit findings shown in the Summary Schedule of Prior Audit Findings related to direct funding. (Mark (X) all that apply or None)

- 98 U.S. Agency for International Development
10 Agriculture
23 Appalachian Regional Commission
11 Commerce
94 Corporation for National and Community Service
12 Defense
84 Education
81 Energy
66 Environmental Protection Agency
83 Federal Emergency Management Agency
39 General Services Administration
93 Health and Human Services
97 Homeland Security
14 Housing and Urban Development
03 Institute of Museum and Library Services
15 Interior
16 Justice
17 Labor
09 Legal Services Corporation
43 National Aeronautics and Space Administration
89 National Archives and Records Administration
05 National Endowment for the Arts
06 National Endowment for the Humanities
47 National Science Foundation
07 Office of National Drug Control Policy
59 Small Business Administration
96 Social Security Administration
19 U.S. Department of State
20 Transportation
21 Treasury
82 United States Information Agency
64 Veterans Affairs
00 None
 Other - Specify:

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

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

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

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

FORM SF-SAC (5-2004)

PART III FEDERAL PROGRAMS - Continued

9. FEDERAL AWARDS EXPENDED DURING FISCAL YEAR

10. AUDIT FINDINGS

Federal Agency Prefix ¹ (a)	Extension ² (b)	Research and development (c)	Name of Federal program (d)	Amount expended (e)	Direct award (f)	Major program		Type(s) of compliance requirement(s) ⁴ (a)	Audit finding reference number(s) ⁵ (b)
						Major program (g)	If yes, type of audit report ³ (h)		
1 0	.558	1 <input type="checkbox"/> Yes 2 <input checked="" type="checkbox"/> No	CHILD AND ADULT CARE FOOD PROGRAM	\$ 19,477.00	1 <input type="checkbox"/> Yes 2 <input checked="" type="checkbox"/> No	1 <input type="checkbox"/> Yes 2 <input checked="" type="checkbox"/> No		O	N/A
1 4	.871	1 <input type="checkbox"/> Yes 2 <input checked="" type="checkbox"/> No	SECTION 8 HOUSING CHOICE VOUCHERS PROGRAM	\$ 391,881.00	1 <input checked="" type="checkbox"/> Yes 2 <input type="checkbox"/> No	1 <input checked="" type="checkbox"/> Yes 2 <input type="checkbox"/> No	U	E	04-III-04, 04-III-05, 04-III-06, 04-III-09, 04-III-10, 04-II-1-11
1 4	.228	1 <input type="checkbox"/> Yes 2 <input checked="" type="checkbox"/> No	STATE BLOCK GRANT PROGRAM	\$ 1,613,101.00	1 <input type="checkbox"/> Yes 2 <input checked="" type="checkbox"/> No	1 <input checked="" type="checkbox"/> Yes 2 <input type="checkbox"/> No	U	B	04-III-02, 04-II-1-07
1 6	.592	1 <input type="checkbox"/> Yes 2 <input checked="" type="checkbox"/> No	LOCAL LAW ENFORCEMENT BLOCK GRANT	\$ 59,073.00	1 <input type="checkbox"/> Yes 2 <input checked="" type="checkbox"/> No	1 <input type="checkbox"/> Yes 2 <input checked="" type="checkbox"/> No		O	N/A
2 0	.660	1 <input type="checkbox"/> Yes 2 <input checked="" type="checkbox"/> No	STATE AND COMMUNITY HIGHWAY SAFETY	\$ 7,739.00	1 <input type="checkbox"/> Yes 2 <input checked="" type="checkbox"/> No	1 <input type="checkbox"/> Yes 2 <input checked="" type="checkbox"/> No		O	N/A
9 3	.600	1 <input type="checkbox"/> Yes 2 <input checked="" type="checkbox"/> No	HEAD START PROGRAM	\$ 516,814.00	1 <input checked="" type="checkbox"/> Yes 2 <input type="checkbox"/> No	1 <input checked="" type="checkbox"/> Yes 2 <input type="checkbox"/> No	U	BDN	04-III-01, 04-II-1-03, 04-III-06
9 3	.575	1 <input type="checkbox"/> Yes 2 <input checked="" type="checkbox"/> No	CHILD CARE AND DEVELOPMENT BLOCK GRANT	\$ 190,473.00	1 <input type="checkbox"/> Yes 2 <input checked="" type="checkbox"/> No	1 <input type="checkbox"/> Yes 2 <input checked="" type="checkbox"/> No		O	N/A
		1 <input type="checkbox"/> Yes 2 <input type="checkbox"/> No		\$.00	1 <input type="checkbox"/> Yes 2 <input type="checkbox"/> No	1 <input type="checkbox"/> Yes 2 <input type="checkbox"/> No			
		1 <input type="checkbox"/> Yes 2 <input type="checkbox"/> No		\$.00	1 <input type="checkbox"/> Yes 2 <input type="checkbox"/> No	1 <input type="checkbox"/> Yes 2 <input type="checkbox"/> No			
		1 <input type="checkbox"/> Yes 2 <input type="checkbox"/> No		\$.00	1 <input type="checkbox"/> Yes 2 <input type="checkbox"/> No	1 <input type="checkbox"/> Yes 2 <input type="checkbox"/> No			
TOTAL FEDERAL AWARDS EXPENDED				\$ 2,798,558.00	IF ADDITIONAL LINES ARE NEEDED, PLEASE PHOTOCOPY THIS PAGE, ATTACH ADDITIONAL PAGES TO THE FORM, AND SEE INSTRUCTIONS				

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

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

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

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

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

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

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

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

⁵ N/A for NONE

UNIVERSITY OF PUERTO RICO
OFFICE OF THE COMPTROLLER
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**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO**

BASIC FINANCIAL STATEMENTS

FISCAL YEAR ENDED JUNE 30, 2004

(WITH THE ADDITIONAL REPORTS AND INFORMATION REQUIRED BY
THE GOVERNMENT AUDITING STANDARDS AND OMB CIRCULAR A-133)

OFFICE OF THE COMPTROLLER
UNIVERSITY OF PUERTO RICO
SAN JUAN, P.R. 00925
05 APR 12 AM 10:09

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO
BASIC FINANCIAL STATEMENTS
FISCAL YEAR ENDED JUNE 30, 2004
(WITH THE ADDITIONAL REPORTS AND INFORMATION
REQUIRED BY THE GOVERNMENT AUDITING STANDARDS
AND OMB CIRCULAR A-133)

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PART I
FINANCIAL



CPA DIAZ-MARTINEZ, PSC
Certified Public Accountants & Consultants

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TEL (787) 746-0510
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INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the **Municipality of Isabela, Puerto Rico (Municipality)**, as of and for the fiscal year ended June 30, 2004, which collectively comprise the **Municipality's** basic financial statements as listed in the Table of Contents. These financial statements are the responsibility of the **Municipality's** management. Our responsibility is to express an opinion on these basic combined 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 basic financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the basic financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall basic financial statements presentation. We believe that our audit provide a reasonable basis for our opinion.

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**, as of June 30, 2004, and the respective changes in financial position, for the fiscal year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated January 17, 2005 on our consideration of the **Municipality's** internal control over financial reporting on our test of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis and budgetary comparison information on pages 4 through 16, and 34 and 35, 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.

INDEPENDENT AUDITORS' REPORT

Page 2

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

CPA Diaz Martinez, PSC
CPA DIAZ-MARTINEZ, PSC
Certified Public Accountants & Consultants
License Number 12, expires on December 1, 2007

Caguas, Puerto Rico
January 17, 2005



**Commonwealth of Puerto Rico
MUNICIPALITY OF ISABELA**

MANAGEMENT DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2004

The following discussion and analysis of the Municipality of Isabela's financial performance provides an overview of the Municipality's financial activities for the fiscal period ended June 30, 2004. Please read it in conjunction with the financial statements which follow this section.

FINANCIAL HIGHLIGHTS

Highlights for Government-wide Financial Statements

The government-wide financial statements report information about the Municipality as a whole using the economic resources measurement focus and accrual basis of accounting:

- The assets of the Municipality, on a government-wide basis, exceeded its liabilities at the close of fiscal year 2004 by \$30,191,893 (net assets).
- Revenues (not including special items) increased by \$8,847,189 (48%) and expenses increased \$573,735 (3.7%) in comparison with year 2003, as restated.
- Net change in net assets amounted to \$12,016,538, an increase of 65% with respect to prior year (2003) net change, as restated.
- The Municipality reported special items revenue for \$1,016,046 mainly from tax amnesty and legal claim settlements for 2004.
- The Municipality accounted as part of its revenues \$4,452,516 from donated assets (including infrastructure) received from the Central Government developed and constructed projects or facilities, \$350,000 from a landfill waste disposal grant with Autoridad de Desperdicios Sólidos (ADS) and \$700,000 for a federal grant expenses reimbursements of a 2001-2003 water front project.

Highlights for Fund Financial Statements

The fund financial statements provide detailed information about the Municipality's most significant funds using the current financial resources measurement focus and modified accrual basis of accounting:

- At the close of the current fiscal year, the Municipality's governmental funds reported combined ending fund balances of \$11,211,420, an increase of \$6,047,791 in comparison with the prior year, as restated. Approximately 42% (or \$4,691,394) of the total combined fund balances is unreserved.
- The General Fund reported an excess of revenues, other financing sources and special items over expenditures and other financing uses of \$6,145,886 and an unreserved fund balance of \$4,691,394. Unreserved fund balances increased \$3,958,015 from prior year, as restated.
- Management has designated \$2,286,999 for future special activities in the general fund for which \$2,182,920 is for community assistance and construction projects at the management discretion. Such funds have been assigned from general funds excess of revenues in current and prior years, as approved by municipal legislature.

Commonwealth of Puerto Rico
MUNICIPALITY OF ISABELA

MANAGEMENT DISCUSSION AND ANALYSIS

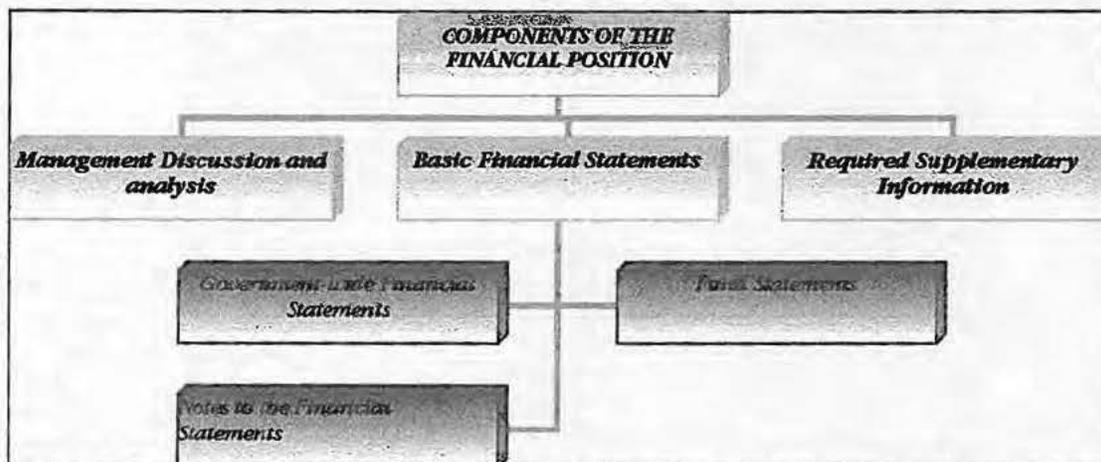
Fiscal year ended June 30, 2004

General Financial Highlights

- The investment in net capital assets as of June 30, 2004 was \$26,419,265 (net of related debt).
- Long term debt decreased to \$12,933,231, approximately decrease of 2.8% (\$361,070) with respect to prior year balance, as restated.
- Other long term debt increases and net reductions from adjustments amounted to \$609,188 and \$87,765, respectively. Such adjustments represent the recognition of other long term debts as reported by the Central Government agencies to the municipality.
- On a budgetary basis, actual revenues exceeded actual expenditures by \$2,185,476, net of \$1,201,482 internally designated funds for future expenditures and transfers out.
- Revenues increase was mainly due to a \$700,000 federal agency expense reimbursement, a \$329,503 increase in municipal property tax collections, \$299,623 in collections from a tax amnesty and \$704,558 from a legal claim settlement of revenues in lieu of taxes.

OVERVIEW OF THE FINANCIAL STATEMENTS

The Municipality's basic financial statements comprise three components: (1) management discussion and analysis (presented here), (2) basic financial statements, and (3) required supplementary information.



The Municipality's basic financial statements consist of two kinds of statements, each with a different view of the Municipality's finances. The government-wide financial statements provide both long-term and short-term information about the Municipality's overall financial status. The fund financial statements focus on major aspects of the Municipality's operations, reporting those operations in more detail than the government-wide statements:

**Commonwealth of Puerto Rico
MUNICIPALITY OF ISABELA**

MANAGEMENT DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2004

Basic Financial Statements

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

The government-wide statements report information about the Municipality as a whole using accounting methods similar to those used by private-sector businesses. They are prepared using the flow of economic resources measurement focus and the accrual basis of accounting. The first government-wide statement – the statement of net assets – presents information on all of the Municipality’s assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in the Municipality’s net assets are an indicator of whether its financial health is improving or deteriorating. Other non-financial factors such as the condition of the Municipality’s roads and other infrastructure may need to be considered to assess the overall health of the Municipality. The second statement – the statement of activities – presents information showing how the net assets changed during the year. All of the current year’s revenues and expenses are taken into account in the statement of activities regardless of when cash is received or paid.

The government-wide statements reports as governmental activities the municipality’s basic services such as public works and sanitation; public safety, culture and recreation, housing, welfare, and community development; education and general administration. These activities are primarily financed through property taxes, other local taxes and intergovernmental revenues. Included in the governmental activities are the governmental funds.

- ***Fund Financial Statements***

The fund financial statements provide more detailed information about the Municipality’s most significant funds. Funds are accounting devices that the Municipality uses to keep track of specific sources of funding and spending for particular purposes. Some funds are required by Federal and Commonwealth regulations, as well by bond covenants.

The Municipality’s basic services are included in governmental funds, which are used to account for essentially the same functions reported as governmental activities in the government-wide statements. However, unlike the government-wide statements, the governmental funds are prepared using the flow of current financial resources measurement focus and the modified accrual basis of accounting. Under this approach the financial statements focus on near-term inflows and outflows of external resources, as well on balances of expendable resources available at year end. Consequently, the governmental fund statements provide a detailed short-term view that helps the reader determine whether there are more or fewer financial resources that can be spent in the near future to finance the Municipality’s programs. Because this information does not encompass the additional long-term focus of the government-wide statements, additional information is provided on a subsequent page that explains the relationship (or differences) between the government-wide and fund statements.

The governmental fund statements focus on major funds. The Municipality’s major funds are the general fund (which accounts for the main operating activities of the Municipality) and funds that complies with a minimum criterion (percentage of the assets, liabilities, revenues or expenditures). Funds that do not comply with this criterion are grouped and presented in a single column as other governmental funds.

**Commonwealth of Puerto Rico
MUNICIPALITY OF ISABELA**

MANAGEMENT DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2004

- *Notes to the financial statements*

The basic financial statements also include notes to explain information in the financial statements and provide more detailed data.

Required supplementary information

The statements and notes are followed by the required supplementary information that contains the budgetary comparison schedule for the General Fund.

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE

Net Assets

The following table presents a summary of the Statements of Net Assets as of June 30, 2004 and 2003:

TABLE 1

Summary Statement of Net Assets		
As of June 30,		
	Governmental Activities	
	2004	(As restated) 2003
Assets		
Current and other assets	\$ 18,877,259	\$ 12,568,027
Capital assets	27,862,510	22,921,596
Total assets	\$ 46,739,769	\$ 35,489,623
Liabilities		
Current and other liabilities	\$ 3,614,645	\$ 4,629,155
Long term liabilities	12,933,231	12,685,113
Total liabilities	16,547,876	17,314,268
Net assets		
Invested in capital assets, net of related debt	26,419,265	21,045,596
Restricted	9,529,845	7,023,263
Unrestricted (deficit)	(5,757,217)	(9,893,504)
Total net assets	\$ 30,191,893	\$ 18,175,355

Net assets (assets over liabilities) may serve over time as a useful indicator of a government's financial position. Net assets for the year increased 72% with respect to prior year. The most significant change was a reduction in unrestricted deficit of \$4,136,287 due to positives changes in net assets related to unrestricted operation, an increase in total assets due to a sustained and positive trend in surpluses and capital infrastructure asset donations from Central Government.

**Commonwealth of Puerto Rico
MUNICIPALITY OF ISABELA**

MANAGEMENT DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2004

The largest portion of the Municipality's net assets reflects its investment in capital assets (e.g., land, buildings, equipment, and infrastructure) for \$32,221,366; less accumulated depreciation (\$4,358,856) and less any related outstanding debt (\$1,443,245) used to acquire those assets. The Municipality uses these assets to provide services to its citizens and consequently, these assets are not available for future spending. The resources needed to repay the debt related to these capital assets must be provided from other sources, because capital assets are not generally liquidated for the purpose of retiring debt.

Restricted net assets represent resources that are subject to external restrictions on how they may be used.

Unrestricted net assets are the part of the net assets that can be used to finance day-to-day operations without constraints established by debt covenants, enabling legislation or other legal requirements.

As of June 30, 2004 the Municipality presented an unrestricted net assets deficit of \$5,757,217. This deficit primarily arise from long term obligations such as compensated absences \$1,385,268, the estimated municipal solid waste landfill future closing cost \$3,722,789 and debts to CRIM (Central Municipal Revenue Collection Agency) \$748,669 for which the Municipality did not provide funding in previous budgets. Historically, such obligations have been budgeted on a pay as you go basis without providing funding for their future liquidation. In addition, operational loans and certain general obligation bonds do not have a related capital asset to be reported as invested in capital assets, net of related debt section of net assets. Therefore, are reported as part of the unrestricted net assets section.

**Commonwealth of Puerto Rico
MUNICIPALITY OF ISABELA**

MANAGEMENT DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2004

Changes in net assets

The following table summarizes the changes in net assets for the years ended June 30, 2004 and 2003:

TABLE 2

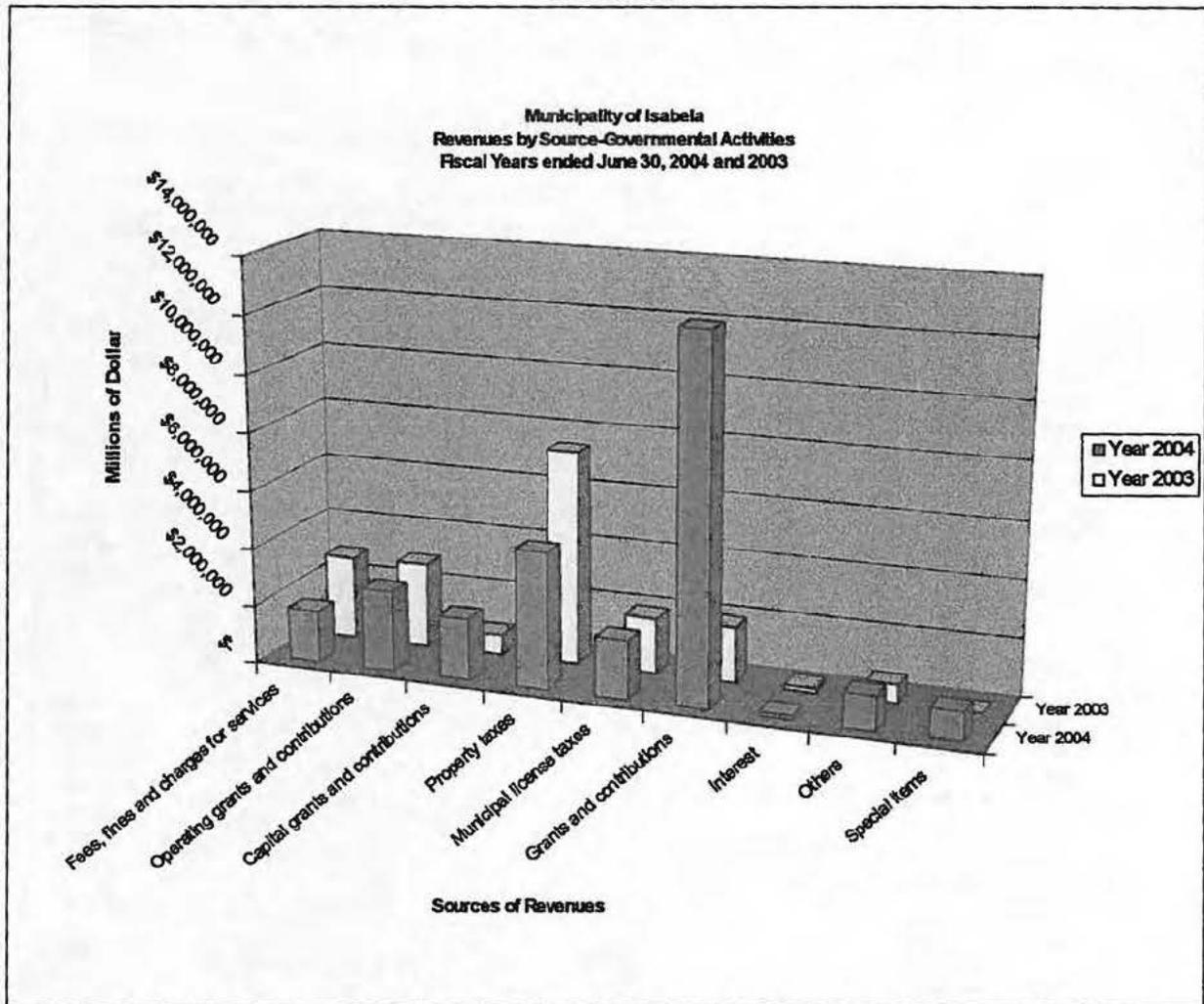
Summary of Changes in Net Assets As of June 30,		
	Governmental Activities	
	2004	(As restated) 2003
Program revenues:		
Fees, fines and charges for services	\$ 1,787,468	\$ 2,861,054
Operating grants and contributions	2,757,403	2,916,224
Capital grants and contributions	2,136,049	713,100
General revenues:		
Property taxes	4,711,064	7,406,242
Municipal license taxes	2,057,207	1,933,105
Grants and contributions not restricted to specific programs	12,564,014	1,929,686
Interest	176,373	145,114
Others	1,167,619	605,483
Total revenues	\$ 27,357,197	\$ 18,510,008
Expenses:		
General government	\$ 5,613,090	\$ 6,304,844
Public safety	799,840	1,040,173
Public works and sanitation	3,461,606	2,602,185
Health	2,542,610	3,615,806
Housing, welfare and community development	1,839,645	1,022,914
Culture and recreation	913,705	596,370
Education	856,873	259,255
Interest on long term debt	329,336	341,423
Total expenses	\$ 16,356,705	\$ 15,782,970
Special items	1,016,046	-
Change in net assets	12,016,538	2,727,038
Net assets-beginning of year (As restated)	18,175,355	15,448,317
Net assets-end of year	\$ 30,191,893	\$ 18,175,355

Commonwealth of Puerto Rico
MUNICIPALITY OF ISABELA

MANAGEMENT DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2004

FIGURE 1

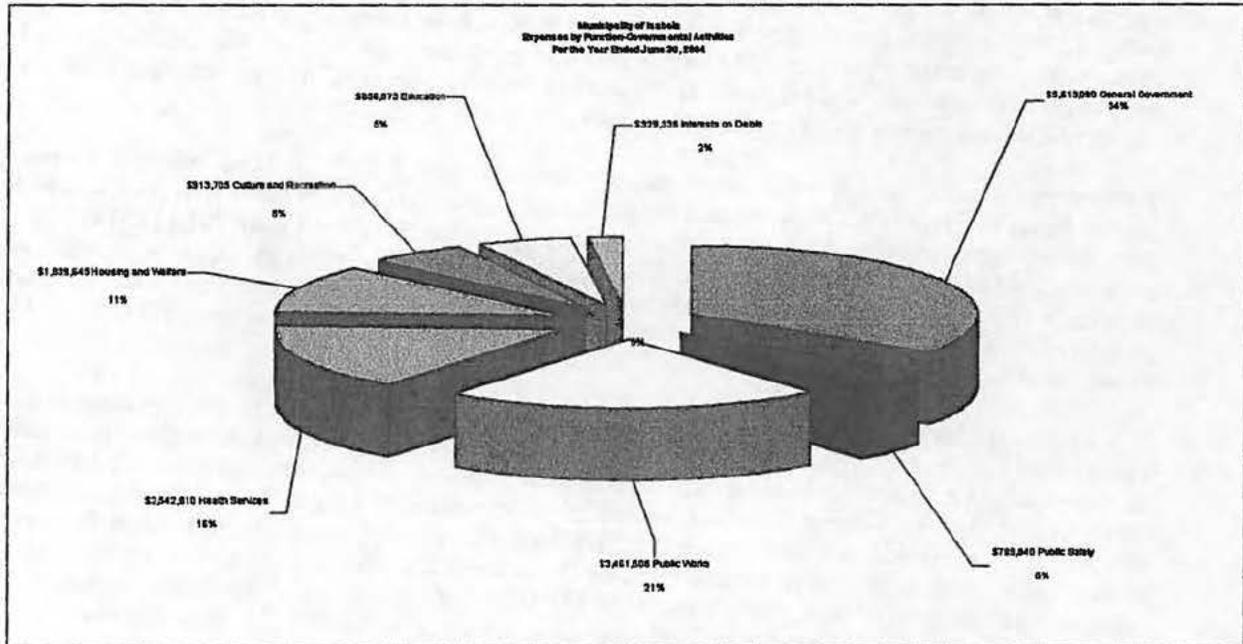


Commonwealth of Puerto Rico
MUNICIPALITY OF ISABELA

MANAGEMENT DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2004

FIGURE 2



**Commonwealth of Puerto Rico
MUNICIPALITY OF ISABELA**

MANAGEMENT DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2004

Approximately 9.7% of the Municipality's revenues came from grants and contributions, 16.6% from property taxes, 6.3% from fees and charges for services and 44.0% from unrestricted grants. The Municipality's expenses cover a range of services. The largest expenses are general government with 34.3%, public works and sanitation representing approximately 21.2% and health services provided with an outpatient health facility known as CIMA. Program revenues of the Municipality covered 48% of total expenses.

With respect to prior year, revenues increased by approximately \$8,847,189 or 48%, excluding revenues on special items of \$1,016,046. Significant increases includes grants and contribution with 55.1%, due to the donation of capital assets and infrastructure constructed by the Central Government (\$4,452,516), additional grant from Administración de Desperdicios Sólidos de P.R.(ADS) for a waste management landfill project, increase in collections of construction permits with a 11.5% or \$483,489 and property taxes with due mainly to an increase in collections and additional revenues due to reimbursement of \$700,000 from EDA for the Isabela Water Front Project.

Expenses increased 3.64% or \$573,735 in comparison with 2003 year, as amended. Such increase excludes a loss of \$251,298 on the disposition of capital asset that was presented as a special item category. Significant increases were registered on housing and welfare with 79.8% due to increases in state legislative grants expenses and donations incurred for the benefit of the community. As part of the housing, welfare and community development activities includes welfare expenses related to donations and others financed with external grants such as Section 8 Voucher and CDBG. An increase of 23.1% in Education is mainly due to the operation of the newly Head Start Program of \$516,814. Public works and sanitation increased due to additional capital assets maintenance and other non-capitalize costs, including motor pool expenses.

Changes in net assets for the year 2004 include additional resources from special items in the amount of \$1,016,046. These special items include \$526,786 for a property tax amnesty and \$704,558 of a legal case settlement from the Puerto Rico Electric Power Authority, a component unit of the Commonwealth of Puerto Rico and losses on disposal of assets of \$251,298.

As noted previously the increase in revenues over the increase in expenses, caused an increase of 65% in the net change in net assets with respect to prior year net change.

The following table focuses on the cost of each of the Municipality's largest programs as well as each program's net cost (total cost less fees generated by the programs and program-specific intergovernmental aid):

TABLE 3

Net Cost of Municipality's Governmental Activities				
Fiscal years ended June 30,				
Functions/Programs	Total Cost of Services		Net Cost of Services	
	2004	2003	2004	2003
General government	\$ 5,613,090	\$ 6,304,844	\$ 3,028,656	\$ 3,079,940
Public works and sanitation	3,461,606	2,602,185	3,109,286	1,266,701
Health	2,542,610	3,615,806	2,542,610	3,615,806
Housing, welfare and community development	1,839,645	1,022,914	231,528	(443,260)
Culture and recreation	913,705	596,370	913,705	596,370
Other	1,986,049	1,640,851	(150,000)	1,248,858
	<u>\$ 16,356,705</u>	<u>\$ 15,782,970</u>	<u>\$ 9,675,785</u>	<u>\$ 9,364,415</u>

**Commonwealth of Puerto Rico
MUNICIPALITY OF ISABELA**

MANAGEMENT DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2004

Some of the cost of governmental activities in 2004 was paid by those who directly benefited from the programs (\$1,787,468) and other governments and organizations that subsidized certain programs with grants and contributions (\$2,757,403 and \$2,136,049, respectively). The \$9,675,785 net cost of services was fully covered by other general revenues including property and municipal license taxes.

FINANCIAL ANALYSIS OF THE MUNICIPALITY'S FUNDS

Governmental funds

The focus of the Municipality's governmental funds is to provide information on near-term inflows, outflows and balances of resources available for spending. Such information is useful in assessing the Municipality's financing requirements. In particular, unreserved fund balance may serve as a useful measure of a Municipality's net resources available at the end of a fiscal year. For the Fiscal year ended June 30, 2004, the governmental funds reported combined ending fund balances of \$11,211,420, a net increase of \$6,047,791 in comparison with the prior year, as restated. This increase was caused primarily by a net change in the general fund of \$6,145,886; \$157,166 increase in the debt service fund and a decrease of (\$255,261) in the other governmental funds. Of total combined fund balances, \$4,691,394 (41.8%) constitutes unreserved fund balance. The remainder of fund balance is reserved to indicate that is not available for new spending.

The general fund is the operating fund of the Municipality. Unreserved fund balance of the general fund represents approximately 46% of total ending general fund balance. For the year ended June 30, 2004, the fund balance of the general fund increased by \$6,145,886 when compared with the prior year, as restated. The principal components of the net increases of \$3,867,982 in revenues in the general fund are an increase of \$7,291,923 in intergovernmental assistance and a decrease in other revenues of \$3,423,941. The net decrease in expenditures of \$758,927 was due to a decrease of \$294,350 in the general government expenditures, a decrease in capital outlay of \$1,121,356; and an increase in other expenditures of \$656,779 in repairs and maintenance of roads, structures and equipment.

GENERAL FUND BUDGETARY HIGHLIGHTS

The general fund original budget for the fiscal period 2003-2004 presented an increase of less than 1.0% with respect to prior year budget. Amendments to the original budget are approved by the Municipal Legislature. During the fiscal year budget revenues were increased by \$2,313,360 due to additional collections of property taxes, construction permits and of others revenues. Budget expenditures were increased by \$2,313,320, including therein a \$1,210,045 transfer out to general funds special designated activities. Actual revenues were greater than the revised budgeted revenues by \$1,245,631 (net). The most significant variance is in fees, fines and charges for services, \$1,060,083.

A positive variance of \$930,255 between revised budget and actual expenditures was due mainly to a net decrease of \$387,153 in general government, \$209,809 in public works and sanitation expenditures and \$185,734 in public safety. The Municipality reported less expenditure than appropriations in those functions on payments for unemployment and general insurance, professional and nonprofessional services, utilities and the administration of the Municipal landfill. Actual revenues exceeded actual expenditures by \$2,185,476.

**Commonwealth of Puerto Rico
MUNICIPALITY OF ISABELA**

MANAGEMENT DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2004

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital assets

At the end of the fiscal year, the Municipality has invested \$27,862,510 (net of accumulated depreciation) in a broad range of capital assets, including buildings, parks, roads, bridges, land and equipment. This amount represents a net increase of \$4,940,911 or approximately 21.6% over the prior year, as restated.

TABLE 4

	Capital Assets, net As of June 30,	
	Governmental Activities	
	2004	(As restated) 2003
Non-depreciable assets:		
Land	\$ 3,668,589	\$ 1,829,943
Construction in progress	3,181,224	46,960
Depreciable assets:		
Buildings	8,241,705	8,409,410
Buildings and buildings improvements	424,949	428,546
Infrastructure	8,527,490	8,319,320
Vehicles, machinery and equipment	3,818,553	3,887,420
Total	\$ 27,862,510	\$ 22,921,599

The Municipality acquired a total of \$1,836,646 of land during the fiscal year 2003-2004 as follows:

- "Plaza de Recreo Land Acquisition" - \$138,800
- "Barrio Mora Land Acquisition for Coliseo Municipal" - \$737,000
- "Picadero Municipal Land Acquisition" - \$255,000
- "Vertedero Municipal Land Acquisition" - \$159,523

**Commonwealth of Puerto Rico
MUNICIPALITY OF ISABELA**

MANAGEMENT DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2004

The Municipality reported additions of \$3,134,264 in construction in progress, \$1,838,646 for land acquisitions and \$621,539 in infrastructure during the year. These additions are composed mainly of capital improvements and donations from construction contractors of municipal, Central Government donations, donations of recreational areas, parks streets and roads. Some of these improvements and donations are detailed as follows:

- “Villa Pesquera Business Center Improvements” - \$873,067
- “Plaza de Recreo Land Acquisition” - \$138,800
- “Barrio Mora Land Acquisition for Coliseo Municipal” - \$737,000
- “Plaza Recreo Building” - \$921,650
- “Plaza del Mercado Facilities” - \$367,415
- “Soterrado Eléctrico del Centro del Pueblo” - \$2,138,038
- “Picadero Municipal Land Acquisition” - \$255,000
- “Mejoras al la Villa de Pescadores” - \$107,243
- Vertedero Municipal Land Acquisition - \$159,523

The Municipality’s fiscal year 2005 consolidated capital budget calls for a significant amount of projects including construction of “Plaza de Mercado \$550,000, facilities for “El Picadero Municipal” with a budget of \$1,600,000, improvements of recreational parks at various wards and rural areas for \$2,711,231. These projects will be financed through Federal and Commonwealth grants, funds from the Commonwealth Legislature, general obligation bonds and Municipal funds. More detailed information about the Municipality’s capital assets is presented in Note 6 to the financial statements.

Long term debt

At year-end, the Municipality had \$12,933,231 in general and special bonds and notes, an increase of 2% with respect to prior year. The following is a summary of the Municipality’s outstanding debt as of June 30, 2004 and 2003:

TABLE 5

Outstanding Long-term Debt		
As of June 30,		
	Governmental Activities	
	2004	(As restated) 2003
General and special obligation bonds and notes	\$ 6,693,363	\$6,726,000
Note payable to CRIM – LIMS	416,394	459,327
Note Payable to CRIM – prior years delinquent accounts	332,275	471,071
Solid waste landfill	3,722,789	3,543,449
Compensated absences	1,385,268	1,485,266
Christmas Bonus	324,219	-
P.R. Water Sewer Authority	58,923	-
Total	\$ 12,933,231	\$ 12,685,113

**Commonwealth of Puerto Rico
MUNICIPALITY OF ISABELA**

MANAGEMENT DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2004

The increase in the general and special obligation bonds and others debts is due to the recording of debts with Municipal Revenue Collection Center (CRIM) for old tax liens accounts repurchased and refinanced with third parties, the Christmas bonus accrual of \$324,219, the issuance of payment plan (debt refinancing) with the P.R. Water and Sewer Authority for \$58,923 and the recording of a past digitalization debt assumed by the municipality in behalf of CRIM LIMS Agreement for \$416,394. More detailed information about the Municipality's long term liabilities is presented in Notes 7 and 8 to the financial statements.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

The Municipality's selected and appointed officials considered many factors when setting the fiscal year 2004-2005 budget. One of these factors is the economy. Among economic areas considered are the population growth estimates, personal income, housing statistics and unemployment rates. The Municipality's unemployment rate now stands at 12.8%, which compares with the Commonwealth rate of 12.4%.

The Municipality applied a conservative approach in development budget estimates. Amounts available for appropriations in the General Fund for the fiscal year 2005 are \$11,249,218, an increase of approximately 11.25% with respect to prior year estimates. Budgeted expenditures are expected to rise accordingly to the increase of budgeted revenues. Among planned projects, this budget included an increase in salaries to employees of approximately \$704,412, the creation of two municipal departments for approximately \$449,506, increase of medical plans benefits and an increase from \$750 to \$1,000 in Christmas bonus to all Municipal employees. If these estimates are realized, the Municipality's budgetary general fund balance is expected to increase by approximately \$881,000 by the close of 2005 fiscal year.

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 demonstrate the Municipality's accountability for the money it receives. If you have questions about this report or need additional information, contact the Municipality's Director of Finance CPA Jason D. León at P.O. Box 507, Isabela, Puerto Rico 00602.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO

STATEMENT OF NET ASSETS

JUNE 30, 2004

	GOVERNMENTAL ACTIVITIES
ASSETS:	
Cash and Investments.....	\$ 9,058,221
Receivables:	
Federal Grant	3,058,938
Others.....	666,468
Commonwealth Government.....	1,056,970
Restricted Assets:	
Cash	3,217,625
Cash with Fiscal Agent.....	1,615,161
Deferred Charges.....	28,920
Inventories and Supplies	<u>174,956</u>
Capital Assets (Notes 1 & 6):	
Land, Improvements, and Construction in Progress.....	6,849,813
Other Capital Assets, Net of Depreciation].....	<u>21,012,697</u>
Total Capital Assets.....	<u>27,862,510</u>
TOTAL ASSETS	<u>46,739,769</u>
LIABILITIES:	
Accounts Payable and Accrued Liabilities.....	1,123,827
Interest Payable	153,194
Due to:	
Commonwealth Government.....	573,543
Federal Government.....	12,722
Deferred Revenues:	
Municipal Licenses Taxes.....	1,608,525
Federal Grants.....	40,964
Other.....	101,870
Long-Term Liabilities (Note 7):	
Due within One Year	1,122,005
Due in More than One Year.....	<u>11,811,226</u>
Total Liabilities	<u>16,547,876</u>
NET ASSETS	
Invested in Capital Assets, Net of Related Debt.....	26,419,265
Restricted for:	
Capital Projects.....	7,833,003
Debt Service	1,468,887
Other Specific Purposes	227,955
Unrestricted (Deficit).....	<u>(5,757,217)</u>
TOTAL NET ASSETS	<u>\$30,191,893</u>

See accompanying Notes to Basic Financial Statements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO

STATEMENT OF ACTIVITIES

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

FUNCTIONS/PROGRAMS	EXPENSES	PROGRAM REVENUES			NET (EXPENSE) REVENUE
		CHARGES FOR SERVICES	OPERATING GRANTS AND CONTRIBUTIONS	CAPITAL GRANTS AND CONTRIBUTIONS	
Governmental Activities:					
General Government.....	\$ 5,613,090	\$ 1,435,148	\$ 1,149,286	\$ -	(\$ 3,028,656)
Public Safety.....	799,840	-	-	2,136,049	1,336,209
Public Works and Sanitation.....	3,461,606	352,320	-	-	(3,109,286)
Health.....	2,542,610	-	-	-	(2,542,610)
Housing, Welfare and Community Development.....	1,839,645	-	1,608,117	-	(231,528)
Culture and Recreation.....	913,705	-	-	-	(913,705)
Education.....	856,873	-	-	-	(856,873)
Interest on Long-Term Debt.....	329,336	-	-	-	(329,336)
Total Governmental Activities.....	<u>\$16,356,705</u>	<u>\$ 1,787,468</u>	<u>\$ 2,757,403</u>	<u>\$ 2,136,049</u>	<u>(9,675,785)</u>
General Revenues:					
Property Taxes.....					4,711,064
Municipal License Taxes.....					2,057,207
Grants and Contributions not Restricted to Specific Programs....					12,564,014
Interest.....					176,373
Other.....					1,167,619
Special Items:					
Property Taxes – Amnesty.....					562,786
Loss on Disposition of Capital Assets.....					(251,298)
Legal Case Settlement – PREPA.....					704,558
Total General Revenues and Special Items.....					<u>21,692,323</u>
CHANGE IN NET ASSETS.....					12,016,538
Net Assets – Beginning of Year, as Restated (Note 15).....					<u>18,175,355</u>
NET ASSETS – ENDING OF YEAR.....					<u>\$30,191,893</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO**

BALANCE SHEET – GOVERNMENTAL FUNDS

JUNE 30, 2004

	<u>GENERAL</u>	<u>CDBG FUND</u>	<u>DEBT SERVICE FUND</u>	<u>OTHER GOVERNMENTAL FUNDS</u>	<u>TOTAL GOVERNMENTAL FUNDS</u>
ASSETS					
Cash and Investments (Note 1).....	\$ 8,442,117	\$ 2,198	\$ -	\$ 613,976	\$ 9,058,221
Receivables, net:					
Federal Grants.....	-	2,998,976	-	59,962	3,058,938
Other.....	518,877	-	48,620	32,471	599,968
Due from Commonwealth Government.....	1,056,970	-	-	-	1,056,970
Due from Other Funds.....	385,560	-	-	-	385,560
Inventories and Supplies.....	174,956	-	-	-	174,956
Restricted Assets:					
Cash.....	3,217,625	-	-	-	3,217,625
Cash with Fiscal Agents.....	2,800	-	1,571,397	40,964	1,615,161
Total Assets.....	<u>13,798,905</u>	<u>3,001,104</u>	<u>1,620,017</u>	<u>747,373</u>	<u>19,167,399</u>
LIABILITIES AND FUND BALANCES					
Accounts Payable and Accrued Liabilities.....	767,270	333,086	-	121,207	1,221,563
Matured Bonds and Interest Payable.....	-	-	837,635	-	837,635
Due to Commonwealth Government.....	475,807	-	-	-	475,807
Due to Federal Government.....	12,722	-	-	-	12,722
Due to Other Funds.....	-	112,610	-	272,950	385,560
Deferred Revenues:					
Municipal License Taxes.....	1,608,525	-	-	-	1,608,525
Property Taxes.....	95,336	-	-	-	95,336
Federal Grants.....	-	2,555,408	-	40,964	2,596,372
Other.....	722,459	-	-	-	722,459
Total Liabilities.....	<u>3,682,119</u>	<u>3,001,104</u>	<u>837,635</u>	<u>435,121</u>	<u>7,955,979</u>
Fund Balances:					
Reserve For:					
Encumbrances.....	439,040	-	-	-	439,040
Debt Service.....	-	-	782,382	-	782,382
Capital Projects.....	4,858,819	-	-	211,830	5,070,649
Other Specific Purposes.....	127,533	-	-	100,422	227,955
Unreserved					
Designated for Future Expenditures.....	2,286,999	-	-	-	2,286,999
Undesignated.....	2,404,395	-	-	-	2,404,395
Total Fund Balances.....	<u>10,116,786</u>	<u>-</u>	<u>782,382</u>	<u>312,252</u>	<u>11,211,420</u>
TOTAL LIABILITIES AND FUND BALANCES.....	<u>\$13,798,905</u>	<u>\$ 3,001,104</u>	<u>\$ 1,620,017</u>	<u>\$ 747,373</u>	<u>\$19,167,399</u>

See accompanying Notes to Basic Financial Statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO**

**RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET
TO THE STATEMENT OF NET ASSETS**

JUNE 30, 2004

Total Fund Balances – Governmental Funds (Page 19)		\$11,211,420
Amounts reported for Governmental Activities in the Statement of Net Assets (Page 17) are different because:		
Capital Assets used in governmental activities are not financial resources and therefore are not reported in the funds.....		27,862,510
Other Assets used in governmental activities are not financial resources and therefore are not reported in the funds		
Deferred Charges		28,920
Other Assets are not available to pay for current-period expenditures and therefore are deferred in the funds:		
Municipal Revenue Collection Center.....	\$ 95,336	
Business Permits Receivable	120,000	
Christmas Bonus.....	150,589	
Grants from PR Department of Recreation and Sports	66,500	
Grants from Solid Waste Authority of Puerto Rico.....	350,000	
Federal Grants – CDBG.....	<u>2,555,408</u>	3,337,833
Interest liabilities are not due and payable in the current period and therefore are not reported in the funds.....		(20,559)
Some Long-Term Liabilities are not due and payable in the current period and therefore are not reported in the funds. Those liabilities consist of:		
General Obligation Bonds and Notes	5,988,363	
Compensated Absences.....	1,385,268	
Municipal Solid Waste Debt.....	3,722,789	
Note payable to Municipal Revenue Collection Center for Financing of Delinquent Accounts	332,275	
Christmas Bonus.....	324,219	
Note Payable to Puerto Rico Aqueduct and Sewer Authority (PRASA)	58,923	
Note Payable to Municipal Revenue Collection Center – LIMS.....	<u>416,394</u>	<u>(12,228,231)</u>
Total Net Assets of Governmental Activities (Page 17)		<u>\$30,191,893</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO**

**STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE –
GOVERNMENTAL FUNDS**

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

	GENERAL	CDBG FUND	DEBT SERVICE FUND	OTHER GOVERNMENTAL FUNDS	TOTAL GOVERNMENTAL FUNDS
REVENUES					
Property Taxes	\$ 3,771,159	\$ -	\$ 1,036,507	\$ -	\$ 4,807,666
Municipal License Taxes	2,057,207	-	-	-	2,057,207
Intergovernmental:					
Commonwealth Government.....	10,650,665	-	-	277,894	10,928,559
Federal Government.....	-	1,613,101	-	899,131	2,512,232
Fees, Fines and Charges for Service.....	2,314,558	-	-	-	2,314,558
Interest.....	151,715	-	10,718	-	162,433
Other.....	13,940	-	-	-	13,940
Total Revenues.....	<u>18,959,244</u>	<u>1,613,101</u>	<u>1,047,225</u>	<u>1,177,025</u>	<u>22,796,595</u>
EXPENDITURES					
Current:					
General Government	6,231,924	162,411	-	-	6,394,335
Public Safety.....	761,238	-	-	66,812	828,050
Public Works and Sanitation.....	2,152,711	-	-	51	2,152,762
Culture and Recreation.....	666,474	-	-	93,116	759,590
Health	2,553,086	-	-	-	2,553,086
Housing, Welfare and Community Development.....	1,425,082	126,600	-	417,950	1,969,632
Education.....	-	-	-	854,357	854,357
Capital Outlay	248,461	1,324,090	-	-	1,572,551
Debt Service:					
Principal.....	-	-	733,976	-	733,976
Interest.....	-	-	303,438	-	303,438
Total Expenditures.....	<u>14,038,976</u>	<u>1,613,101</u>	<u>1,037,114</u>	<u>1,432,286</u>	<u>18,121,777</u>
OTHER FINANCING SOURCES (USES)					
Proceeds – Note Payable PRASA.....	105,629	-	-	-	105,629
Transfers – In.....	9,898	-	54,250	-	64,148
Transfers – Out.....	(54,250)	-	(9,898)	-	(64,148)
Total Other Financing Sources and Uses	<u>61,277</u>	<u>-</u>	<u>44,352</u>	<u>-</u>	<u>105,629</u>
Special Items:					
Property Taxes – Amnesty	459,783	-	103,003	-	562,786
Case Settlement – PREPA.....	704,558	-	-	-	704,558
Total Special Items.....	<u>1,164,341</u>	<u>-</u>	<u>103,003</u>	<u>-</u>	<u>1,267,344</u>
Net Change in Fund Balances.....	6,145,886	-	157,166	(255,261)	6,047,791
Fund Balance – Beginning, as Restated (Note 15)	<u>3,970,900</u>	<u>-</u>	<u>625,216</u>	<u>567,513</u>	<u>5,163,629</u>
FUND BALANCES – ENDING	<u>\$10,116,786</u>	<u>\$ -</u>	<u>\$ 782,382</u>	<u>\$ 312,252</u>	<u>\$11,211,420</u>

See accompanying Notes to Basic Financial

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO**

**RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES
IN FUND BALANCE OF GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES**

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

Net Change in Fund Balances – Total Governmental Funds (Page 21)		\$ 6,047,791
Amounts reported for Governmental Activities in the Statement of Activities (Page 18) are different because:		
Governmental funds report capital 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. In the current period, these amounts are:		
Expenditures for Capital Assets.....	\$ 1,412,687	
Current Year Depreciation	<u>(672,994)</u>	739,693
Governmental funds only report the proceeds received in the disposal of assets. In the Statement of Activities, a gain or loss is reported for each disposal. Thus, the change in net assets differs from the change in fund balance by the cost of the disposed asset.....		(251,298)
Revenues in the Statement of Activities that do not provide current financial resources are not reported as revenues in the governmental funds:		
Municipal Revenue Collection Center.....	95,336	
Business Permits Receivable	120,000	
Christmas Bonus.....	150,589	
Grants from PR Department of Recreation and Sports	66,500	
Grants from Solid Waste Authority of Puerto Rico.....	350,000	
Donated Capital Assets	<u>4,452,516</u>	5,234,941
Revenues reported in governmental funds which are not reported as revenues in the Statement of Activities:		
Municipal Revenue Collection Center.....	(191,938)	
Christmas Bonus.....	(118,949)	
CDBG revenues	<u>(363,452)</u>	(674,339)
Proceeds from note payable to Puerto Rico Aqueduct and Sewer Authority (PRASA) is an other financing source in the governmental funds, but an increase of long-term liabilities in the Statement of Activities		(105,629)
Expenditures reported in governmental funds which are not reported as expenses In the Statement of Activities:		
Mature bonds principal payments (net change).....	(200,000)	
Other Long-Term Liabilities.....	<u>438,087</u>	238,087
Repayment of long-term debt is an expenditure reported in the governmental funds, but reduces long-term liabilities in the Statement of Activities:		
General and Special Obligations	728,945	
Other	<u>466,333</u>	1,195,278
Some expenses reported in the Statement of Activities do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds.		
Compensated Absences	100,000	
Municipal Solid Waste Landfill	(179,349)	
Christmas Bonus.....	(324,219)	
Accrued Interest (net change).....	802	
Amortization of Deferred Charges	<u>(5,220)</u>	(407,986)
Change in Net Assets of Governmental Activities (Page 18)		<u>\$12,016,538</u>

See accompanying Notes to this financial statement.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO**

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The **Municipality of Isabela, Puerto Rico (Municipality)** was founded in the year 1819, and operates as a governmental unit of the Commonwealth of Puerto Rico, under the Law Number 81 of August 30, 1991, known as "Autonomy Municipalities Law of the Commonwealth of Puerto Rico". The governmental system of the **Municipality** is composed of the executive and legislative bodies. The Mayor is the Chief Executive Officer and is elected every four years in the general elections of the Commonwealth of Puerto Rico. The legislative body consists of 14 Legislators also elected in the general elections of Puerto Rico for a four-year period.

The **Municipality** provides services such as: health, public works, sanitation, aids and services to low-income and elderly citizens, public safety, housing and urban development, culture and recreation, planning, zoning and other general and administrative services.

The accounting policies of the **Municipality** conform to accounting principles generally accepted in the United States of America as applicable to governmental units. The following is a summary of the more significant of such policies.

The accompanying basic financial statements of the **Municipality** have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) as prescribed by the Governmental Accounting Standards Board (GASB). The GASB is the standard-setting body for governmental accounting and financial reporting. The GASB periodically updates its codification of the existing Governmental Accounting and Financial Reporting Standards which, along with subsequent GASB pronouncements (Statements and Interpretations) constitutes GAAP for governmental units.

In June 1999, the GASB issued Statement Number 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*. This statement establishes new financial reporting requirements for state and local governments. The **Municipality** adopted the provisions of GASBS No. 34 as well as other statements referred to below as of July 1, 2002. They require new information and restructure much of the information that governments have presented in the past.

Comparability with reports issued in prior years is affected. With the implementation of GASBS No. 34, the **Municipality** has prepared required supplementary information titled Management's Discussion and Analysis, which precedes the basic financial statements.

As previously mentioned, other GASB Statements and Interpretations were required to be implemented in conjunction with GASBS No. 34. Therefore, the **Municipality** has implemented the following GASB Statements in the fiscal year 2002-2003: GASBS No. 37, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments: Omnibus*, GASBS No. 38, *Certain Financial Statement Note Disclosures*, GASBS No. 39, *Determining Whether Certain Organizations Are Component Units*, GASBS No. 41, *Budgetary Comparison Schedules - Perspective Differences*, and GASBS Interpretation No. 6, *Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements*.

The accompanying basic financial statements present the financial position and the results of operations of the **Municipality** and its various funds and fund types. The basic financial statements are presented as of June 30, 2004, and for the fiscal year then ended. The more significant of these accounting policies are described below and, where appropriate, subsequent pronouncements will be referenced.

A. Financial Reporting Entity

The accompanying basic financial statements include all departments and organizations units whose funds are under the custody and control of the **Municipality**. In evaluating the **Municipality** as a reporting entity, management has addressed all the potential component units. The decision to include a potential component unit in the reporting entity was made by applying the provisions of GASBS No. 14, as amended by GASBS No. 39.

The basic criteria for including a potential component unit within the reporting entity is if potential component units are financially accountable and other organizations for which the nature and significance of their relationship with the entity are such that exclusion would cause the **Municipality's** financial statements to be misleading or incomplete. The GASB has 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) 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**.

The relative importance of each criteria must be evaluated in light of specific circumstances in order to determine which components units are to be included as part of the reporting entity. Our specific evaluations of the criteria applicable to the **Municipality** indicate no organizations meet the criteria to be included as component units. Accordingly, these basic financial statements present only the **Municipality** as the reporting entity.

These financial statements present the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information of the **Municipality**, as of June 30, 2004, and the respective changes in financial position, where applicable, thereof for the fiscal year then ended.

B. Measurement Focus and Basis of Accounting

Government-wide Financial Statements

The government-wide financial statements (**the Statement of Net Assets and the Statement of Activities**) are reported using the economic resources measurement focus and the accrual basis of accounting. Revenue is recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grant and similar items are recognized as revenue as soon as all eligibility requirements have been met.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(continuation)

B. Measurement Focus and Basis of Accounting (continuation)

Governmental Fund Financial Statements

The governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recorded when susceptible to accrual; as soon as it is both measurable and available. "Available" means collectible within the current period or soon enough thereafter, normally within sixty (60) days, to be used to pay liabilities of the current period. Expenditures are generally recognized when the related liability is incurred.

The exception to this general rule is the principal and interest on general obligation long-term debt and compensated absences, if any, are recognized when due.

In applying the "susceptible to accrual" concept to intergovernmental revenues (federal grants) pursuant to GASBS No. 33, *Accounting and Financial Reporting for Nonexchange Transactions* (the Municipality may act as either provider or recipient), the provider should recognize liabilities and expenses and the recipient should recognize receivables and revenue when the applicable eligibility requirements including time requirements, are met. Resources transmitted before the eligibility requirements are met should, under most circumstances, be reported as advances by the provider and deferred revenue by the recipient.

There are essentially two types of revenue. For the majority of grants, moneys must be expended by the Municipality on the specific purpose or project before any amounts will be reimbursed. Revenue is, therefore, recognized as expenditures are incurred to the extent available. For the other revenue, moneys are virtually unrestricted and are generally revocable only for failure to comply with prescribed compliance requirements. These resources are reflected as revenue at the time of receipt or earlier if the susceptible to accrual criteria is met. Expenditures are generally recorded when a liability is incurred, as under accrual accounting. Modifications to the accrual basis of accounting include the following:

- Employee's vested annual vacation and sick leave is recorded as expenditure when utilized. The amount of accumulated annual vacation and sick leave unpaid at June 30, 2004, has been reported only in the government-wide financial statements.

C. Financial Statement Presentation

The basic financial statements include both government-wide (based on the Municipality as a whole) and fund financial statements. While the previous financial reporting model emphasized fund types (the total of all funds of a particular type), in the new financial model the focus is on either the Municipality as a whole, or major individual funds (within the basic financial statements). Both the government-wide and fund financial statements (within the basic financial statements) categorize primary activities as either governmental or business type.

Government-wide Financial Statements

The government-wide financial statements (the **Statement of Net Assets** and the **Statement of Activities**) report information of all the activities of the Municipality. For most part, the effect of interfund activity has been removed from these government-wide financial statements. Governmental activities, which normally are supported by taxes and intergovernmental revenues, are reported separately from business-type activities, which rely to a significant extent on fees and charges for support.

The focus of the **Statement of Net Assets** is designed to be similar to bottom line results for the Municipality and its governmental activities. This statement, for the first time, combines and consolidates governmental fund's current financial resources (short-term spendable resources) with capital assets and long-term obligations.

The **Statement of Net Assets** presents the reporting entities' assets and liabilities, with the difference reported as net assets. Net assets are reported in three categories:

- **Invested in Capital Assets, Net of Related Debt** – These consists of capital assets, net of accumulated depreciation and amortization and reduced by outstanding balances for bonds, notes, and other debt that are attributed to the acquisition, construction, or improvement of those assets.
- **Restricted Net Assets** – These result when constraints placed on net assets use are either externally imposed by creditors, grantors, contributors, and the like, or imposed by law through constitutional provisions or enabling legislation.
- **Unrestricted Net Assets** – These consist of net assets which do not meet the definition of the two preceding categories. 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 on resources that are imposed by management, but can be removed or modified.

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

The **Statement of Activities** is focused on both the gross and net costs per functional category. The statement reduces gross expenses (including depreciation) by related program revenues, operating and capital grants. This is intended to summarize and simplify the user's analysis of cost of various governmental services.

Governmental Fund Financial Statements

The fund financial statements (the **Balance Sheet**, the **Statement of Revenues, Expenditures, and Changes in Fund Balances**, the **Statement of Net Assets**) are, in substance, very similar to the financial statements presented in the previous financial reporting model. Emphasis here is on the major funds in the governmental category. Non-major funds are summarized into a single column.

continue

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(continuation)

C. Financial Statement Presentation (continuation)

Traditional users of governmental financial statements will find the Fund Financial Statements presentation more familiar. The focus is on Major Funds, rather than the previous financial model's fund types. The Governmental Major Fund Statements are presented on current financial resources and modified accrual basis of accounting.

This is the manner in which these funds are normally budgeted. This presentation deemed most appropriate to (a) demonstrate legal and covenant compliance, (b) demonstrate the source and use of liquid resources, and (c) demonstrate how the Municipality's actual experience conforms to the budgeted fiscal plan.

Since the governmental fund statements are presented in different measurement focus and basis of accounting than the government-wide statements, reconciliation is presented and separate explanation for each differences.

The Municipality reports its financial position (**Balance Sheet**) and results of operations (**Statement of Revenues, Expenditures and Changes in Fund Balance**) in funds, which are considered separate accounting entities. The operations of each fund are accounted for within a set of self-balancing accounts. Fund accounting segregates funds according to their intended purpose and is used to aid management in demonstrating compliance with legal, financial, and contractual provisions.

The new model as defined in GASBS No. 34 established criteria (percentage of the assets, liabilities, revenues, or expenditures/expenses of either fund category in the governmental fund) for the determination of major funds. The non-major funds are combined in a single column in the fund financial statements. The Municipality reports the following major fund:

General Fund – This is the general operating fund of the Municipality. It is used to account for all financial resources, except those required to be accounted for in another fund.

Debt Service Fund – This is used to account for the accumulation of resources for, and the payment of long-term debt principal and interests

Community Development Block Grant Program Fund (CDBG) – This is the fund used to account for all the transactions of the State Community Development Block Grant Program. The primary objectives of this program is to development of viable communities by providing decent housing, a suitable living environment and expanded economic opportunities, principally for persons of low and moderate income.

GASBS No. 34 eliminates the presentation of Account Groups, but provides for these records to be maintained and incorporates the information into the Governmental column in the government-wide **Statement of Net Assets**.

D. Budgetary Data

The Municipality's annually adopts the Budget Resolution for all operating funds of the Municipality except for certain restricted accounts of Proprietary Funds and Special Revenue Funds. Budgetary control is legally maintained at the fund level. The budget is prepared using the modified accrual basis of accounting with encumbrance included as budgetary basis expenditures. The Municipality's Budget Resolution provides transfer authority (1) to the Mayor and the Management and Budget Director, within and between departments and funds, as long as the total budget of the Municipality (net of interfund transfers) is not increased; (2) to the Management and Budget Director to implement grant budgets as the grant applications are accepted by the Municipality; and (3) to the Management and Budget Director to amend (re-appropriate) each new year's budget, to the extent of outstanding encumbrances, and/or unexpended project/grant appropriations at year end. Municipality's Legislature action is required for (1) use of the budgeted Legislature contingency, and (2) the approval of a supplemental appropriation(s). During the year, several supplemental appropriations were necessary.

The budget columns (original and final budgets) of the Budgetary Comparison – General Fund reflect the original budget and the amended budget (which have been adjusted for legally authorized revisions of the annual budgets during the year). Appropriations, except remaining project appropriations, encumbrances, and unexpended grant appropriations, lapse at the end of each fiscal year.

Amendments to the budget, including transfers, require the approval of the Municipal Legislature. Unencumbered appropriations lapse at the end of the next fiscal year. The Municipality follows these procedures, in accordance with law, in order to establish the budgetary data reflected in the basic financial statements:

1. Prior of May 15 of each fiscal year, the Mayor submits to the Municipal Legislature a proposed budget for the fiscal year commencing the following July 1 in addition of a budget message.
2. The budget document is available for public inspection prior to its approval by the Municipal Legislature.
3. The Commissioner of Municipal Affairs examines the budget to verify if it complied with the law's standards and sends it to the Mayor for any comments or recommendation before the limited date establishes by the Law.
4. Prior to June 13, the annual budget is legally enacted through passage of the annual appropriation ordinance.
5. If a budget is not adopted prior to the end of the end of the fiscal year, the annual budget for the preceding fiscal year, as approved by the Municipal Legislature and the Mayor, is automatically renewed for the ensuing fiscal year until a new budget is approved. This permits the Municipality to continue making payments for its operating and other expenses until the new budget is approved.

continue

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO
NOTES TO THE BASIC FINANCIAL STATEMENTS**

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

**NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(continuation)**

D. Budgetary Data (continuation)

6. Subsequent to the enactment of the annual appropriation ordinance, the Municipal Legislature has the authority to make necessary amendments made during the fiscal year and are reflected in the budget information included in the Budgetary Comparison Schedule – General Fund.

Since the budgetary basis differs from accounting principles generally accepted in the United States of America (GAAP), actual amounts for the General Fund in the accompanying Budgetary Comparison Schedule, is presented on the budgetary basis to enhance comparability.

The principal differences between the budgetary and GAAP bases are the following:

1. Encumbrances are recorded as expenditures under the budgetary basis and as a reserve of fund balances under GAAP.
2. The non-exonerated portion of the property tax advances are presented as revenue in the budgetary basis and as other financing sources under GAAP (See Note 9).
3. Interfund transactions of the General Funds are not included in the budgetary basis.
4. Certain accrued liabilities and other debts are not included in the budgetary basis.
5. Certain revenues susceptible to accrual, i.e., both measurable and available, are not included in the budgetary data.

All encumbrance appropriations in the operating budget lapse at the end of the fiscal year. Property taxes collected during the current year by the Municipal Revenue Collection Center (Fiscal Agent) are presented as revenues in the accounting basis but are not considered in the budgetary schedule.

The special funds of the Special Revenue Fund have not been included in the budgetary comparison because balances are not budgeted. Also the budget prepared for the Federal Finance Awards Programs included in the Capital Projects and Special Revenue Funds is based on a program period which is not necessarily a year. Accordingly, it's not practical to present an annual comparison of budget for such programs.

E. Cash, Cash Equivalent and Investment

The Director of Finance of the Municipality is responsible for investing the available resources in certificates of deposit and other short-term investments. Investments are made from the available combined funds of the Municipality and, accordingly, it is not practical to disclose certificates of deposit and other short-term investments individually by fund in the combined financial statements. Interest earned on certificates of deposit and other short-term investments are recognized as revenue in the General Fund. Cash in the Special Revenue, Debt Service and

Capital Project Funds are restricted; accordingly, resources available were not used for pool investments.

Cash with fiscal agent represents property tax collections retained by the Municipal Revenues Collection Center and undisbursed proceeds of certain bonds, loans or grants which are maintained in a cash custodian account by the Government Development Bank of the Commonwealth of Puerto Rico.

Cash balance recognized in the Debt Service Fund is restricted for the payment of the Municipality's obligations, and others are restricted for specific projects, such as the acquisition or construction of permanent improvements. This sinking fund is maintained by the Governmental Development Bank of Puerto Rico, agency which acts as the insurer and payer of the Municipality's bonds and notes issued in accordance with law.

F. Receivable

Receivable are stated nets of estimated allowances for uncollectible accounts, which are determined upon past collection experience and current economic conditions. Receivable from Federal Government represents amounts owed to the Municipality for reimbursement of expenditures incurred pursuant to federally funded programs.

G. Inventories

The General, Special Revenue and Capital Project Funds, purchases office and printing supplies, gasoline, oil and other expendable supplies held for consumption. The cost of purchases is recorded as expenditure in the appropriate fund and the inventory is not recorded in the basic financial statements. Only inventory medicine and medical supplies of the Isabelina Advance Medical Center in the amount of \$174,956 are included in the financial statements.

H. Capital Assets

Property, plant and equipment purchased or acquired is carried at historical cost or estimated historical cost. Contributed assets are recorded at fair market value as of the date received. The Municipality's capitalization levels are \$500 on personal property. For improvements other than buildings, the capital outlay must be greater than \$10,000, extend the estimated useful life for ten years, and be greater than 10% of the original cost of the asset. Other costs incurred for repairs and maintenance is expensed as incurred.

Depreciation on all assets is provided on the straight-line basis over the following estimated useful lives: (See Table 1)

TABLE 1	
CAPITAL ASSETS	YEARS
Buildings	50
Improvement Other Than Buildings	50
Infrastructure	10-50
Vehicles	5
Machinery and Equipment	5-10

continue

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(continuation)

I. Compensated Absences

The **Municipality** accrues accumulated unpaid vacation and sick leave and associated employee-related costs when earned (or estimated to be earned) by the employee. The **Municipality's** employees are granted 30 days of vacations and 18 days of sick leave annually. Vacations may be accumulated up to a maximum of sixty (60) days and sick leave up to a maximum of ninety (90) days. In the event of employee resignation, the employee is paid for accumulated vacation days up to the maximum allowed. Separation from employment prior to use of all or part of the sick leave terminates all rights for compensation, except for employees with ten years of service who are entitled to sick leave pay up to the maximum allowed. The **Municipality** accrued a liability for compensated absences, which meet the following criteria:

1. The **Municipality's** obligation relating to employee's rights to receive compensation for future absences is attributable to employee's services already rendered.
2. The obligation relates to rights that vest or accumulate.
3. Payment of the compensation is probable.
4. The amount can be reasonably estimated.

In accordance with the above criteria and requirements as established by GASBS No. 16; the **Municipality** has accrued a liability for compensated absences, which has been earned but not taken by **Municipality's** employees. For the government-wide statements, the current portion is the amount estimated to be used in the following year. For the governmental funds statements, all of the compensated absences are considered long-term and therefore, are not a fund liability and represents a reconciling item between the fund level and government-wide presentations (see Note 7).

J. Insurance

The **Municipality** has insurance coverage for its public facilities, primarily to provide protection from catastrophic losses. Also, principal officials of the **Municipality** are covered under various surety bonds. The Secretary of the Treasury Department of the Commonwealth of Puerto Rico is the agent commissioned to place all of the **Municipality's** insurance coverage. Corresponding premiums payable are withheld by the Municipal Revenue Collection Center from quarterly advances of annual property tax and subsidy sent to the **Municipality**.

K. Interfund Transactions

Interfund transactions are reflected as loans, reimbursements or transfers. Loans are reported as receivables and payables as appropriate and are subject to elimination upon consolidation. Reimbursements occur when one fund incurs a cost, charges the appropriate benefiting fund and reduces its related cost as a reimbursement. All other interfund transactions are treated as transfers. Transfers between governmental funds are netted as part of the reconciliation to the government-wide

columnar presentation. The **Municipality** has the following types of transactions among funds:

Interfund Transfers – Legally required transfers that are reported when incurred as transfers-in by the recipient fund and as transfers-out by the disbursing fund, with receivables and payables presented as amounts due to and due from other funds. Advances between funds are also presented as amounts due to and due from other funds. However, these transfers and related amounts receivables and payables are considered internal balances and activities that have been eliminated in the government-wide financial statements.

L. Reservations of Fund Balance – Governmental Funds

The governmental fund financial statements present fund balance reserves for those portions of fund balance (1) not available for appropriation for expenditures or (2) legally segregated for a specific future use. The reserves for related assets such as inventories and prepayments are examples of the former. Reserves for debt service and other specific purposes are examples of the latter.

M. Claims and Judgments

The estimated amount of the liability for claims and judgments, if any, which is due on demand, such as from adjudicated or settled claims, is recorded in the General Fund. The Long-Term Liabilities includes an amount estimated as a contingent liability or liabilities with a fixed or expected due date, which will require future available financial resources for its payment.

N. Use of Estimates

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

NOTE 2 CASH, CASH EQUIVALENTS AND INVESTMENTS

Investments consist of certificates of deposit. The **Municipality's** cash, cash equivalent and investments at year-end were entirely covered by the Federal Deposit Insurance Corporation (FDIC) coverage, up to a maximum of \$100,000 in each bank, and the excess by collateral provided by the banks and held by the Department of the Treasury pursuant the applicable laws and regulations. Cash with fiscal agent is maintained in interest bearing accounts in the Government Development Bank of Puerto Rico and is not collateralized.

Puerto Rico laws authorize governmental entities to invest in direct obligations or obligations guaranteed by the federal government or the Commonwealth of Puerto Rico. The **Municipality** is also allowed to invest in bank acceptances, other bank obligations and certificates of deposit in financial institutions authorized to do business under the federal and Commonwealth laws.

continue

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO**

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

**NOTE 2 CASH, CASH EQUIVALENTS AND INVESTMENTS
(continuation)**

During the year, the **Municipality** invested its funds in interest bearing bank accounts and short-term certificates of deposit. As June 30, 2004, the market value of investments recorded in General Fund approximated its carrying value as follow: (See Table 2)

CERTIFICATE OF DEPOSIT ISSUED BY	PRINCIPAL NUMBER	INTEREST AMOUNT	RATE	TABLE 2 EXPIRATION DATE
Popular Bank of Puerto Rico ...	1110000023	\$1,031,537	1.80%	08-07-04
Popular Bank of Puerto Rico ...	1110000025	469,860	1.80%	08-09-04
Popular Bank of Puerto Rico ...	1110000026	313,535	1.80%	08-09-04
Popular Bank of Puerto Rico ...	1110000027	1,735,841	1.60%	09-07-04
Popular Bank of Puerto Rico ...	1110000031	207,132	1.80%	12-09-04
Popular Bank of Puerto Rico ...	1110000032	209,617	1.80%	12-09-04
Popular Bank of Puerto Rico ...	1110000033	1,000,000	1.60%	09-13-04
Popular Bank of Puerto Rico ...	1110000034	301,180	1.55%	09-13-04
Popular Bank of Puerto Rico ...	1110000035	<u>700,000</u>	1.80%	12-15-04
TOTAL		<u>\$5,968,702</u>		

NOTE 3 OTHERS RECEIVABLES

As of June 30, 2004, this amount consist of the following: (See Table 3)

TABLE 3	AMOUNT
Levy – Villa Pesquera Apartment	\$101,870
PR Treasury Department.....	107,660
Patents.....	7,671
Construction Taxes.....	120,000
Plaza del Mercado	4,128
Other (Special Funds).....	11,530
Interests	15,429
Christmas Bonus.....	<u>150,589</u>
TOTAL	<u>\$518,877</u>

NOTE 4 INTERFUND TRANSFER AND BALANCES

A. INTERFUND TRANSFERS

Transfers are indicative of funding for capital projects or debt service, and subsidies of various operations. (See Table 4)

INTERFUND TRANSFERS WITHIN THE GOVERNMENTAL FUNDS			TABLE 4
SOURCES	TRANSFER TO	AMOUNT	PURPOSE
Debt Service Fund	General Fund	\$ 9,898	Interests
General Fund	Debt Service	<u>54,250</u>	Debt payment
TOTAL		<u>\$64,148</u>	

B. INTERFUND RECEIVABLE AND PAYABLE BALANCES

Interfund receivables and payables at June 30, 2004 are summarized as follows: (See Table 5)

INTERFUND RECEIVABLE	INTERFUND PAYABLE	TABLE 5 AMOUNT
General Fund	SBCP	\$112,610
General Fund	Other Governmental Fund	<u>272,950</u>
TOTAL		<u>\$385,560</u>

NOTE 5 DUE TO COMMONWEALTH GOVERNMENT

As of June 30, 2004, balance due to Commonwealth of Puerto Rico's entities of the General Fund for services rendered to the **Municipality**, consists of the following: (See Table 6)

TABLE 6	AMOUNT
Department of Labor	\$435,253
PR Aqueduct and Sewer Authority.....	<u>40,554</u>
Total Due to Governmental Units	<u>\$475,807</u>

**COMMONWEALTH OF PUERTO RICO
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NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

NOTE 6 CAPITAL ASSETS

Capital Assets activities for the fiscal year ended June 30, 2004 was as follows: (See Table 7)

TABLE 7	BALANCE JULY 1, 2003	ADJUSTMENTS	ADDITIONS	RETIREMENTS	BALANCE JUNE 30, 2004
Non-Depreciable Capital Assets:					
Land	\$ 1,537,443	\$ 292,500	\$ 1,838,646	\$ -	\$ 3,668,589
Construction in Progress	-	46,960	3,134,264	-	3,181,224
Total Non-Depreciable Capital Assets	<u>1,537,443</u>	<u>339,460</u>	<u>4,972,910</u>	<u>-</u>	<u>6,849,813</u>
Depreciable Capital Assets:					
Buildings	9,331,733	(14,800)	-	-	9,316,933
Buildings Improvements	-	428,546	-	-	428,546
Infrastructure	9,411,504	-	621,539	(282,046)	9,750,997
Machinery and Equipment	<u>5,732,520</u>	<u>(112,856)</u>	<u>270,754</u>	<u>(15,341)</u>	<u>5,875,077</u>
Total Depreciable Capital Assets	<u>24,475,757</u>	<u>300,890</u>	<u>892,293</u>	<u>(297,387)</u>	<u>25,371,553</u>
Less Accumulated Depreciation:					
Buildings	(907,787)	264	(167,705)	-	(1,075,228)
Buildings Improvements	-	-	(3,597)	-	(3,597)
Infrastructure	(1,092,182)	(2)	(170,767)	39,444	(1,223,507)
Machinery and Equipment	<u>(1,810,528)</u>	<u>78,284</u>	<u>(330,925)</u>	<u>6,645</u>	<u>(2,056,524)</u>
Total Accumulated Depreciation	<u>(3,810,497)</u>	<u>78,546</u>	<u>(672,994)</u>	<u>46,089</u>	<u>(4,358,856)</u>
Total Depreciable Capital Assets (Net)	<u>20,665,260</u>	<u>379,436</u>	<u>219,299</u>	<u>(251,298)</u>	<u>21,012,697</u>
CAPITAL ASSETS, NET	<u>\$22,202,703</u>	<u>\$ 718,896</u>	<u>\$ 5,192,209</u>	<u>(\$ 251,298)</u>	<u>\$27,862,510</u>

Depreciation expenses were charged to governmental functions/programs as follows: (See Table 8)

TABLE 8	AMOUNT
General Government	\$ 42,575
Public Safety	63,015
Public Works and Sanitation	389,476
Health	1,831
Culture and Recreation	159,402
Housing, Welfare and Community Development	14,179
Education	<u>2,516</u>
Total Depreciation Expenses	<u>\$672,994</u>

NOTE 7 GENERAL LONG-TERM DEBTS

A. GENERAL AND SPECIAL OBLIGATIONS PAYABLE

The principal long-term obligations of the Municipality are general and special obligations notes issued to finance the construction and improvements of public facilities and purchase of equipment. The Municipality's obligations long-term debt retirements are appropriated and paid from resources accumulated in the Debt Service Fund (See Note 8). The special obligations long-term notes retirements are paid through retention made by the Municipal Revenue Collection Center from

monthly advance of annual property tax and subsidy send to the Municipality.

General and Special obligations payable as of June 30, 2004, are comprised of the following individual issues:

DESCRIPTION	AMOUNT
General Obligations:	
\$305,000, Series 2000, for construction purposes, payable in semiannual installments ranging from \$20,000 to \$40,000, excluding interests at 2.8%, through July 1, 2010	\$ 235,000
\$525,000, Series 1996, for construction purposes, payable in semiannual installments ranging from \$13,000 to \$36,000, excluding interest at 4.50%, through January 1, 2021 (Water and Waste Disposal Loans and Grants)	433,713
\$410,000, Series 1999, for construction purposes, payable in annual installments ranging from \$11,000 to \$29,000, excluding interests at 4.50%, through January 1, 2024 (Water and Waste Disposal Loans and Grants)	384,650
\$3,455,000, Series 2001, for operational purposes, payable in semiannual installments ranging from \$45,000 to \$299,000, excluding interests 5.0% through July 1, 2026	3,355,000

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**COMMONWEALTH OF PUERTO RICO
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NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

NOTE 7 GENERAL LONG-TERM DEBTS (continuation)

DESCRIPTION	AMOUNT
\$985,000, Series 2001, for equipment, payable in semiannual installments ranging from \$170,000 to \$230,000, excluding interests from 2.8% to 3.21%, through July 1, 2006.....	\$ 635,000
\$1,510,000, Series 2001, for equipment payable in semiannual installments ranging from \$20,000 to \$65,000, excluding variable interests from 4.375% to 8.0%, through July 1, 2015	575,000
Total General Obligations.....	<u>5,618,363</u>

Special Obligations:

\$505,000, Series 1993, for operational purposes, payable in semiannual installments ranging from \$20,000 to \$65,000, excluding variable interests from 4.375% to 8.00%, through July 1, 2009.....	285,000
\$1,160,000, Series 1999, for construction purposes, payable in semiannual installments ranging from \$80,000 to \$155,000, excluding interests at 7.08%, through July 1, 2009.....	790,000
Total Special Obligations.....	<u>1,075,000</u>
Total General and Special Obligations	<u>\$6,693,363</u>

The annual requirements to amortize the general and special obligations outstanding as of June 30, 2004 are as follows (See Table 9):

YEAR ENDING JUNE 30,	PRINCIPAL PAYMENT	INTEREST PAYMENT	TOTAL PAYMENT
2005	\$ 705,000	\$ 136,878	\$ 841,878
2006	795,000	333,237	1,128,237
2007	531,000	347,793	878,793
2008	322,000	320,452	642,452
2009	344,000	299,098	643,098
2010-2015	986,000	1,216,625	2,202,625
2016-2021	942,000	937,155	1,879,155
2022-2027	1,231,713	573,630	1,805,343
2028-2033	836,650	125,805	962,455
TOTAL	<u>\$ 6,693,363</u>	<u>\$ 4,290,673</u>	<u>\$10,984,036</u>

B. OTHER LONG-TERM DEBTS

Following are the Other Long-Term Debts (See Table 10):

DESCRIPTION	BALANCE JULY 1, 2003	NEW ISSUES	RETIREMENTS AND ADJUSTMENT *	BALANCE JUNE 30, 2004
Landfill.....	\$4,000,000	\$ 179,340	(\$ 456,551)	\$3,722,789
Property Taxes - MRCC.....	-	-	332,275	332,275
Christmas Bonus.....	-	324,219	-	324,219
PR Aqueduct and Sewer Authority	-	105,629	(46,706)	58,923
MRCC-LIMS.....	-	-	416,394	416,394
Compensated Absences.....	1,718,445	-	(333,177)	1,385,268
TOTAL	<u>\$5,718,445</u>	<u>\$ 609,188</u>	<u>(\$ 87,765)</u>	<u>\$6,239,868</u>

* As adjusted (see Note 15)

C. CHANGES IN GENERAL LONG-TERM DEBTS

The following is a summary of changes in long-term debts for the year ended June 30, 2004: (See Table 11)

DESCRIPTION	BALANCE JULY 1, 2003	NEW ISSUES	RETIREMENTS AND ADJUSTMENT	BALANCE JUNE 30, 2004	AMOUNTS DUE WITHIN ONE YEAR	AMOUNTS DUE AFTER NEXT YEAR
General.....	\$ 6,206,000	\$ -	(\$ 587,637)	\$ 5,618,363	\$ 585,000	\$ 5,033,363
Special.....	1,225,000	-	(150,000)	1,075,000	150,000	925,000
Others Debts .	5,718,445	609,188	(87,765)	6,239,868	387,005	5,852,863
TOTAL	<u>\$13,149,445</u>	<u>\$ 609,188</u>	<u>(\$ 825,402)</u>	<u>\$12,933,231</u>	<u>\$ 1,122,005</u>	<u>\$11,811,226</u>

NOTE 8 DEBT RETIREMENT

Revenues of the debt service fund consists of the ad-valorem property taxes which are recognized as revenue when collected from taxpayers and reported by the Municipal Revenue Collection Center of the Commonwealth of Puerto Rico to the Municipality (See Note 9).

These property taxes are accumulated by the Municipal Revenue Collection Center in costs of the general obligations bonds issued by the Municipality (See Note 7). Payments are made to the Government Development Bank of the Commonwealth of Puerto Rico from such accumulated funds by the Municipal Revenue Collection Center of Puerto Rico.

NOTE 9 PROPERTY TAXES

The Municipal Revenue Collection Center of the Commonwealth of Puerto Rico is responsible for the assessment of all real and personal property located within the Municipality and for the levy, administration and collection of the corresponding tax contribution.

The property tax contribution is levied each year over the appraised value of the property at the beginning of the calendar year. The real property assessment is based on the current value existing in the year 1957 and the personal property at the current value at the date of the assessment.

The tax rate per annum is 7.53% for real property and 5.83% for personal property of which 1.03% of both belong to the Commonwealth of Puerto Rico and 6.00% and 4.00%, respectively, belongs to the Municipality. From the portion belonging to the Municipality, 6.00% and 4.00%, respectively, represents the Municipality's basic tax rate that is appropriated for general purposes and therefore accounted for through the general fund.

The remaining portion belonging to the Municipality of 1.50% represents the ad-valorem property taxes withheld by the Municipal Revenue Collection Center of the Commonwealth of Puerto Rico and restricted for debt service, which is accounted for through the debt service fund (See Note 8). The Municipality has reached the maximum statutory tax rate limit for the basic tax while there is no limitation for the ad-valorem tax rate.

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**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO**

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

NOTE 9 PROPERTY TAXES (continuation)

The Commonwealth of Puerto Rico grants complete real property tax exoneration on the first \$15,000 has assessed valuation on residential units occupied by their owners. However, the **Municipality** receives the full amount levied, except for residential units assessed at less than \$3,500 on which a complete exemption is granted. The Municipal Revenue Collection Center, instead of the property taxpayer, becomes the source of payment in these cases.

The **Municipality** grants a complete exemption from personal property taxes up to an assessment value of \$50,000, to retailers with an annual net sales volume of less than \$150,000. The Municipal Revenue Collection Center advances to the **Municipality**, on monthly payments, 100% of the contribution assessed over property for each fiscal year. In accordance to Law, these advances will be contributions by the Municipal Revenue Collection Center from taxpayers. The Municipal Revenue Collection Center periodically informs to the **Municipality** the amounts collected from taxpayers and applied to outstanding advances.

The **Municipality** records as revenue in the general fund the property tax contribution when received from monthly advances from Municipal Revenue Collection Center.

Due to the fact that collections of property tax are applied to the advances of property tax paid by the Municipality Revenue Collection Center, the amortization of the advance at end of year was not available due to that is in process of verification by external auditors. As of June 30, 2004, the Debt Service Fund presented a receivable of \$48,620 for the collection of additional property taxes during the next 60 days after end of year.

NOTE 10 VOLUME OF BUSINESS TAX

The volume of business tax is levied each year based on the prior year's gross revenues for all commercial and industrial organizations doing business in the **Municipality** and which are not totally or partially exempt from this tax under the Industrial Incentives Laws of the Commonwealth of Puerto Rico. All taxpayers are required to file their declarations by April 23 of each year. The tax rates are as follows:

- a. 1.50% for financial institutions and savings and loan associations.
- b. 0.40% for all other organizations with volume of sales less than \$200,000 and 0.50% for volume of sales in excess of \$200,000.

Taxes are payable in two equal semi-annual installments on July 1 and January 1 following the date of levy. If they are paid with declaration, the taxpayer is granted a 5% of discount. Collections of taxes during current fiscal year, applicable to the next fiscal year, are recorded as deferred revenues in the General Fund.

NOTE 11 INTERGOVERNMENTAL REVENUES

Intergovernmental revenues consist primarily of funds received from the Commonwealth of Puerto Rico, "in lieu of tax" payments from the quasi-public corporation, Puerto Rico Electric Power Authority, and federal financial assistance received from federal government.

Grants and subsidies received from the Commonwealth of Puerto Rico and federal agencies include, among others, a general subsidy for urban development and capital improvements. Intergovernmental revenues are accounted for through the General Fund except for those directly related to urban development and capital improvements, which are accounted for through the Special Revenue and the Capital Project Funds. Federal Financial Assistance is recorded in the Special Revenue Fund.

NOTE 12 EMPLOYEE'S RETIREMENT PLAN

The Employee's Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS) is the administrator of a cost-sharing multiple-employer retirement system established by the Commonwealth of Puerto Rico. The ERS was created under the Act 447, approved on May 15, 1951, as amended, and became effective on January 1, 1952. ERS covers all regular employees of the Commonwealth of Puerto Rico 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.

The **Municipality** adopted the requirements of GASBS No. 25 for all the career employees that are covered under the Commonwealth of Puerto Rico Employee's Retirement System, a multiple-employer public employee retirement system, established by State Laws.

Under the plan, the employees and employer portions are contributed, for which, the employee amount is withheld from salaries. Covered employees are required by Commonwealth statute 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 all salary. The **Municipality** contributes to the system 9.275% of the participating employee's salaries.

Law Number 305 of September 24, 1999, amends the Act Number 447 that establish a savings program. All employees active in the system as of December 31, 1999 may elect to transfer from defined contribution programs to the new savings program (a defined contribution plan). Employees in the savings program may now contribute from a minimum of 8.275% up to a maximum of 10% of their monthly salary, and will 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.

continue

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO**

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

NOTE 12 EMPLOYEE'S RETIREMENT PLAN (continuation)

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.

The pension benefit for participants who retire with less than 30 years of service is computed at the rate of 1½% of their average compensation of each year of credit service for the remaining years. The System also provides for death and disability benefits and the assets of the System pertaining to the participant employees.

A variety of significant actuarial assumptions are used to determine the standard measure of the pension benefit obligation and these assumptions are summarized below:

- a. The present value of the future pension payments was computed by using a discount of 9%.
- b. Future pension payments reflect an assumption of a 6% salary increase.

All employees that do not elect to transfer for the new program and who at the time of employment are 55 years old or less are eligible to participate in the System. Pension benefits for participants with 30 years of service are as follows (See Table 12)

YEARS OF SERVICE	PARTICIPANT'S AGE	PENSION BENEFITS	TABLE 12
30 or more	55 or less	65% of the average of the three years of highest salary during the employee's service period.	
30 or more	58 or more	75% of the average of the three years of highest salary during the employee's service period.	
30 or more	65 or more	75% of the average of the three years of highest salary during the employee's service period (employees started working after April 1, 1990).	

The amount of the total pension benefit obligation is based on a standardized measurement established by GASBS No. 27, *Financial Reporting for Defined Benefit Pension Plans and Notes Disclosure for Defined Contributions Plans*. The standardized measurement is the actuarial present value of estimated defined pension benefits, adjusted for the effects of projected salary increases and step-rate benefits, estimated to be payable in the future as a result of employee services performed to date. The measure is intended to help users assess the System's funding status on a going-concern basis, assess progress made in accumulating sufficient assets to pay benefits when due, and make comparisons among other public retirement systems. The measure is independent of the actuarial funding method used to determine contributions to the plan.

The membership of retirees and beneficiaries currently receiving benefits and terminated employees entitled to benefits, but not yet receiving benefits, and active employees and the distribution of active employees between vested and non-vested is not readily available.

Contributions in 2004 and prior years were made based on percentages established by the law. Such percentage has not been based on actuarial studies, as required by accounting principles generally accepted in the United States of America. An actuarial compilation of the annual contribution applicable to the Municipality has not been prepared. Accordingly, the accounts by which the actual contributions differ from the required actuarial contributions are not known.

The total pension expenditures recorded in the category of administration for the Fiscal Year Ended June 30, 2004 was approximately \$268,248. All employees who at the time of employment are 55 years old or less are eligible to participate in the System. No benefit is payable if the participant receives a refund of his accumulated contributions.

The historical trend information regarding the accumulation of assets and pension benefit obligation in the ERS is not available. For the ten-year trend information, refer to the separately issued financial statements of the ERS as of and for the fiscal year ended June 30, 2004. The P.R. Retirement Plan Administration provides additional information of the ERS. They issue a publicly available financial report that includes financial statements and required supplementary information for ERS, as a component unit of the Commonwealth of Puerto Rico. That report may be obtained by writing to the Administration at PO Box 42003, Minillas Station, San Juan, PR 00940.

NOTE 13 ESTIMATED MUNICIPAL SOLID WASTE LANDFILL CLOSING COSTS

State and Federal laws and regulations require the Municipality to place a final cover on its landfill when closed and perform certain maintenance and monitoring function at the landfill site for thirty years after closure. In addition to the operating expenditures related to current activities of the landfill, an expense provision and related liability are being recognized based on futures closure and post-closure care costs that will be incurred near or after the date the landfill no longer accepts waste. The Municipality has performed a study of the activities that need to be implemented at

the Municipality's landfill to comply with applicable laws and regulations. As result of this study, the Municipality has recognized an estimated liability for future closure and post-closure care costs.

The recognition of this liability is based on the amount of the landfill used during the year. The estimated liability for landfill closure and post-closure care costs has a discounted balance of \$3,722,789 (based on a 6% discount rate) as of June 30, 2004, which is based on 87% usage of the landfill. It is estimated that an additional \$800,000 will be recognized as closure and post-closure care expenditures between the date of the balance sheet and the date the landfill is expected to be filled to capacity (December 2008). The estimated total current costs of the landfill closure and post-closure care (\$4,160,000) is based on the amount that would be paid if all the equipment, facilities and services required to close, monitor and maintain the landfill were acquired as of June 30, 2004. However, the actual cost of closure and post-closure care may be higher due to inflation, changes in technology, or changes in landfill laws and regulations. As of June 30, 2004 the Municipality has not made contributions to finance closure and post-closure care costs.

continue

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO**

NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

NOTE 14 CONTINGENCIES

A. CLAIMS AND JUDGMENTS

The **Municipality** is, at present, a defendant in a number of legal matters that arise from alleged improper application of policies and negligence in the ordinary course of the **Municipality's** activities. The legal counsel of the **Municipality** has advised that at this stage in the proceedings of lawsuits he cannot offer an opinion as to the probable outcome.

In addition, the **Municipality** is a defendant or co-defendant in several legal proceedings, which are in discovery stage. Certain of these claims are covered by insurance. Legal counsel with the information currently available can not determine the final outcome of these claims.

B. FEDERAL GRANTS

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

NOTE 15 ACCOUNTING CHANGES, CHANGES IN REPORTING ENTITY AND RESTATEMENTS

During fiscal year 2002-2003, the **Municipality** implemented several new accounting standards and an interpretation issued by GASB. As part of the implementation of the new standards, during the current fiscal year 2003-2004, the **Municipality** continued the documentation of capital assets not previously reported and the inventory of infrastructure.

The other adjustment corresponded to the receivable and payables not previously identified.

Table 13 reconciles the June 30, 2003 Net Assets/Fund Balance, as previously reported to Beginning Net Assets/Fund Balance as restated, July 1, 2003.

NOTE 16 FUTURE ADOPTION OF ACCOUNTING PRONOUNCEMENT

The Governmental Accounting Standards Board (GASB) issued GASBS No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*, which is effective for fiscal year beginning after December 15, 2004. Early application is encouraged. The **Municipality** has not adopted the requirement of this statement. Other two pronouncements are issued (GASBS Nos. 43 and 44), but do not apply to the **Municipality**.

Table 13			
Governmental-Wide		NET ASSETS	
Net Assets, as Previously Reported, June 30, 2003.....			\$18,072,778
Adjustment to Accounts Payable.....		(617,907)	
Adjustment to Accounts Receivable.....		2,415	
Property Tax Doubtful Accounts.....		(471,071)	
Municipal Solid Waste Landfill Debt.....		456,551	
Compensated Absences.....		233,179	
MRCC - LIMS Debt.....		(459,327)	
Deferred Revenue - Farmer Home.....		208,701	
Deferred Charges 2003.....		31,140	
Adjustment to Capital Assets.....		718,896	
Beginning Net Assets, as Restated, July 1, 2003.....			<u>\$18,175,355</u>
Governmental Fund	GENERAL FUND	OTHER FUNDS	
Fund Balance, as Previously Reported, June 30, 2003.....	\$ 4,336,843	\$	509,683
Adjustment to Accounts Payable.....	(487,307)		57,830
Adjustment to Accounts Receivable.....	121,364		-
Beginning Fund Balance, as Restated, July 1, 2003.....	<u>\$ 3,970,900</u>		<u>\$ 567,513</u>

END OF NOTES

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO**

**REQUIRED SUPPLEMENTARY INFORMATION
BUDGETARY COMPARISON SCHEDULE – GENERAL FUND**

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

	BUDGET AMOUNTS		ACTUAL AMOUNTS (BUDGETARY BASIS) (SEE NOTE A)	VARIANCE WITH FINAL BUDGET POSITIVE (NEGATIVE)
	ORIGINAL	FINAL		
REVENUES:				
Property Taxes	\$ 3,650,964	\$ 3,775,779	\$ 3,950,588	\$ 174,809
Municipal License Taxes	1,583,990	1,952,236	2,057,207	104,971
Intergovernmental	4,214,252	5,400,076	5,232,245	(167,831)
Fees, Fines and Charges for Service	494,600	1,114,475	2,174,558	1,060,083
Interests	53,500	51,800	44,099	92,299
Miscellaneous	2,400	18,700	-	(18,700)
Total Revenues (Inflows).....	9,999,706	12,313,066	13,558,697	1,245,631
EXPENDITURES:				
General Government	4,971,666	5,919,376	5,532,223	387,153
Public Safety	918,579	943,424	757,690	185,734
Public Works and Sanitation	2,182,944	2,231,420	2,021,611	209,809
Culture and Recreation	510,166	717,300	666,474	50,826
Health	572,686	575,086	552,952	22,134
Housing, Welfare and Community Development	780,865	802,415	727,816	74,599
Total Expenditures (Outflows)	9,936,906	11,189,021	10,258,766	930,255
Excess of Revenues Over Expenditures.....	62,800	1,124,045	3,299,231	2,175,886
Other Financing Sources (Uses):				
Transfer-in	62,800	87,027	87,027	-
Transfer-out	-	(1,210,032)	(1,201,482)	8,550
Other Financing Sources (Uses)	-	(1,123,005)	(1,114,455)	8,550
BUDGETARY FUND BALANCE, JUNE 30, 2004.....	\$ -	\$ 1,040	\$ 2,185,476	\$ 2,184,436

See accompanying Notes to Required Supplementary Information.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO**

**BUDGETARY COMPARISON SCHEDULE – GENERAL FUND
NOTE TO REQUIRED SUPPLEMENTARY INFORMATION**

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

NOTE A Explanation of Differences between Budgetary Inflows and Outflows and GAAP Revenues and Expenditures

Actual Amounts (Budgetary Basis) "Available for Appropriation" from the Budgetary Comparison Schedule (See Page 34).....	\$ 2,185,476
Budget to GAAP Timing Differences:	
Non budgeted funds recorded as revenues for financial reporting purposes	6,139,003
Non budgeted funds recorded as expenditures for financial reporting purposes.	(3,932,110)
Non budgeted transfers in	1,660,141
Non budgeted transfers out.	(599,936)
Revenues recorded for financial reporting purposes but not in budgetary basis.....	462,615
Revenues recorded in budgetary basis but not for financial reporting purposes.....	(60,000)
Expenditures recorded for financial reporting purposes but not in budgetary basis	(132,591)
Expenditures recorded in budgetary basis but not for financial reporting purposes.....	146,133
Current year encumbrances recorded as expenditures for budgetary reporting purposes	<u>179,060</u>
Net Change in Fund Balance (See Page 21)	<u>\$ 6,047,791</u>

END OF THIS SECTION

PART II

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
AND REPORTS REQUIRED BY GOVERNMENT AUDITING
STANDARDS AND OMB CIRCULAR A-133**

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO**

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

FEDERAL GRANTOR / PASS THROUGH GRANTOR / PROGRAM OR CLUSTER TITLE	FEDERAL CFDA NUMBER	PASS-THROUGH ENTITY IDENTIFYING NUMBER	FEDERAL EXPENDITURES
U.S. Department of Agriculture:			
Pass-Through PR Department of Education:			
Child and Adult Care Food Program.....	10.558	N/AV	<u>\$ 19,477</u>
U.S. Department of Housing and Urban Development:			
Direct Programs:			
Section 8 Housing Choice Vouchers Program	14.871	N/A	391,881
Indirect Programs:			
Pass-Through State – Office of the Commissioner of Municipal Affairs			
State Block Grant Program (SBGP)	14.228	01-FD-32 00-FD-32 99-FD-32 98-FD-32 97-FD-32 96-FD-32 95-FD-32 94-AF-FD-32	<u>1,613,101</u>
Total U.S. Department of Housing and Urban Development ...			<u>2,004,982</u>
U.S. Department of Justice:			
Pass Through PR Department of Justice:			
Local Law Enforcement Block Grant	16.592	N/AV	<u>59,073</u>
U.S. Department of Transportation – National Highway Traffic Safety Administration:			
Pass Through PR Department of Transportation – (Traffic Safety Commission):			
State and Community Highway Safety	20.660	N/AV	<u>7,739</u>
U.S. Department of Health and Human Services:			
Head Start Program	93.600	N/A	516,814
Pass Through Administration of Children and Families:			
Child Care and Development Block Grant.....	93.575	N/A	<u>190,473</u>
Total U.S. Department of Health and Human Services.....			<u>707,287</u>
TOTAL EXPENDITURES OF FEDERAL AWARDS			<u>\$2,798,558</u>

The accompanying Notes to Schedule of Expenditures of Federal Awards are an integral of this Schedule.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO**

NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

NOTE 1 GENERAL

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activities of the **Municipality of Isabela, Puerto Rico**. The information in this Schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this Schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements. The **Municipality** reporting entity is defined in Note (1) (A) to the basic financial statements. All federal financial awards received directly from federal agency as well as federal financial awards passed-through other government agencies are included on the Schedule.

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

NOTE 3 FEDERAL CFDA NUMBER

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

NOTE 4 PASS-THROUGH GRANTOR'S NUMBER

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

NOTE 5 LOAN OUTSTANDING

In determining the value of total noncash awards expended for loans and loan guarantees, the balances of loans from previous years must be included if the federal government imposes continuing compliance requirements. OMB Circular A-133 does not specifically define the term continuing compliance requirements. Therefore, it is a matter of judgment as to whether continuing compliance requirements are significant enough to require inclusion of prior-year loan or loan guarantee balances. The **Municipality of Isabela, Puerto Rico** had the following outstanding balance at June 30, 2004 for Water and Waste Disposal Loans Programs. For these loans the grantor does not impose continuing compliance requirements, as described on the OMB Circular A-133. Therefore, the prior year balances are not considered expenditures on the Schedule of Expenditures of Federal Awards. The amount presented in the Schedule, represent federal expenditures according to modified accrual basis of accounting (see Note 2). The loans outstanding balances were included in the Long-Term Liabilities of the Statement of Net Assets.

PROGRAM TITLE	FEDERAL CFDA NUMBER	AMOUNT OUTSTANDING
Water and Waste Disposal Loans and Grants	10.770	\$384,650
Water and Waste Disposal Loans and Grants	10.770	433,713

NOTE 6 MAJOR PROGRAMS

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

END OF NOTES



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INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS REQUIRED BY GOVERNMENT AUDITING STANDARDS

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

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of **Municipality of Isabela, Puerto Rico (Municipality)**, as of and for the fiscal year ended June 30, 2004, which collectively comprise the **Municipality's** basic financial statements and has issued our report thereon dated January 17, 2005. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the **Municipality's** internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control would not necessarily disclose all matters in the internal control over financial reporting that might be material weakness. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

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

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS REQUIRED BY GOVERNMENT AUDITING STANDARDS

Page 2

This report is intended solely for the information and use of the management, the Honorable Mayor and Members of the Municipal Legislature, Office of the Commissioner of Municipal Affairs, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

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Caguas, Puerto Rico
January 17, 2005





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INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM AND INTERNAL CONTROL OVER COMPLIANCE REQUIRED BY OMB CIRCULAR A-133

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

Compliance

We have audited the compliance of the **Municipality of Isabela, Puerto Rico (Municipality)** with the types of compliance requirements described in the *U. S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the fiscal year ended June 30, 2004. The **Municipality's** major federal programs are identified in the summary of auditors' result section of the accompanying Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the **Municipality's** management. Our responsibility is to express an opinion on the **Municipality's** compliance based on our audit.

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

In our opinion, the **Municipality** complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the fiscal year ended June 30, 2004. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying Schedule of Findings and Questioned Costs as items 04-III-02 through 04-III-11.

Internal Control Over Compliance

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

INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM AND INTERNAL CONTROL OVER COMPLIANCE REQUIRED BY OMB CIRCULAR A-133

Page 2

We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect the **Municipality's** ability to administer a major federal program in accordance with applicable requirements of laws, regulations, contracts and grants. Reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs as item 04-III-01 through 04-III-07.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that none of the reportable conditions described above is a material weakness.

This report is intended solely for the information and use of the management, the Honorable Mayor and Members of the Municipal Legislature, Office of the Commissioner of Municipal Affairs, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

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Caguas, Puerto Rico
January 17, 2005



PART III
FINDINGS AND QUESTIONED COSTS

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

SECTION I – SUMMARY OF AUDITORS' RESULTS

Financial Statements

Type of auditors' report issued: Unqualified Opinion Qualified Opinion
 Adverse Opinion Disclaimer Opinion

Internal control over financial reporting:

● Reportable condition(s) identified? Yes None Reported

● Material weakness(es) identified? Yes No

Noncompliance material to financial statements noted? Yes No

Federal Awards

Internal control over major programs:

● Reportable condition(s) identified? Yes None Reported

● Material weakness (es) identified? Yes No

Type of auditors' report issued on compliance for Major Programs:

Unqualified Opinion Qualified Opinion
 Adverse Opinion Disclaimer Opinion

Any audit finding disclosed that are required to be reported in accordance with Section 510 (a) of Circular A-133? Yes No

Identification of Major Programs:

CFDA NUMBER	NAME OF FEDERAL PROGRAM OR CLUSTER
14.228	State Block Grant Program (SBGP)
14.871	Section 8 Housing Choice Vouchers
93.600	Head Start Program

Dollar threshold used to distinguish between Type A and Type B Programs:

\$300,000

Auditee qualified as low-risk auditee? Yes No

continue

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

SECTION II – FINANCIAL STATEMENT FINDINGS

NO MATTER IS REPORTED.

continue

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING	NUMBER 04-III-01
FEDERAL PROGRAM	HEAD START PROGRAM (CFDA 93.600) U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES
REQUIREMENT	INTERNAL CONTROL
NONCOMPLIANCE	ALLOWABLE COST/COST PRINCIPLES
CONDITION	It was noted in our tests of Municipality's internal control over disbursement process, that supporting documents related to thirteen (13) issued checks were not stamped as paid, there was one (1) disbursement voucher without purchase order, five (5) vouchers did not have the invoices, and ten (10) vouchers did not have a receiving report.
CRITERIA	Code of Federal Regulations, 45 CFR, Part 74, Subpart C, Section 74.21(b)(3), state that recipients' financial management systems shall provide for effective control over and accountability for all funds, property and other assets. Additional, regulation states that recipients shall adequately safeguard all such assets and assure them are used solely for authorized purposes.
CAUSE	There are no adequate internal control procedures implemented to assure this compliance.
EFFECT	Liabilities could be paid twice by the Municipality . The Municipality is not in compliance with Code of Federal Regulations, 45 CFR, Part 74, Subpart C, Section 74.21(b)(3).
RECOMMENDATION	Municipality should implement adequate procedures to ensure that all supporting documents of all disbursement transactions are stamped as paid in order to assure compliance with this requirement.
QUESTIONED COSTS	None
MANAGEMENT RESPONSE	The Finance Department Director was instructed to verify the deficiencies related to the disbursement vouchers and orient each employee who contributed to this finding, of the importance of properly authorizing and canceling such documents.

continue

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING	NUMBER 04-III-02
FEDERAL PROGRAM	STATE BLOCK GRANT PROGRAM (CFDA NO. 14.228) U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT PASS-THROUGH STATE – OFFICE OF COMMISSIONER OF MUNICIPAL AFFAIRS
REQUIREMENT	COMPLIANCE AND INTERNAL CONTROL
NONCOMPLIANCE	ALLOWABLE COST/COST PRINCIPLES
CONDITION	It was noted in our tests of Municipality's internal control over disbursement process, that supporting documents related to thirteen (13) issued checks were not stamped as paid.
CRITERIA	Code of Federal Regulations, 24 CFR, Part 24, Subpart C, Section 84.21(b)(3), state that recipients' financial management systems shall provide for effective control over and accountability for all funds, property and other assets. Additional, regulation states that recipients shall adequately safeguard all such assets and assure them are used solely for authorized purposes.
CAUSE	There are no adequate internal control procedures implemented to assure this compliance.
EFFECT	Liabilities could be paid twice by the Municipality . The Municipality is not in compliance with Code of Federal Regulations, 24 CFR, Part 24, Subpart C, Section 84.21(b)(3).
RECOMMENDATION	Municipality should implement adequate procedures to ensure that all supporting documents of all disbursement transactions are stamped as paid in order to assure compliance with this requirement.
QUESTIONED COSTS	None
MANAGEMENT RESPONSE	Finance Director established strict procedures to ensure that all vouchers and receiving reports are processed, authorized and cancelled according to generally accepted accounting principles and regulations.

continue

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING	NUMBER 04-III-03
FEDERAL PROGRAM	HEAD START PROGRAM (CFDA NO. 93.600) U.S. DEPARTMENT OF HEALTH AND HUMAN RESOURCES
REQUIREMENT	COMPLIANCE AND INTERNAL CONTROL
NONCOMPLIANCE	DAVIS-BACON ACT
CONDITION	During our test we noted that the Municipality did not perform interviews to ensure that contractors paid prevailing wages according to Department of Labor.
CRITERIA	Davis-Bacon Act, as amended (40 USC 276a – 276a-7).
CAUSE	Municipality did not establish a process that ensures contractors paid prevailing wages as required by the act.
EFFECT	Municipality is not in compliance with Davis-Bacon Act (40 USC 276a – 276a-7).
RECOMMENDATION	We recommend management to develop a monitoring system that includes obtaining prevailing wage rates from the Department of Labor, the assignment of specific responsibility to one municipal employee to monitor contractors and subcontractors for compliance, obtaining contractor's payrolls and perform the interviews to contractor's and subcontractor's laborers accordingly to the established requirements.
QUESTIONED COSTS	None
MANAGEMENT RESPONSE	Copy of the contractor's payroll was presented to the auditor. A procedure will be established for future reference.

continue

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING	NUMBER 04-III-04
FEDERAL PROGRAM	SECTION 8 HOUSING CHOICE VOUCHER PROGRAM (CFDA NO. 14.871) U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
REQUIREMENT	COMPLIANCE AND INTERNAL CONTROL
NONCOMPLIANCE	ELIGIBILITY TEST
CONDITION	During our Participant Files Test we noted that two (2) participant files did not have evidence of the HUD-approved release and consent forms submitted by the family as required by federal regulation.
CRITERIA	Code of Federal Regulations, 24 CFR, Subpart F, Section 5.617 (b) stated that as a condition of admission to, or continued occupancy of, any assisted unit, the Municipality shall require the family head and other such family members as it designated, on 24 CFR, Subpart B, Section 5.230 (a), to execute a HUD-approved release and consent form authorizing any depository or private source of income, or any federal, state or local agency, to furnish or release to the Municipality and to HUD such information as the Municipality and HUD determines to be necessary. Also it is stated on 24 CFR, Subpart K, Section 982.516 (g).
CAUSE	Municipality does not have consent forms that authorize the collection of income information from State Wages Information Collection Agencies (SWICA), and wages, net earnings from self-employment, payments of retirement income, and unearned income as referenced at 26 U.S.C. 6103. In addition, the consent form may authorize the collection of other information from applicants and participants to determine eligibility or level of benefits.
EFFECT	Municipality is not in compliance with 24 CFR, Subpart F, Section 5.617(b); Subpart B, Section 5.230(a); and Subpart K, Section 982.516 (g).
RECOMMENDATION	We recommend management to require each member of the family of an assistance applicant or participant who is at least 18 years of age, and each family head and spouse regardless of age, to sign a release form.
QUESTIONED COSTS	None
MANAGEMENT RESPONSE	On December 1, 2003, the Municipality appointed a Housing Inspector. Instructions were given in order to perform the required housing inspections prospectively from the date of his appointment. The Municipality continues to inspect and review all findings in the assigned housing units.

continue

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING	NUMBER 04-III-05
FEDERAL PROGRAM	SECTION 8 HOUSING CHOICE VOUCHER PROGRAM (CFDA NO. 14.871) U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
REQUIREMENT	COMPLIANCE AND INTERNAL CONTROL
NONCOMPLIANCE	ELIGIBILITY TEST
CONDITION	During our Participant Files Test we noted that Municipality did not assure that participants submit a third parties verifications regarding the family income and the family composition.
CRITERIA	Code of Federal Regulations, 24 CFR, Subpart K, Section 982.516 (a)(2) stated that the Municipality must obtain and document in the tenants' file third party verification of the following factors, or must document in the tenant file why third party verification was not available: (i) reported family annual income, (ii) the value of assets, (iii) expenses related to deductions from annual income and (iv) other factors that affect the determination of adjusted income.
CAUSE	Municipality does not maintain tenants' files as required by federal regulations in order to verify the information provided by the applicant or participants regarding the family income and the family composition.
EFFECT	Municipality is not in compliance with 24 CFR, Subpart K, Section 982.516 (a)(2).
RECOMMENDATION	We recommend management to implement the necessary procedures in order to comply with program regulations.
QUESTIONED COSTS	None
MANAGEMENT RESPONSE	Pending the Corrective Action Plan.

continue

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING	NUMBER 04-III-06
FEDERAL PROGRAM	SECTION 8 HOUSING CHOICE VOUCHER PROGRAM (CFDA NO. 14.871) U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
REQUIREMENT	COMPLIANCE AND INTERNAL CONTROL
NONCOMPLIANCE	ELIGIBILITY TEST
CONDITION	During our Participant Files Test we noted that seven (7) participants' files did not have evidence of the Certificate of No Penal Record submitted by the family.
CRITERIA	Code of Federal Regulations, 24 CFR, Subpart L, Section 982.553 (a)(1-2) stated that at any time, the PHA may deny assistance to an applicant, or terminate assistance to a participant family if any member of the family commits a drug-related criminal activity; or violent criminal activity.
CAUSE	Municipality did not assure that all participants submit a Certificate of No Penal Record.
EFFECT	Is not possible for the Municipality to determine if the participant incur in this activities that can affect its eligibility.
RECOMMENDATION	We recommend management to require each member of the family of an assistance applicant or participant who is at least 18 years of age to submit a Certificate of No Penal Record.
QUESTIONED COSTS	None
MANAGEMENT RESPONSE	Pending the Corrective Action Plan.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING	NUMBER 04-III-07
FEDERAL PROGRAM	STATE BLOCK GRANT PROGRAM (CFDA NO. 14.228) U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT PASS-THROUGH STATE – OFFICE OF COMMISSIONER OF MUNICIPAL AFFAIRS
REQUIREMENT	COMPLIANCE AND INTERNAL CONTROL
NONCOMPLIANCE	PROCUREMENT STANDARDS
CONDITION	The model for construction contracts used by the Municipality did not contain the clause detailed for compliance with the provisions for Energy Policy and Conservation Act as required by the program regulation.
CRITERIA	Code of Federal Regulations, Subpart C, 24 CFR Section 85.36 (i) (1-13) stated that subgrantee's contract must contain provision in paragraph (i) of this Section. Federal agencies are permitted to require changes, remedies, changed conditions, access and records retention, suspension of work, and other clauses approved by the Office of Procurement Policy.
CAUSE	Federal Program and Finance Departments did not maintain appropriate procurement standard procedures, in order to assure that contractor complies with some requirements.
EFFECT	Municipality is not in compliance with Subpart C, 24 CFR, Section 85.36 (i) (1-13) of OMB Common Rules.
RECOMMENDATION	We recommend management to update contract model according with the federal requirement.
QUESTIONED COSTS	None
MANAGEMENT RESPONSE	Pending the Corrective Action Plan.

continue

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING	NUMBER 04-III-08
FEDERAL PROGRAM	HEAD START PROGRAM (CFDA 93.600) U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES
REQUIREMENT	COMPLIANCE
NONCOMPLIANCE	SPECIAL TESTS AND PROVISIONS
CONDITION	During our test we noted that the records of the employees did not have evidence of a signed declaration that includes the required information related to child abuse.
CRITERIA	Code of Federal Regulations, 45 CFR, Part 1301, Subpart D, Section 1301.31, (c) (1-3) state that the Personnel policies must require that all prospective employees must sign a declaration prior to employment which lists: (1) All pending and prior criminal arrests and charges related to child sexual abuse and their disposition; (2) Convictions related to other forms of child abuse and/or neglect; and (3) All convictions of violent felonies.
CAUSE	Personnel Department did not assure that all prospective employees sign the required declarations.
EFFECT	Municipality is not in compliance with Code of Federal Regulations, 45 CFR, Part 1301, Subpart D, Section 1301.31, (c) (1-3).
RECOMMENDATION	We recommend to management to implement internal control procedures in order to comply with this requirement.
QUESTIONED COSTS	None
MANAGEMENT RESPONSE	The declaration will be included in the Personnel policies accordingly with the Code of Federal Regulations.

continue

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING	NUMBER 04-III-09
FEDERAL PROGRAM	SECTION 8 HOUSING CHOICE VOUCHER PROGRAM (CFDA NO. 14.871) U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
REQUIREMENT	COMPLIANCE AND INTERNAL CONTROL
NONCOMPLIANCE	SPECIAL TESTS AND PROVISIONS
CONDITION	During our Participant Files Test we noted that fourteen (14) tenant's files do not documented the determination that the rent to owner is reasonable in accordance with the Municipality's administrative plan initially and during the contract term.
CRITERIA	Code of Federal Regulations, 24 CFR, Subpart D, Section 982.158 (f) (7) stated that the Municipality must maintain records to document the basis for the Municipality's determination that the rent to owner is a reasonable rent (initially and during the term of the HAP contract).
CAUSE	Municipality does not implement procedures in order to document the reasonable rent to owner.
EFFECT	Municipality is not in compliance with 24 CFR, Subpart D, Section 982.158 (f) (7).
RECOMMENDATION	We recommended management to document the basis for the determination that the rent to owner is a reasonable rent (initially and during the term of the HAP contract).
QUESTIONED COSTS	None
MANAGEMENT RESPONSE	At the present, Municipality management is documenting the reasonable rent at the moment of the inspection. The Municipality management is in the process of modifying the Administrative Plan for the Section 8 program. In February of 2005, the Municipality will be holding public hearings in order to establish an alternative rent reasonable test per sector or community.

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SCHEDULE OF FINDINGS AND QUESTIONED COSTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING	NUMBER 04-III-10
FEDERAL PROGRAM	SECTION 8 HOUSING CHOICE VOUCHER PROGRAM (CFDA NO. 14.871) U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
REQUIREMENT	COMPLIANCE
NONCOMPLIANCE	SPECIAL TESTS AND PROVISIONS
CONDITION	During our Participant Files Test we noted that two (2) participants' files do not have evidence of an initial unit inspection and eleven (11) do not have evidence of a periodic unit inspection.
CRITERIA	Code of Federal Regulations, 24 CFR, Subpart D, Section 982.405 (a) stated that the Municipality must inspect the unit leased to a family prior to the initial term of the lease, at least annually during assisted occupancy, and at other times as needed, to determine if the unit meets the Housing Quality Standards.
CAUSE	Municipality does not conduct initial and periodic inspections as required by the federal regulation.
EFFECT	Municipality is not in compliance with 24 CFR, Subpart D, Section 982.405 (a) and Section 982.305 (b)(1)(I).
RECOMMENDATION	We recommend management to conduct the Housing Quality Standards Inspections as established under federal regulation.
QUESTIONED COSTS	None
MANAGEMENT RESPONSE	Municipality corrected the situation on the spot and faxed to auditor, document was misplaced. The Municipality will correct immediately this situation.

continue

**COMMONWEALTH OF PUERTO RICO
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SCHEDULE OF FINDINGS AND QUESTIONED COSTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING	NUMBER 04-III-11
FEDERAL PROGRAM	SECTION 8 HOUSING CHOICE VOUCHER PROGRAM (CFDA NO. 14.871) U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
REQUIREMENT	COMPLIANCE
NONCOMPLIANCE	SPECIAL TESTS AND PROVISIONS
CONDITION	During our verification of units with failed Housing Quality Standards Inspections we noticed that in ten (10) participant's files was no evidence of a unit inspection report or other verification documenting that any PHA required repairs were completed.
CRITERIA	Code of Federal Regulations, 24 CFR, Subpart I, Section 982.404 stated that the Municipality must not make any housing assistance payments for a dwelling unit that fails to meet the Housing Quality Standards, unless the responsible person (owner and/or participant) correct the defect within the period specified by the Municipality and the Municipality verifies the correction.
CAUSE	Municipality does not verified the correction of the Housing Quality Standards deficiencies; therefore, the Municipality fails to take prompt and vigorous action to enforce the owner and/or participants obligations.
EFFECT	Municipality is not in compliance with 24 CFR, Subpart I, Section 982.404.
RECOMMENDATION	We recommend to management to implement internal control procedures to establish a correction time period to assure that the units Housing Quality Standards deficiencies were corrected during the specified period established by the federal regulation.
QUESTIONED COSTS	None
MANAGEMENT RESPONSE	Municipality corrected the situation on the spot and faxed to auditor, document was misplaced. The Municipality will correct immediately this situation.

END OF SCHEDULE

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO**

SCHEDULE OF PRIOR AUDIT'S FINDINGS AND QUESTIONED COSTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

(1) **Audit Findings that have been Fully Corrected:**

FISCAL YEAR 2003

Finding Number 03-III-04 **Special Tests and Provisions- Evidence of revision of the allowable utility schedule.**

CFDA Number 14.871

Questioned Cost NONE

Auditee Comments System and procedures corrected.

Finding Number 03-III-07 **Special Tests and Provisions- Municipality did not perform supervisory quality control HQS inspections.**

CFDA Number 14.871

Questioned Cost NONE

Auditee Comments System and procedures corrected.

FISCAL YEAR 2002

Finding Number 02-III-01 **Allowable Costs/ Cost Principles- Missing documents on vouchers payments.**

CFDA Number 14.228

Questioned Cost NONE

Auditee Comments System and procedures corrected.

Finding Number 02-III-08 **Special Tests and Provisions- Evidence of revision of the allowable utility schedule.**

CFDA Number 14.871

Questioned Cost NONE

Auditee Comments System and procedures corrected.

Finding Number 02-III-11 **Special Tests and Provisions- Municipality did not perform supervisory quality control HQS inspections.**

CFDA Number 14.871

Questioned Cost NONE

Auditee Comments System and procedures corrected.

continue

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO**

SCHEDULE OF PRIOR AUDIT'S FINDINGS AND QUESTIONED COSTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

(2) Audit Findings not Corrected or Partially Corrected:

FISCAL YEAR 2003

Finding Number 03-III-01 **Allowable Cost/Cost Principles- Missing and not cancelled documents on vouchers payments.**

CFDA Number 14.228

Questioned Cost None

Auditee Comments On January 29, 2004 Mr. Jason D. León, Finance Director, established strict procedures to ensure that invoices and disbursements are processed, authorized, and cancelled according to government accounting rules and regulations.

Finding Number 03-III-02 **Eligibility – Missing documentation (HUD-approved release and consent forms).**

CFDA Number 14.871

Questioned Cost None

Auditee Comments The Federal Grants Office Director (FGOD) instructed the official in charge of the Section 8 Housing Choice Voucher Program to use a release and consent form approved by the U.S. department of Housing and Urban Development local office for approval. Each family member of an assistance applicant or participant who is at least 18 years of age, and each family head and spouse regardless of age will be required to sign the release and consent forms.

Finding Number 03-III-03 **Special Tests and Provisions- Evidence of the determination of the reasonableness of the rent paid to the owners.**

CFDA Number 14.871

Questioned Cost None

Auditee Comments Municipality did not properly document the reasonable rent test performed. Since, December 1, 2003, the Housing Inspector implemented the Rent Reasonableness Form to improve the documentation of the procedures performed.

Finding Number 03-III-05 **Special Tests and Provisions- Missing inspection reports.**

CFDA Number 14.871

Questioned Cost None

Auditee Comments Mr. Miguel Serrano was appointed as Housing Inspector effective December 1, 2003. We estimate that in approximately an eight month period the annual housing inspections, the rent reasonableness and the HQS will be revised and inspected for each unit.

continue

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO**

SCHEDULE OF PRIOR AUDIT'S FINDINGS AND QUESTIONED COSTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

(2) Audit Findings not Corrected or Partially Corrected: (continuation)

Finding Number 03-III-06 **Special Tests and Provisions- Missing verification documenting that any PHA-required repairs were completed.**

CFDA Number 14.871

Questioned Cost None

Auditee Comments To adhere to Housing Quality Enforcement Standards, we have implemented a form that will help us successfully achieve the program goals.

FISCAL YEAR 2002

Finding Number 02-III-03 **Eligibility – Missing documentation (HUD-approved release and consent forms).**

CFDA Number 14.871

Questioned Cost None

Auditee Comments Federal Grants Office Director (FGOD) has been instructed and is in process to request to all participants, on a case by case basis, the update and completion of forms, and to include these in the participant files in accordance with Subpart F, Section 5.617(b); Subpart B, Section 5.230(a); and Subpart K, Section 982.516 (g). The program documents (forms) filling and correction is expected to be completed by April 30, 2003. FGOD will submit on a monthly basis progress reports to the Internal Auditor, Finance Director, Municipal Legislature and Mayor on the program special provisions performance and correction of findings mentioned on items 6, 7, 8 and 9 starting on April 2003.

Finding Number 02-III-07 **Special Tests and Provisions – Evidenced of the determination of the reasonable of the rent paid to the owners.**

CFDA Number 14.871

Questioned Cost None

Auditee Comments Federal Grants Office Director (FGOD) has been instructed and is in process to include documentation of the rent to be pay to owners in accordance to federal regulations by May 30, 2003.

Finding Number 02-III-09 **Special Tests and Provisions – Missing inspection reports.**

CFDA Number 14.871

Questioned Cost None

Auditee Comments Specific instructions have been addressed to the FGOD in order to comply with Section 982.158(d) to perform required HQS inspections and re-inspections on a regularly basis. HQS inspections to the program files commenced during second half of the fiscal year. Also municipal internal auditor will be assigned to audit this area and to test program personnel compliance with Sections 982.158(d). FGOD will submit on a monthly basis progress reports to the Internal Auditor, Finance Director, Municipal Legislature and Mayor on the program special provisions performance and correction of findings mentioned on items 3, 4 and 5 [Refer to Sections 928.54(b), 982.405(b) and 982.404].

continue

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA, PUERTO RICO**

SCHEDULE OF PRIOR AUDIT'S FINDINGS AND QUESTIONED COSTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

(2) Audit Findings not Corrected or Partially Corrected: (continuation)

Finding Number	02-III-10	Special Tests and Provisions Missing verification documenting that any PHA-required repairs were completed.
CFDA Number	14.871	
Questioned Cost	None	
Auditee Comments	Specific instructions have been addressed to the FGOD in order to comply with Section 982.404 to perform monthly sample and tests to the HQS inspections on a regularly basis. Supervisory HQS inspections to the program files commenced during second half of the fiscal year. Also municipal internal auditor will be assigned to audit this area and to test program personnel compliance with Sections 982.404 and 405(b).	

(3) Corrective action taken is significantly different from corrective action previously reported:

NONE

(4) Audit findings is no longer valid:

NONE

COMA
DIVISION REGISTRATION
E INTERVENCIÓN
05 APR 12 AM 10:09

END OF SCHEDULE