

**OFICINA DEL COMISIONADO DE ASUNTOS MUNICIPALES**

**AREA DE ASESORAMIENTO, REGLAMENTACION E INTERVENCION FISCAL**

**AREA DE ARCHIVO DIGITAL**

**MUNICIPIO DE ISABELA**

**AUDITORIA 2004-2005**

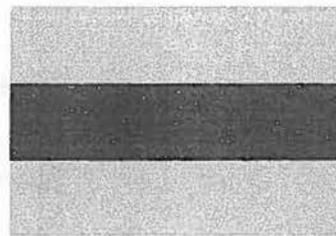
**30 DE JUNIO DE 2005**

Carthago. 16/17

RECIBIDO  
UNIDAD DE CORREO  
06 JUN -7 AM 9:33  
MUNICIPALIDAD



**MUNICIPALITY OF ISABELA**  
***FINANCIAL STATEMENTS AND  
INDEPENDENT AUDITORS' REPORT***  
***FISCAL YEAR ENDED JUNE 30, 2005***



**Hon. Carlos Delgado Altieri**  
**Mayor**

**Jason Darius León, CPA**  
**Finance Director**

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ISABELA  
BASIC FINANCIAL STATEMENTS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2005**

**TABLE OF CONTENTS**

	<u>Pages</u>
<b>PART I - FINANCIAL SECTION</b>	
Independent Auditors' Report .....	1-2
Management's Discussion and Analysis .....	3-16
Basic Financial Statements:	
Government-Wide Financial Statements:	
Statement of Net Assets .....	17
Statement of Activities .....	18
Fund Financial Statements-Governmental Funds	
Balance Sheet .....	19-20
Reconciliation of the Governmental Funds Balance Sheet to Statement of Net Assets .....	21
Statement of Revenues, Expenditures and Changes in Fund Balances . . . .	22
Reconciliation of the Statement of Revenues, Expenditures and Changes in Fund Balance of Governmental Funds to the Statement of Activities . . .	23-24
Notes to Basic Financial Statements .....	25-51
Required Supplementary Information - Budgetary Comparison Schedule - General Fund .....	53
Notes to Required Supplementary Information .....	54-55
Combining Financial Statements - General Fund .....	57-58

**ORTIZ, RODRIGUEZ, RIVERA & CO.**

CERTIFIED PUBLIC ACCOUNTANTS • VALUE ADDED SERVICES

Suite 152, PO Box 70250, San Juan, P.R. 00936-7250 • Phone (787) 756-8524, Fax (787) 274-0562

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ISABELA  
BASIC FINANCIAL STATEMENTS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2005**

**TABLE OF CONTENTS (CONTINUED)**

	<u>Pages</u>
<b>PART II – SINGLE AUDIT SECTION</b>	
Schedule of Expenditures of Federal Awards .....	60
Notes to Schedule of Expenditures of Federal Awards .....	61
Independent Auditor's Report on Compliance and on Internal Control over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards .....	62-63
Independent Auditor's Report on Compliance with Requirements Applicable to Each Major Program and on Internal Control over Compliance in Accordance with OMB Circular A-133 .....	64-66
Schedule of Findings and Questioned Costs .....	67-73
Schedule of Status of Prior Year Audit Findings and Questioned Costs .....	74-77

**ORTIZ, RODRIGUEZ, RIVERA & CO.**

CERTIFIED PUBLIC ACCOUNTANTS • VALUE ADDED SERVICES

Suite 152, PO Box 70250, San Juan, P.R. 00936-7250 • Phone (787) 756-8524, Fax (787) 274-0562

## **PART I - FINANCIAL SECTION**

**ORTIZ, RODRIGUEZ, RIVERA & CO.**

CERTIFIED PUBLIC ACCOUNTANTS • VALUE ADDED SERVICES

Suite 152, PO Box 70250, San Juan, P.R. 00936-7250 • Phone (787) 756-8524, Fax (787) 274-0562



**ORTIZ, RODRIGUEZ, RIVERA & CO.**

CERTIFIED PUBLIC ACCOUNTANTS • VALUE ADDED SERVICES

CPA Orlando Luis Ortiz Cabrera  
CPA Marco Antonio Rivera Zúñiga  
CPA Luis O. Rivera Zúñiga

**Members:**  
American Institute of Certified  
Public Accountants (AICPA)  
Puerto Rico Board of Certified  
Public Accountants  
Management Consulting  
Services Division

## INDEPENDENT AUDITORS' REPORT

To the Honorable Mayor and  
Municipal Legislature  
Municipality of Isabela  
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, as of and for the year ended June 30, 2005, which collectively comprise the Municipality's basic financial statements, as listed in the table of contents. These financial statements are the responsibility of the Municipality's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund and the aggregate remaining fund information of the Municipality of Isabela as of June 30, 2005 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 November 30, 2005, on our consideration of the Municipality's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting

and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis on pages 3 through 16 and Budgetary Comparison Schedule - General Fund on page 53 was 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 inquires of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Municipality's basic financial statements. The accompanying combining financial statements of the general fund and the schedule of expenditures of federal awards are 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 are also not a required part of the basic financial statements of the Municipality. The combining financial statements of the general fund and the schedule of expenditures of federal awards have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

*Ortiz Rodriguez, RIVERA & CO*

San Juan, Puerto Rico  
November 30, 2005

The stamp 2101413 was affixed  
to the original of this report.



ORTIZ, RODRIGUEZ, RIVERA & CO.

CERTIFIED PUBLIC ACCOUNTANTS • VALUE ADDED SERVICES

Suite 152, PO Box 70250, San Juan, P.R. 00936-7250 • Phone (787) 756 8524 Fax (787) 756 8525

## MUNICIPALITY OF ISABELA

### MANAGEMENT DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2005

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, 2005. 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 2005 by \$36,184,678 (net assets).
- Revenues (not including special items) decreased by \$2,525,219 (9.2%) and expenses increased \$3,283,852 (19.9%) in comparison with fiscal year 2004, as restated.
- Net change in net assets amounted to \$5,169,405, an increase of 16.7% with respect to prior year (2004) net change, as restated.
- The Municipality reported capital loss of \$151,445 arising from disposition of equipments.
- The Municipality accounted as part of its revenues \$643,521 from donated assets received from the Central Government developed and constructed projects or facilities.

##### 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 \$14,121,268, an increase of \$2,347,943 in comparison with the prior year, as restated. Approximately 44% (or \$6,229,815) 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 \$1,826,105 and an unreserved fund balance of \$6,229,815. Unreserved fund balances increased \$1,305,837 from prior year, as restated.
- Management has designated \$2,059,458 for future special activities in the general fund for which \$1,294,082 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.

**MUNICIPALITY OF ISABELA**  
**MANAGEMENT DISCUSSION AND ANALYSIS**

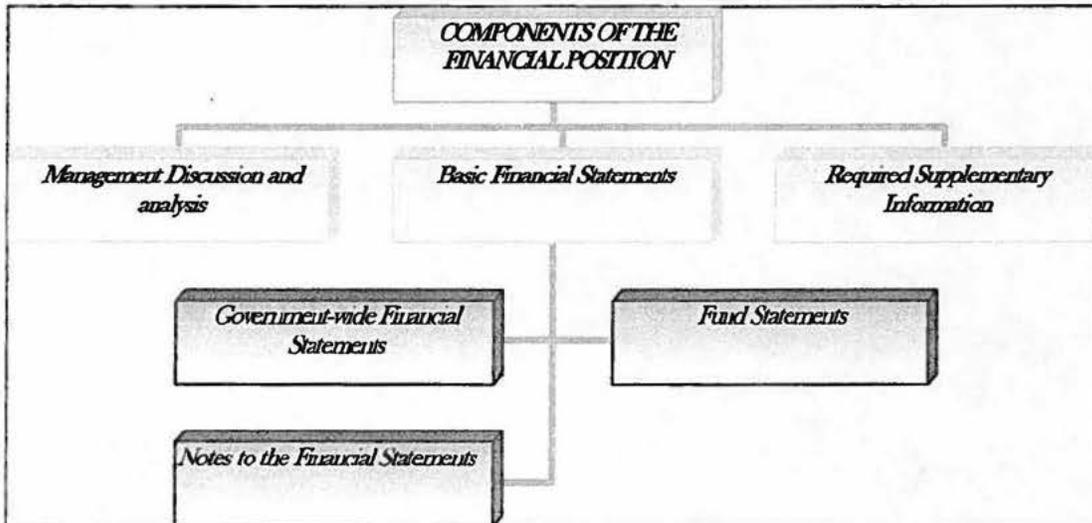
**Fiscal year ended June 30, 2005**

**General Financial Highlights**

- The investment in net capital assets as of June 30, 2005 was \$30,161,980 (net of related debt).
- Total (net) increase in long term debt amounted to \$800,440.
- General obligation long term debt decreased to \$6,217,024, an approximately decrease of 7.2% (\$480,000) with respect to prior year balance, as restated.
- Other long term debt increases and net reductions from adjustments amounted to \$2,135,817 and \$859,038, 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 \$1,236,687, net of \$1,053,296 transfers out, internally designated funds for future expenditures as approved by municipal legislature.
- Total government wide revenues decreased by \$2,525,219. Decrease was mainly due to a decreased in property donations of \$3,808,995, an increase in property tax collections of \$645,120, increase in Head Start program of \$977,171 and others net decreases in revenues of \$338,515.

**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:

**MUNICIPALITY OF ISABELA**  
**MANAGEMENT DISCUSSION AND ANALYSIS**

**Fiscal year ended June 30, 2005**

**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.

**MUNICIPALITY OF ISABELA**  
**MANAGEMENT DISCUSSION AND ANALYSIS**

**Fiscal year ended June 30, 2005**

**- 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, 2005 and 2004:

**TABLE 1**

<b>Summary Statement of Net Assets</b>		
<b>As of June 30,</b>		
	<b>Governmental Activities</b>	
	<b>2005</b>	<b>(As restated) 2004</b>
<b>Assets</b>		
Current and other assets	\$ 22,926,492	\$ 19,516,180
Capital assets	31,112,242	28,127,646
<b>Total assets</b>	<b>\$ 54,038,734</b>	<b>\$ 47,643,826</b>
<b>Liabilities</b>		
Current and other liabilities	\$ 4,120,385	\$ 3,691,661
Long term liabilities	13,733,671	12,936,892
<b>Total liabilities</b>	<b>17,854,056</b>	<b>16,628,553</b>
<b>Net assets</b>		
Invested in capital assets, net of related debt	30,161,980	26,684,401
Restricted	11,293,264	9,859,166
Unrestricted (deficit)	(5,270,566)	(5,528,294)
<b>Total net assets</b>	<b>\$ 36,184,678</b>	<b>\$ 31,015,273</b>

## MUNICIPALITY OF ISABELA

### MANAGEMENT DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2005

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 16.7% with respect to prior year. The most significant change was an increased in invested capital assets of \$3,477,579 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.

The largest portion of the Municipality's net assets reflects its investment in capital assets (e.g., land, buildings, equipment, and infrastructure) for \$35,916,506; less accumulated depreciation (\$4,804,264) and any related outstanding debt (\$950,262) 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 constrains established by debt covenants, enabling legislation or other legal requirements.

As of June 30 2005 the Municipality presented an unrestricted net assets deficit of \$5,270,566. This deficit primarily arise from long term obligations such as compensated absences \$1,771,331, the estimated municipal solid waste landfill future closing cost \$3,920,497 and other debts agreements such as LIMS, delinquent debts and other amount due to Commonwealth governmental entities \$1,824,000 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.

**MUNICIPALITY OF ISABELA**  
**MANAGEMENT DISCUSSION AND ANALYSIS**

**Fiscal year ended June 30, 2005**

**Changes in net assets**

The following table summarizes the changes in net assets for the years ended June 30, 2005 and 2004:

**TABLE 2**  
**Summary of Changes in Net Assets**  
**As of June 30,**

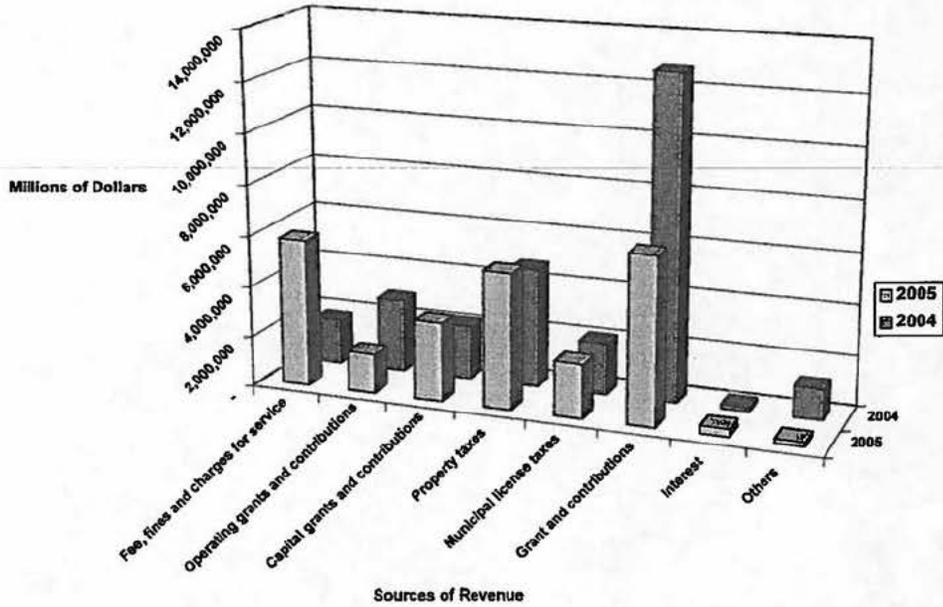
	<b>Governmental Activities</b>	
	<b>2005</b>	<b>(As restated) 2004</b>
<b>Program revenues:</b>		
Fees, fines and charges for services	\$ 5,809,374	\$ 1,787,468
Operating grants and contributions	1,569,789	2,888,416
Capital grants and contributions	3,123,954	2,136,049
<b>General revenues:</b>		
Property taxes	5,356,184	4,711,064
Municipal license taxes	2,146,076	2,057,207
Grants and contributions not restricted to specific programs	6,574,448	12,730,180
Interest	328,772	176,373
Gain (loss) on disposition of capital assets	(151,445)	(251,298)
Others	187,727	1,234,639
<b>Total revenues</b>	<b>\$ 24,944,879</b>	<b>\$ 27,470,098</b>
<b>Expenses:</b>		
General government	\$ 7,788,228	\$ 5,836,368
Public safety	1,087,704	799,840
Public works and sanitation	3,786,637	3,375,156
Health	2,929,966	2,542,609
Housing, welfare and community development	2,174,937	1,839,644
Culture and recreation	837,676	913,705
Education	879,391	856,873
Interest on long term debt	292,844	329,336
<b>Total expenses</b>	<b>\$ 19,777,383</b>	<b>\$ 16,493,531</b>
<b>Special items</b>	<b>1,909</b>	<b>1,267,344</b>
<b>Change in net assets</b>	<b>5,169,405</b>	<b>12,243,911</b>
<b>Net assets-beginning of year (As restated)</b>	<b>31,015,273</b>	<b>18,771,362</b>
<b>Net assets-end of year</b>	<b>\$ 36,184,678</b>	<b>\$ 31,015,273</b>

**MUNICIPALITY OF ISABELA**  
**MANAGEMENT DISCUSSION AND ANALYSIS**

**Fiscal year ended June 30, 2005**

**FIGURE 1**

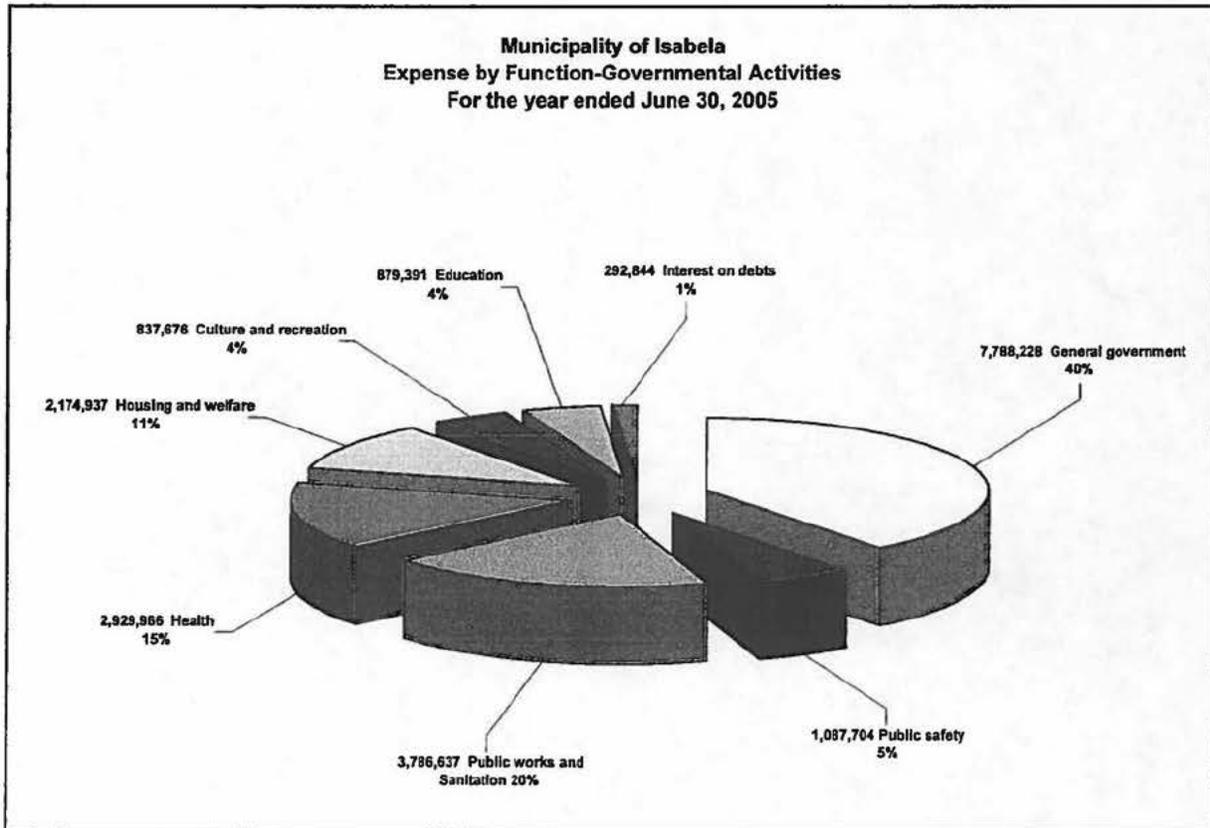
**Municipality of Isabela  
Revenues by Source-Government Activities  
Fiscal Years ended June 30, 2005 and 2004**



**MUNICIPALITY OF ISABELA**  
**MANAGEMENT DISCUSSION AND ANALYSIS**

**Fiscal year ended June 30, 2005**

**FIGURE 2**



**MUNICIPALITY OF ISABELA**  
**MANAGEMENT DISCUSSION AND ANALYSIS**

**Fiscal year ended June 30, 2005**

Approximately 18.8% of the Municipality's revenues came from operating and capital grants and contributions, 12.5% from property taxes, 10.1% from fees and charges for services and 37.6% from unrestricted grants. The Municipality's expenses cover a range of services. The largest expenses are general government with 39.4%, public works and sanitation represents approximately 19.1% and health services provided with an outpatient health facility known as CIMA. Program revenues of the municipality covered 39.6% of total expenses.

With respect to prior year, revenues decreased by approximately \$2,525,219 or 9.2%. The significant decreased (\$3,808,995) was grants and contribution due to the donation of capital assets and infrastructure constructed by the Central Government. ||

Expenses increased 19.9% or \$3,283,852 in comparison with 2004 year, as amended. Such increase does not include a loss of \$151,445 on the disposition of capital asset.

A 33.4% expenditures increase was registered on general government activity. This increase includes the followings:

- Workmen Compensation Insurance- \$178,077
- Municipal Activities with the community - \$214,252
- Christmas Bonus - \$214,978
- Claims of prior years - \$288,668 (which include a debt with PR Department of Treasury for \$163,458, estimated legal claims \$63,000, and \$25,000 (down payment) for Administration Solid Waste payment plan.
- \$881,634 increase in salaries and fringe benefits.

A 36% increase in public safety activity is due to new hiring of police force by the state program "Códigos Orden Público".

As part of the housing, welfare and community development activities includes a new assignment of two new programs of PR Department of Family and CDBG for assistance of elderly participants in their home, \$426,894.

Public works and sanitation increased due to a debt of prior years with Administration Solid Waste (ADS) by the used of machinery and equipment which also was refinanced with a long term debt payment plan.

As noted previously the increase in revenues over the increase in expenses, caused an increase of 16.7% in the net change in net assets with respect to prior year net change.

**MUNICIPALITY OF ISABELA**  
**MANAGEMENT DISCUSSION AND ANALYSIS**

**Fiscal year ended June 30, 2005**

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**

<b>Net Cost of Municipality's Governmental Activities</b>				
<b>Fiscal years ended June 30.</b>				
<b>Functions/Programs</b>	<b>Total Cost of Services</b>		<b>Net Cost of Services</b>	
	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>
General government	\$ 7,788,228	\$ 5,836,368	\$ 3,726,021	\$ 3,140,090
Public works and sanitation	3,786,637	3,375,156	2,205,163	3,022,836
Health	2,929,966	2,542,609	250,214	2,542,609
Housing, welfare and community development	2,174,937	1,839,644	1,540,208	203,394
Public Safety	1,087,704	799,840	(457,251)	(1,336,209)
Culture and recreation	837,676	913,705	837,676	913,705
Other	1,172,235	1,186,209	1,172,235	1,186,209
	<b>\$ 19,777,383</b>	<b>\$ 16,493,531</b>	<b>\$ 9,274,266</b>	<b>\$ 9,681,598</b>

Some of the cost of governmental activities in 2005 was paid by those who directly benefited from the programs for \$3,129,622 and other governments and organizations that subsidized certain programs with grants and contributions for \$1,569,789 and \$3,123,954, respectively. The \$9,274,266 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, 2005, the governmental funds reported combined ending fund balances of \$14,121,268, a net increase of \$2,347,943 in comparison with the prior year, as restated. This increase was caused primarily by a net increase in the general fund of \$1,826,105, \$164,709 increase in the debt service fund and an increase of \$357,129 in the other governmental funds. Of total combined fund balances, the unreserved portion represents the 44.1% (\$6,229,815). The remainder of fund balance is reserved to indicate that is not available for new spending.

**MUNICIPALITY OF ISABELA**  
**MANAGEMENT DISCUSSION AND ANALYSIS**

**Fiscal year ended June 30, 2005**

The general fund is the operating fund of the Municipality. Unreserved fund balance of the general fund represents approximately 51.2% of total ending general fund balances. For the year ended June 30, 2005, the fund balance of the general fund increased by \$1,826,105 as results of an excess of revenues over expenditures.

As compared with prior year, net change in fund balance of the general fund decreased \$4,135,044. This decrease was due to a net decrease of \$408,856 in total revenues in the general fund. The decrease in general fund revenues was caused by a decreased of \$3,591,636 in intergovernmental assistance, an increase of \$2,393,870 in fees, fines and charge, an increase of \$528,778 in property taxes, and an increase of \$260,132 in other revenues. The net increase in expenditures of \$3,629,436 was due to an increase of \$811,918 in public work and sanitation, an increase of \$677,589 in the general government expenditures, an increase in capital outlay of \$1,678,538; and an increase in other expenditures of \$461,391.

**GENERAL FUND BUDGETARY HIGHLIGHTS**

The general fund original budget for the fiscal period 2004-2005 presented an increase of 1.15% 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 \$1,741,577 due to additional collections of property taxes advances (\$241,852), construction permits (\$1,019,691), municipal license tax (\$308,179) and of others net revenues. Budget expenditures increases of \$1,741,577 includes \$840,567 increase in general expenditures, a transfer in of \$102,000 from others special funds and a \$1,062,810 transfer out, to general funds special designated activities. As part of theses transfer out, the funds assigned includes \$400,000 for an employee early retirement plan.

Actual revenues were greater than the revised budgeted revenues by \$385,773 (net). The most significant variances are Fees, Fines and Charges for Services of \$230,889 (primarily construction permits charges to developers) and property taxes for \$133,656.

A positive variance of \$841,400 between revised budget and actual expenditures was due mainly to a net decrease in salaries and fringe benefits and controls over budgeted expenses of \$167,814 in general government, \$280,200 in public works and sanitation expenditures and \$198,227 in public safety. The Municipality reported less expenditure than appropriations in those functions on payments for salaries and fringe benefits and general insurance \$57,739.

Total general fund salaries and fringe benefits during the current fiscal increased in comparison with fiscal year 2003-2004 by \$881,634.

Actual revenues exceeded actual expenditures by \$1,236,687 due to the receipts on nonrecurring revenues.

**MUNICIPALITY OF ISABELA**  
**MANAGEMENT DISCUSSION AND ANALYSIS**

**Fiscal year ended June 30, 2005**

**CAPITAL ASSET AND DEBT ADMINISTRATION**

**Capital assets**

At the end of the fiscal year, the Municipality has invested \$31,112,242 (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 \$2,984,596 or approximately 10.6% over the prior year, as restated.

**TABLE 4**

	Capital Assets, net As of June 30,	
	Governmental Activities	
	2005	(As restated) 2004
<b>Non-depreciable assets:</b>		
Land	\$ 3,685,589	\$ 3,668,589
Construction in progress	3,117,144	3,267,674
<b>Depreciable assets, net:</b>		
Buildings and buildings improvements	11,252,543	8,666,652
Infrastructure	8,689,107	8,527,492
Vehicles, machinery and equipment	4,367,859	3,997,239
<b>Total</b>	<u>\$ 31,112,242</u>	<u>\$ 28,127,646</u>

The Municipality reported additions of \$2,128,851 in construction in progress during the year. These additions are composed mainly of capital improvements and donations from construction contractors of municipal and Central Government. Some of these improvements and donations are detailed as follows:

- "Picadero Municipal" - \$786,225
- "Plaza de Recreo" (asset donated) - \$619,521
- "Mejoras Anfiteatro Justo Mendez" - \$389,151
- Parks improvement at various sites - \$191,332
- Others local projects - \$142,662

In additions some projects were completed during the year and reclassified as buildings. These projects were "Plaza de Recreo" \$1,470,201, "Plaza de Mercado" \$602,577 and "Cancha Mickey Coll" \$206,602. The Municipality's fiscal year 2006 consolidated capital budget calls for a significant amount of projects including construction of "Parque Urbano" with a budget of \$3,015,500, "Paseo Lineal" with a budget of \$338,500 and the continuing construction facilities for "El Picadero Municipal" with a budget of \$2,372,000 and improvements of recreational

**MUNICIPALITY OF ISABELA**  
**MANAGEMENT DISCUSSION AND ANALYSIS**

**Fiscal year ended June 30, 2005**

parks at various wards and rural areas for \$345,000. 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 F to the financial statements.

**Long-term debt**

At year-end, the Municipality had \$13,733,671 in general and special bonds and notes and other long term debts. Such amount represents an increase of 6.2% with respect to prior year. The following is a summary of the Municipality's outstanding debt as of June 30, 2005 and 2004:

**TABLE 5**

<b>Outstanding Long-term Debt</b>		
<b>As of June 30,</b>		
	<b>Governmental Activities</b>	
	<b>2005</b>	<b>(As restated) 2004</b>
General and special obligation bonds and notes	\$ 6,217,024	\$ 6,697,024
Note payable to CRIM – LIMS	370,869	416,394
Note Payable to CRIM – prior years delinquent accounts	152,324	332,275
PR Department of Labor	306,142	-
Solid waste landfill	3,920,497	3,722,789
Compensated absences	1,771,331	1,385,268
Christmas Bonus	628,071	324,219
P.R. Water Sewer Authority	17,260	58,923
Payable to CRIM – property tax advances	33,613	-
PR Waste Management Administration (ADS)	252,868	-
Others	63,672	-
<b>Total</b>	<b>\$ 13,733,671</b>	<b>\$ 12,936,892</b>

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 \$628,071, the issuance of payment plan (debt refinancing) with the P.R. Water and Sewer Authority for \$17,260 and the recording of a past digitalization debt assumed by the municipality in behalf of CRIM LIMS Agreement for \$370,869. More detailed information about the Municipality's long term liabilities is presented in Note G to the financial statements.

## **MUNICIPALITY OF ISABELA**

### **MANAGEMENT DISCUSSION AND ANALYSIS**

**Fiscal year ended June 30, 2005**

#### **ECONOMIC FACTORS AND NEXT YEAR'S BUDGET**

The Municipality's selected and appointed officials considered many factors when setting the fiscal year 2005-2006 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 12.7%, which compares with the Commonwealth rate of 12.6%.

The Municipality applied a conservative approach in the development of budget estimates for the 2005-2006 fiscal year. The municipality estimates that the amounts available for appropriations in the General Fund for the fiscal year 2006 will be \$11,823,409, a decrease of approximately 9% with respect to prior year final budget. The decrease in the budgeted estimate for fiscal year 2006 is due in part to an unexpected increase in revenue during the prior fiscal year which has not been projected for the current fiscal year. In addition the municipality administration has undertaken a fiscal policy to reduce expenditures in light of the sudden increase in the cost for petroleum and gasoline. Subsequently, the Management and Budget Office of the PR Commonwealth Government notified the municipality a decrease in its municipal subsidy of \$700,000 as part of its budget constrains. This reduction was subsequently notified and adjusted in the Isabela's 2005-2006 consolidated municipal budget.

In spite on the unfavorable economic factors which the city currently faces, the administration will continue to pursue new strategies to increase revenues and decrease expenditures. As is past fiscal years, the realization of all unbudgeted revenues will be use to increase general fund expenditure for the city operations.

#### **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 or at telephone (787) 872-2100, ext. 238.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ISABELA  
STATEMENT OF NET ASSETS  
JUNE 30, 2005**

<u>Assets</u>	<u>Governmental Activities</u>
Cash and investments (Note B)	\$ 10,463,800
Accounts receivable (Note C)	464,029
Due from (Note D):	
Commonwealth of Puerto Rico	1,391,728
Federal government	4,126,918
Restricted assets:	
Cash	4,353,299
Cash with fiscal agent	1,884,945
Deferred charges	25,613
Inventories and supplies	216,160
Capital assets, net (Note F)	31,112,242
<b>Total assets</b>	<b>\$ 54,038,734</b>

**Liabilities and Net Assets**

<b>Liabilities</b>	
Accounts payable and accrued liabilities	\$ 1,901,497
Interest payable	139,499
Due to (Note D):	
Commonwealth of Puerto Rico	252,051
Federal government	59,743
Deferred revenues:	
Municipal license taxes (Note J)	1,665,724
Other	101,871
Noncurrent liabilities (Note G):	
Due within one year	1,774,747
Due in more than one year	11,958,924
<b>Total liabilities</b>	<b>17,854,056</b>

**COMMITMENTS AND CONTINGENCIES (Notes M and N)**

<b>Net Assets</b>	
Investment in capital assets, net of related debt	30,161,980
Restricted for:	
Capital projects	9,145,876
Debt service	1,699,271
Other specific purposes	448,117
Unrestricted (deficit)	(5,270,566)
<b>Total net assets</b>	<b>\$ 36,184,678</b>

The accompanying notes are an integral part of these basic financial statements.

-17-

**ORTIZ, RODRIGUEZ, RIVERA & CO.**

CERTIFIED PUBLIC ACCOUNTANTS • VALUE ADDED SERVICES

Suite 152, PO Box 70250, San Juan, P.R. 00936-7250 • Phone (787) 756-8524, Fax (787) 274-0562

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ISABELA  
STATEMENT OF ACTIVITIES  
FOR THE FISCAL YEAR ENDED JUNE 30, 2005**

<u>Functions/Programs</u>	<u>Expenses</u>	<u>Program Revenues</u>			<u>Net (Expense) Revenue and Changes in Net Assets</u>
		<u>Charges for Services</u>	<u>Operating Grants and Contributions</u>	<u>Capital Grants and Contributions</u>	
<b>Primary Government:</b>					
General government	\$ 7,788,228	\$ 3,127,147	\$ 935,060	\$ -	\$ (3,726,021)
Public safety	1,087,704			1,544,955	457,251
Public works and sanitation	3,786,637	2,475		1,578,999	(2,205,163)
Culture and recreation	837,676				(837,676)
Health	2,929,966	2,679,752			(250,214)
Housing, welfare, and community development	2,174,937		634,729		(1,540,208)
Education	879,391				(879,391)
Interest on long-term debt	292,844				(292,844)
<b>Total primary government</b>	<b>\$ 19,777,383</b>	<b>\$ 5,809,374</b>	<b>\$ 1,569,789</b>	<b>\$ 3,123,954</b>	<b>(9,274,266)</b>
<b>General revenues:</b>					
Property taxes (Note I)					5,356,184
Municipal license tax (Note J)					2,146,076
Grants and contributions not restricted to specific programs					6,574,448
Interest					328,772
Miscellaneous					189,636
Loss on disposition of assets					(151,445)
<b>Total general revenues</b>					<b>14,443,671</b>
Change in net assets					5,169,405
Net assets at beginning of year, as restated (Note P)					31,015,273
Net assets at end of year					<b>\$ 36,184,678</b>

The accompanying notes are an integral part of these basic financial statements.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ISABELA  
BALANCE SHEET-GOVERNMENTAL FUNDS  
JUNE 30, 2005**

<u>Assets</u>	<u>General</u>	<u>Child Care/ Head Start Programs</u>	<u>Community Development Block Grant Program</u>	<u>Debt Service</u>	<u>Other Governmental Funds</u>	<u>Total Governmental Funds</u>
Cash and investments (Note B)	\$ 9,155,511	\$ -	\$ 1,368	\$ -	\$ 1,306,921	\$ 10,463,800
Accounts receivable	464,029					464,029
Due from (Note D):						
Commonwealth of Puerto Rico	1,100,840			290,889	380,149	1,771,878
Federal government		345,236	3,401,532			3,746,768
Due from other funds (Note E)	814,389					814,389
Inventories and supplies	216,160					216,160
Restricted assets:						
Cash	4,353,299					4,353,299
Cash with fiscal agent	255,783			1,546,043	83,119	1,884,945
<b>Total assets</b>	<b>\$ 16,360,011</b>	<b>\$ 345,236</b>	<b>\$ 3,402,900</b>	<b>\$ 1,836,932</b>	<b>\$ 1,770,189</b>	<b>\$ 23,715,268</b>

The accompanying notes are an integral part of these basic financial statements.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ISABELA  
BALANCE SHEET-GOVERNMENTAL FUNDS  
JUNE 30, 2005**

<u>Liabilities and Fund Balance</u>	<u>General</u>	<u>Child Care/ Head Start Programs</u>	<u>Community Development Block Grant Program</u>	<u>Debt Service</u>	<u>Other Governmental Funds</u>	<u>Total Governmental Funds</u>
<b>Liabilities</b>						
Account payable and accrued liabilities	\$ 1,456,672	\$ 184,743	\$ 183,572	\$ -	\$ 76,510	\$ 1,901,497
Due to (Note D):						
Commonwealth of Puerto Rico	252,051					252,051
Federal government					59,743	59,743
Due to other funds (Note E)		160,493	18,662		635,234	814,389
Matured bonds payable				730,000		730,000
Matured interest payable				159,841		159,841
Deferred revenues:						
Municipal license tax (Note J)	1,665,724					1,665,724
Property taxes	66,500					66,500
Federal government			3,200,666			3,200,666
Other	743,589					743,589
Total liabilities	<u>4,184,536</u>	<u>345,236</u>	<u>3,402,900</u>	<u>889,841</u>	<u>771,487</u>	<u>9,594,000</u>
<b>Fund Balance</b>						
Reserved for:						
Encumbrances	80,136					80,136
Inventories	216,160					216,160
Debt service				947,091		947,091
Capital projects	5,493,095				706,854	6,199,949
Other specific purposes	156,269				291,848	448,117
Unreserved:						
Designated for future expenditures	2,059,458					2,059,458
Undesignated	4,170,357					4,170,357
Total fund balance	<u>12,175,475</u>	<u>-</u>	<u>-</u>	<u>947,091</u>	<u>998,702</u>	<u>14,121,268</u>
Total liabilities and fund balance	<u>\$ 16,360,011</u>	<u>\$ 345,236</u>	<u>\$ 3,402,900</u>	<u>\$ 1,836,932</u>	<u>\$ 1,770,189</u>	<u>\$ 23,715,268</u>

The accompanying notes are an integral part of these basic financial statements.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ISABELA  
RECONCILIATION OF THE GOVERNMENTAL FUNDS  
BALANCE SHEET TO STATEMENT OF NET ASSETS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2005**

Total fund balances - governmental funds \$ 14,121,268

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

<ul style="list-style-type: none"> <li>• Capital assets, net used in governmental activities are not current financial resources and therefore are not reported in the governmental funds balance sheet.</li> </ul>	31,112,242
<ul style="list-style-type: none"> <li>• Other assets used in governmental activities are not financial resources and therefore are not reported in the funds:               <ul style="list-style-type: none"> <li>Deferred charges</li> </ul> </li> </ul>	25,613
<ul style="list-style-type: none"> <li>• Other assets are not available to pay for current period expenditures and therefore are deferred in the funds:               <ul style="list-style-type: none"> <li>Christmas bonus</li> <li>Grants from Puerto Rico Department of Recreation and Sports</li> <li>Grants from Solid Waste Authority of Puerto Rico</li> <li>Federal grants - CDBG</li> </ul> </li> </ul>	291,720 66,500 350,000 <u>3,200,665</u> <u>3,908,885</u>
<ul style="list-style-type: none"> <li>• Interest liabilities are not due and payable in the current period and therefore, are not reported in the funds.</li> </ul>	(19,659)
<ul style="list-style-type: none"> <li>• Long-term liabilities, including bonds payable, are not due and payable in the current period and therefore are not reported in the funds:               <ul style="list-style-type: none"> <li>General obligation bonds and notes</li> <li>Note payable to CRIM - LIMS</li> <li>Note payable to CRIM - financing of delinquent accounts</li> <li>Note payable to PR Department of Labor</li> <li>Note payable to PR Waste Management Administration</li> <li>Compensated absences</li> <li>Christmas bonus</li> <li>Judgment and claims</li> <li>Municipal Solid Waste debt</li> <li>Payable to CRIM-excess of property tax advances</li> <li>Note payable to Puerto Rico Acueduct and Sewer Authority</li> </ul> </li> </ul>	(5,447,024) (370,869) (152,324) (306,142) (252,868) (1,771,331) (628,071) (63,672) (3,920,497) (33,613) (17,260) <u>(12,963,671)</u>
<p>Net assets of governmental activities</p>	<u>\$ 36,184,678</u>

The accompanying notes are an integral part of these basic financial statements.

-21-

**ORTIZ, RODRIGUEZ, RIVERA & CO.**

CERTIFIED PUBLIC ACCOUNTANTS • VALUE ADDED SERVICES

Suite 152, PO Box 70250, San Juan, P.R. 00936-7250 • Phone (787) 756-8524. Fax (787) 274-0562

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ISABELA  
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES-GOVERNMENTAL (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2005**

	General	Child Care/ Head Start Programs	Community Development Block Grant Program	Debt Service	Other Governmental Funds	Total Governmental Funds
<b>REVENUES</b>						
Taxes:						
Property taxes (Note I)	\$ 4,299,937	\$ -	\$ -	\$ 1,185,196	\$ -	\$ 5,485,133
Municipal license taxes (Note J)	2,146,076					2,146,076
Intergovernmental revenues (Note K):						
Commonwealth government	7,161,909				735,313	7,897,222
Federal government		1,477,806	933,742		843,218	3,254,766
Fees, fines, and charges for services	4,775,448					4,775,448
Interest	308,970			19,802		328,772
Other revenues	27,948					27,948
Total revenues	<u>18,720,288</u>	<u>1,477,806</u>	<u>933,742</u>	<u>1,204,998</u>	<u>1,578,531</u>	<u>23,915,365</u>
<b>EXPENDITURES</b>						
Current:						
General government	7,129,130		159,830		118,973	7,405,933
Public safety	945,315				78,143	1,023,458
Public works and sanitation	2,984,629		138,749		99,552	3,200,930
Culture and recreation	644,955				3,924	648,879
Health	2,918,498					2,918,498
Housing, welfare and community development	1,356,487		214,072		584,577	2,155,136
Education		710,595			158,310	868,905
Capital outlays	1,926,999	787,211	423,091		117,858	3,235,159
Debt service:						
Principal retirement				800,000		800,000
Interest and other				276,067		276,067
Debt issuance costs	2,017					2,017
Total expenditures	<u>17,888,028</u>	<u>1,477,806</u>	<u>933,742</u>	<u>1,076,067</u>	<u>1,159,337</u>	<u>22,534,980</u>
Excess of revenues over expenditures	<u>832,280</u>	<u>-</u>	<u>-</u>	<u>128,931</u>	<u>419,194</u>	<u>1,380,385</u>
<b>OTHER FINANCING SOURCES (USES)</b>						
General obligation bonds	255,000					255,000
Transfers in	89,862			50,088	11,580	151,528
Transfers out	(61,666)			(16,217)	(73,645)	(151,528)
Total other financing sources (uses)	<u>283,196</u>	<u>-</u>	<u>-</u>	<u>33,869</u>	<u>(62,065)</u>	<u>255,000</u>
<b>SPECIAL ITEMS (Note Q)</b>						
Property taxes-amnesty						
Issuance of note payable - PR Department of Labor	432,781			1,909		434,690
Issuance of note payable - PR Waste Management Administration	277,868					277,868
Total special items	<u>710,649</u>	<u>-</u>	<u>-</u>	<u>1,909</u>	<u>-</u>	<u>712,558</u>
Excess of revenues and other sources over expenditures and other uses	<u>1,826,105</u>	<u>-</u>	<u>-</u>	<u>164,709</u>	<u>357,129</u>	<u>2,347,943</u>
<b>FUND BALANCES AT BEGINNING OF YEAR, AS RESTATED (Note P)</b>						
	<u>10,349,370</u>			<u>782,382</u>	<u>641,573</u>	<u>11,773,325</u>
<b>FUND BALANCES AT END OF YEAR</b>						
	<u>\$ 12,175,475</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 947,091</u>	<u>\$ 998,702</u>	<u>\$ 14,121,268</u>

The accompanying notes are an integral part of these basic financial statements.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ISABELA  
RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND  
BALANCES OF GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES  
FOR THE FISCAL YEAR ENDED JUNE 30, 2005**

Net change in fund balances - total governmental funds \$ 2,347,943

Amounts reported for governmental activities in the statement of activities 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.
 

Expenditures for capital assets	3,228,067
Less current year depreciation	<u>(735,547)</u>
	<u>2,492,520</u>
  
- Governmental funds only report 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. (151,445)
  
- Revenues in the statement of activities that do not provide current financial resources are not reported as revenues in the funds:
 

Christmas bonus reimbursement	291,719
CDBG	645,257
Donated capital assets	<u>643,521</u>
	<u>1,580,497</u>
  
- Revenues reported in funds which are not reported as revenues in the statement of activities:
 

Due from Commonwealth entities:	
Property taxes	(33,613)
CRIM - prior year	(95,336)
Business permits - prior year	(120,000)
Christmas bonus - prior year	<u>(150,589)</u>
	<u>(399,538)</u>
  
- Proceeds from general obligation bonds is an other financing source in the governmental funds, but an increase of long-term liabilities in the statement of net assets. (255,000)
  
- Proceeds from note payable to the Puerto Rico Department of Labor is an other financing source in the governmental funds, but an increase of long-term liabilities in the statement of net assets. (432,781)

The accompanying notes are an integral part of these basic financial statements.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ISABELA**

**RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND  
BALANCES OF GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2005**

• Proceeds from note payable to the Puerto Rico Waste Management Administration is an other financing source in the governmental funds, but an increase of long-term liabilities in the statement of net assets.	\$ (277,868)
• Expenditures reported in funds which are not reported as expenses in the statement of activities	
Matured bonds principal payments (net change)	65,000
• Repayment of long-term debt is an expenditure in the governmental funds, but reduces long-term liabilities in the statement of net assets.	
General obligation bonds and notes	735,000
Other long-term liabilities	742,997
	<u>1,477,997</u>
• Governmental funds reported the effect of bond issuance costs as expenditure when debt is first issued, whereas these amounts are deferred and amortized in the statement of activities. This amount is the net effect of these differences.	
Bond issuance costs	2,017
Amortization of bond issuance costs	(5,324)
	<u>(3,307)</u>
• Some expenses reported in the statement of activities do not require the use of current financial resources; therefore, are not reported as expenditures in governmental funds.	
Compensated absences	(386,063)
Municipal solid waste landfill	(197,708)
Judgment and claims	(63,672)
Christmas bonus	(628,071)
Accrued interest (net change)	901
	<u>(1,274,613)</u>
<b>Changes in net assets of governmental activities</b>	<u><b>\$ 5,169,405</b></u>

The accompanying notes are an integral part of these basic financial statements.

-24-

**ORTIZ, RODRIGUEZ, RIVERA & CO.**

CERTIFIED PUBLIC ACCOUNTANTS • VALUE ADDED SERVICES

Suite 152, PO Box 70250, San Juan, P.R. 00936-7250 • Phone (787) 756-8524. Fax (787) 274-0562

**MUNICIPALITY OF ISABELA**  
**NOTES TO FINANCIAL STATEMENTS**

**June 30, 2005**

**NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The Municipality of Isabela was founded in 1819. The Municipality is governed by the executive and the legislative branch elected for a four year term during the general elections in Puerto Rico. The Mayor is the executive officer and the legislative branch consists of fourteen (14) members of the Municipal Legislature. The Municipality engages in a comprehensive range of services to the community such as: general government administration, public works, health, environmental control, education, public security, welfare, housing, community development and culture and recreation activities.

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

**1. *Financial reporting entity***

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

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

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

**MUNICIPALITY OF ISABELA**  
**NOTES TO FINANCIAL STATEMENTS**

June 30, 2005

**NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued**

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

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

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

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

**2. *Basis of presentation, measurement focus and basis of accounting***

The financial report of the Municipality consists of a Management Discussion and Analysis (MD&A), basic financial statements, notes to the financial statements and required supplementary information other than the MD&A. Following is a summary presentation of each, including the measurement focus and basis of accounting measurement focus is a term used to describe *which* transactions are recorded within the various financial statements. Basis of accounting refers to *when* transactions are recorded regardless of the measurement focus.

**Management Discussion and Analysis**

This consists of a narrative introduction and analytical overview of the Municipality's financial activities. This analysis is similar to analysis the private sector provides in their annual reports.

**Basic financial statements**

Basic financial statements include both government-wide and fund financial statements. Both levels of statements categorize primary activities as governmental type, which are primarily supported by taxes and intergovernmental revenues.

**MUNICIPALITY OF ISABELA**  
**NOTES TO FINANCIAL STATEMENTS**

**June 30, 2005**

**NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued**

**Government-wide statements**

The government-wide statements consist of a Statement of Net Assets and a Statement of Activities. These statements are prepared using the economic resources measurement focus, which concentrates on an entity or fund's net assets. All transactions and events that affect the total economic resources (net assets) during the period are reported. The statements are reported on the accrual basis of accounting. Revenues are recognized in the period earned and expenses recognized in the period in which the associated liability is incurred. Fiduciary activities, if any, whose resources are not available to finance government programs, are excluded from the government-wide statements. The effect of inter-fund activities is eliminated.

The Statement of Net Assets incorporates all capital (long lived) assets and receivables as well as long term debt and obligations. The Statement of Activities reports revenues and expenses in a format that focus on the net cost of each function of the Municipality. Both the gross and net cost of the function, which is otherwise being supported by the general government revenues, is compared to the revenues generated directly by the function. This Statement reduces gross expenses, including depreciation, by related program revenues, operating and capital grants, and contributions. Program revenues must be directly associated with the function.

The types of transactions included as program revenues are: charges for services, fees, licenses and permits; operating grants which include operating-specific and discretionary (either operating or capital) grants; and capital grants which are capital-specific grants. Internally dedicated resources are reported as general revenues rather than as program revenues. Likewise, general revenues include all taxes. Property taxes (imposed nonexchange transactions) are recognized as revenues in the year for which they are levied and municipal license taxes (derived tax revenues) when the underlying exchange has occurred. Revenues on both operating and capital grants are recognized when all eligibility requirements (which include time requirements) imposed by the provider have been met. For certain expenditure-driven grants revenue is recognized after allowable expenditures are incurred. As a policy, indirect expenses in the Statement of Activities are not allocated. The Municipality first uses restricted assets for expenses incurred for which both restricted and unrestricted assets are available.

The Municipality reports deferred revenues in the government-wide statements. Deferred revenues arise when resources are received before the Municipality has a legal claim to them or before applicable eligibility requirements are met (in case of certain federal expenditure-driven grants if resources are received before allowable expenditures are incurred). In subsequent periods, when the Municipality has a legal claim to the resources, the liability for deferred revenues is removed and the revenue is recognized.

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

-27 -

ORTIZ, RODRIGUEZ, RIVERA & CO.

CERTIFIED PUBLIC ACCOUNTANTS • VALUE ADDED SERVICES

Suite 152, PO Box 70250, San Juan, P.R. 00936-7250 • Phone (787) 756-8524, Fax (787) 274-0562

MUNICIPALITY OF ISABELA  
NOTES TO FINANCIAL STATEMENTS

June 30, 2005

**NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued**

**Fund Statements**

The financial transactions of the Municipality are recorded in individual funds, each of which are considered an independent fiscal entity. Each fund is accounted for by providing a separate set of self balancing accounts that comprise its assets, liabilities, reserves, fund equity, revenues and expenditures. Funds are segregated according to their intended purpose which helps management in demonstrating compliance with legal, financial and contractual provisions. Governmental Funds are those through which most governmental functions of the Municipality are financed. The governmental fund statements include a Balance Sheet and a Statement of Revenues, Expenditures and Changes in Fund Balances with one column for the general fund, one for each major fund and one column combining all non-major governmental funds. Major funds are determined based on a minimum criterion, that is, a percentage of the assets, liabilities, revenues or expenditures (for Community Development Block Grant Program Fund) or based on the Municipality's official's criteria, if the fund is particularly important to financial statement users (for Child Care/Head Start Program Fund and Debt Service Fund).

The Municipality reports the following major governmental funds:

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

**Community Development Block Grant Program Fund (CDBG):** CDBG fund is used to account for revenues sources for the development of viable urban communities by providing decent housing, a suitable living environment and expanding economic opportunities, principally for persons of low and moderate income.

**Child Care/Head Start Program:** Child Care/Head Start is used to account for revenues sources for the related activities that promote school readiness by enhancing the social and cognitive development of low-income children, including children of federally recognized reservations and children of migratory farm workers, through the provisions of comprehensive health, educational, nutritional, social and other services; and to involve parents in their children's learning and to help parents make progress toward their educational, literacy and employment goals. The program also emphasizes the significant involvement of parents in the administration of their local Head Start programs.

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

Governmental funds are accounted for using the current financial resources measurement focus. With this measurement focus, only current assets and current liabilities are included on the balance sheet in the funds statements. Long-term assets and long-term liabilities are included in the government-wide statements. Operating statements of these funds present increases (i.e., revenues and other financing sources) and decreases (i.e., expenditures and other financing uses) in net current assets.

-28 -

ORTIZ, RODRIGUEZ, RIVERA & CO.

CERTIFIED PUBLIC ACCOUNTANTS • VALUE ADDED SERVICES

Suite 152, PO Box 70250, San Juan, P.R. 00936-7250 • Phone (787) 756-8524, Fax (787) 274-0562

**MUNICIPALITY OF ISABELA**  
**NOTES TO FINANCIAL STATEMENTS**

**June 30, 2005**

**NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued**

The fund statements are maintained and reported on the modified accrual basis of accounting. Under this method of accounting, revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the Municipality considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. Expenditures generally are recorded when the related liability is incurred.

Property taxes (imposed nonexchange transactions) are recognized as revenues in the year for which they are levied and municipal license taxes (derived tax revenues) when the underlying exchange has occurred, subject to the availability criteria. Revenues on intergovernmental grants are recognized when all eligibility requirements (which include time requirements) imposed by the provider have been met and revenue becomes available. For certain expenditure-driven grants revenue is recognized after allowable expenditures are incurred. Licenses and permits, charges for services, rent and miscellaneous revenues are recorded as revenues when received because they are not measurable and available.

The Municipality reports deferred revenues in the governmental funds statements which arise when potential revenue does not meet both measurable and available criteria for recognition in the current period (in the government-wide statements revenue is recognized as soon as it is earned regardless of its availability). Deferred revenues also arise when resources are received before the Municipality has a legal claim to them or before applicable eligibility requirements are met (in case of certain federal expenditure-driven grants if resources are received before allowable expenditures are incurred). In subsequent periods, when the revenue recognition criteria is met, or when the Municipality has a legal claim to the resources, the liability for deferred revenues is removed from the combined balance sheet and the revenue is recognized.

Expenditures are generally recognized when the related liability is incurred. Certain exceptions to this fundamental concept include the following:

- 1) payments of principal and interest on general long term debt, which are recorded as expenditures when due, except for principal and interest due on July 1 (in this case amounts are recorded as liabilities and expenditures on June 30 since amounts have been accumulated or transferred to the debt service fund before July 1 payments are made);
- 2) vested compensated absences, claims and judgments and special termination benefits which are recorded as expenditures only to the extent that they are expected to be liquidated with expendable financial resources (in the government-wide statements the expense and related accrual liability for long term portions of debt must be included).

Since the governmental fund statements are presented on a different measurement focus and basis of accounting than the government-wide statements, reconciliation is necessary to explain the adjustments needed to transform the fund financial statements into the government-wide statements. This reconciliation is part of the financial statements.

**MUNICIPALITY OF ISABELA**  
**NOTES TO FINANCIAL STATEMENTS**

**June 30, 2005**

**NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued**

**Notes to Financial Statements**

The notes to financial statements provide information that is essential to a user's understanding of the basic financial statements.

**Required Supplementary Information:**

Required supplementary information consists of the Budgetary Comparison Schedule – General Fund as required by GASB.

**3. *Cash, cash equivalents (unrestricted and restricted) and restricted cash with fiscal agents***

Cash and cash equivalents consists of cash on hand, demand deposits and short term investments with original maturities of three months or less from the date of acquisition. The Municipality follows the practice of pooling cash of all funds except for certain Commonwealth's grants, restricted funds generally held by outside custodians and federal grants. Available pooled cash balance beyond immediate needs is invested in certificates of deposits. Cash and cash equivalents related to Commonwealth and Federal grants are restricted since their use is limited by applicable agreements or required by law.

Restricted cash with fiscal agent in the debt service fund consists of the undisbursed balance of property tax collections retained by the Commonwealth of Puerto Rico which are restricted for the repayment of the Municipality's general and special obligation bonds and notes as established by law. Restricted cash with fiscal agent of the general and other governmental funds represent the undisbursed proceeds of certain bonds, loans or grants which are maintained in a cash custodian account by the GDB or a federal government agency.

**4. *Receivables and due from governmental entities***

Receivables are stated net of estimated allowances for uncollectible accounts, which are determined upon past collection experience and current economic conditions.

Amounts due from federal government represent amounts owed to the Municipality for the reimbursement of expenditures incurred pursuant to federally funded programs. Amounts reported in the debt service fund represent property tax revenue of current fiscal year collected by the CRIM on the first month (July) of subsequent fiscal year.

**5. *Interfund receivables and payables***

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

**MUNICIPALITY OF ISABELA**  
**NOTES TO FINANCIAL STATEMENTS**

**June 30, 2005**

**NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued**

**6. Inventories**

The Municipality purchases gasoline, oil and other expendable supplies held for consumption. The cost of those purchases is recorded as expenditure when incurred in the appropriate fund but the year-end inventory is not recorded in the Statement of Net Assets, as management believes is not significant. Only inventory of medicines and medical supplies of the Municipality's Advanced Medical Center ("CIMA") in the amount of \$216,160 are included in the financial statements.

**7. Capital assets**

Capital assets, which include property, plant, equipment, and infrastructure, (e.g., roads, bridges, sidewalks, and similar items) are reported in the governmental activities column in the Statement of Net Assets. Capital assets are capitalized at historical cost or estimated historical cost if historical cost is not available. Donated assets are recorded as capital assets at their estimated fair market value at the date of donation. The municipality maintains a threshold level of \$500 or more for capitalizing vehicles, machinery and equipment. Infrastructure assets are capitalized based on a percentage of the estimated useful life. The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend assets lives are not capitalized. Major outlays for capital assets and improvements are capitalized as projects are constructed.

All capital assets, other than land, are depreciated using the straight-line method over the following useful lives:

<u>Description</u>	<u>Years</u>
Land improvements	50
Buildings and building improvements	50
Infrastructure	10-50
Vehicles, machinery and equipment	5-10

**8. Long-term obligations**

Long-term debt and other long-term obligations, which are reported as liabilities in the governmental activities column in the Statement of Net Assets, consists of general and special obligation bonds, liabilities for compensated absences, claims and judgments, and long-term liabilities to other governmental entities.

**9. Deferred bond issuance costs**

Bond issuance costs are reported as deferred charges and amortized as required by current standards. Governmental fund types recognize bond issuance costs as expenditures during the current period. Those issuance costs, whether or not withheld from the actual debt proceeds received, are reported as expenditures in the appropriate fund.

MUNICIPALITY OF ISABELA

NOTES TO FINANCIAL STATEMENTS

June 30, 2005

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

10. *Compensated absences*

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

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

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

11. *Fund balances and Net Assets*

a. Fund balances:

In the fund financial statements, governmental funds report reserved and unreserved fund balances. Reservations of fund balance represent portions of the fund balance that are legally segregated for a specific future use or are not appropriated for expenditure. The Municipality has the following reservations of fund balance:

Encumbrances:	Represent future expenditures under purchase orders and other commitments, which generally will become liabilities in future periods as the goods or services are received.
Inventories:	Represent the valuation amount assigned for the restriction and use of resources accounted in inventory on hand.
Debt Service:	Represents net assets available to finance future debt service payments.
Capital Projects:	Represent amounts to be used for future expenditures for capital projects under contracts and other commitments. These commitments generally will become liabilities in future periods as the projects are completed.
Other specified purposes:	Represent amounts to be used for future expenditures of Federal and Commonwealth's grants as well as funds reserved through enabling legislation passed by the government itself, to be used to finance activities other than construction or capital improvement commitments

**MUNICIPALITY OF ISABELA**  
**NOTES TO FINANCIAL STATEMENTS**

**June 30, 2005**

**NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued**

**b. Net assets**

In the government-wide statements net assets are segregated into three categories:

**Invested in capital assets, net of related debt:** Consists of capital asset balances net of accumulated depreciation and outstanding balances of any bonds, notes and other borrowings that are attributable to the acquisition, construction, or improvement of those assets. This category should not include cash that is restricted to capital asset acquisition or construction (unspent bond proceeds) and any unamortized debt issue costs.

**Restricted net assets:** Represents net assets that are subject to restrictions beyond the Municipality's control. These include restrictions that are externally imposed (by creditors, grantors, contributors, or laws and regulations of other governments) or restrictions imposed by the law through constitutional provisions or enabling legislation (including enabling legislation passed by the government itself).

**Unrestricted net assets:** Represent net assets that do not meet the definition of net assets Invested in capital assets, net of related debt or restricted. Unrestricted assets are often designated to indicate that management does not consider them to be available for general operations. These types of constraints are internal and management can remove or modify them. Designations are not reported on the face of the statement of net assets.

**12. *Interfund transactions***

The Municipality reports certain transactions as operating transfers, which are legally required transfers that are reported when incurred as "Operating transfers-in" by the recipient fund and as "Operating transfers-out" by the disbursing fund.

**13. *Risk financing***

The Puerto Rico Treasury Department (PRDT) acts as an agent, obtaining and determining the coverage for the municipalities of Puerto Rico. The coverage for the Municipality consists of professional, public responsibility, property and theft, auto and fidelity bond coverage.

**14. *Use of estimates***

The preparation of the basic financial statements in accordance 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 disclosure of contingent assets and liabilities at the date of the basic financial statements and the reported amounts of revenues and expenditures during the reporting period. Actual results could differ from those estimates.

-33 -

**ORTIZ, RODRIGUEZ, RIVERA & CO.**

CERTIFIED PUBLIC ACCOUNTANTS • VALUE ADDED SERVICES

Suite 152, PO Box 70250, San Juan, P.R. 00936-7250 • Phone (787) 756-8524. Fax (787) 274-0562

**MUNICIPALITY OF ISABELA**  
**NOTES TO FINANCIAL STATEMENTS**

**June 30, 2005**

**NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued**

**15. Future adoption of accounting pronouncements**

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

Statement	To be Adopted in Fiscal year ended,
42      Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries	June 30, 2006
43      Financial Reporting for Post employment Benefits Plans Other Than Pension Plans	June 30, 2008
44      Economic Condition Reporting: The Statistical Section – an amendment of NCGA Statement No. 1	June 30, 2006
45      Accounting and Financial Reporting by Employers for Post employment Benefits Other Than Pensions	June 30, 2009
46      Net Assets Restricted by Enabling Legislation, an amendment of GASB Statement No. 34	June 30, 2007
47      Accounting for Termination Benefits	June 30, 2006; for termination benefits provided through an existing defined benefit OPEB plan, the provisions of this Statement should be implemented simultaneously with the requirements of Statement 45.

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

**MUNICIPALITY OF ISABELA**  
**NOTES TO FINANCIAL STATEMENTS**

June 30, 2005

**NOTE B – CUSTODIAL CREDIT RISK - DEPOSITS**

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

Under Commonwealth of Puerto Rico statutes, public funds deposited in commercial banks must be fully collateralized for the amount deposited in excess of federal deposit insurance. All securities pledged as collateral by the Municipality are held by the Secretary of Treasury of Puerto Rico in the Municipality's name. At year end the Municipality's bank balance in commercial banks amounts to \$15,523,071.

Deposits in governmental banks are uninsured and uncollateralized. At year end the Municipality's bank balance in governmental banks amounts to \$1,884,945.

**NOTE C – RECEIVABLES OTHERS**

Accounts receivable others as of June 30, 2005 are detailed as follow:

	Amount
Construction permits levy – Villa Pesquera Apartment	\$ 101,870
Puerto Rico Department of Treasury	119,460
Healthcare providers billings	122,619
Interest	53,580
Puerto Rico Recreation and Sports Department	66,500
	\$ 464,029

**NOTE D - DUE FROM (TO) GOVERNMENTAL ENTITIES**

1. Amounts due from governmental entities as of June 30, 2005 follows:

	Commonwealth Entities	Federal Government
Municipal Revenue Collection Center (CRIM) – property taxes (debt service fund)	\$ 290,889	\$ -
Puerto Rico Department of Family – Child Care	-	130,186
Puerto Rico Department of Family – Head Start	-	345,236
Puerto Rico Department of Family – Temporary Assistance for Needy Families	-	206,995
Office of Commissioner of Municipal Affairs – CDBG	-	2,071,587
US Department of Housing and Urban Development – CDBG	-	1,329,946
US Department of Housing and Urban Development – Section 8	-	1,856

-35 -

**ORTIZ, RODRIGUEZ, RIVERA & CO.**

CERTIFIED PUBLIC ACCOUNTANTS • VALUE ADDED SERVICES

Suite 152, PO Box 70250, San Juan, P.R. 00936-7250 • Phone (787) 756-8524, Fax (787) 274-0562

**MUNICIPALITY OF ISABELA**  
**NOTES TO FINANCIAL STATEMENTS**

**June 30, 2005**

**NOTE D - DUE FROM (TO) GOVERNMENTAL ENTITIES - Continued**

	Commonwealth Entities	Federal Government
Puerto Rico Department of Transportation-State and Community Highway Safety	\$ -	\$ 41,112
Puerto Rico Department of Health	209,836	
Puerto Rico Department of Transportation	147,633	-
Puerto Rico Department of Education	20,000	-
Puerto Rico Department of Labor	81,651	-
Puerto Rico Solid Waste Management Authority	350,000	-
Puerto Rico Department of Treasury - Christmas bonus reimbursement	291,719	-
	\$ 1,391,728	\$ 4,126,918

The amount due from Puerto Rico Department of Treasury - Christmas bonus (\$291,719) is recorded as deferred revenue in the governmental funds statements (general fund) since is not available as required by current standards.

2. Amounts due to governmental entities as of June 30, 2005 follows:

	Commonwealth Entities	Federal Government Entities
Puerto Rico Aqueduct and Sewer Authority (PRASA)	\$ 37,603	\$ -
Puerto Rico Department of Treasury	163,458	-
Puerto Rico Department of Labor	10,528	-
Puerto Rico General Services Administration	40,462	-
Federal Emergency Management Agency	-	59,743
	\$ 252,051	\$ 59,743

**MUNICIPALITY OF ISABELA**  
**NOTES TO FINANCIAL STATEMENTS**

June 30, 2005

**NOTE E - INTERFUND TRANSACTIONS**

**1. Due from/to other funds:**

Amounts due from/to other funds represent temporary advances to other funds by the general fund payroll and payroll taxes expenditures, as follows:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
General Fund	Major fund-CDBG	\$ 18,662
General Fund	Major fund – Head Start	160,493
General Fund	Other governmental funds-Section 8	32,998
General Fund	Other governmental funds-Child Care	169,872
General Fund	Other governmental funds-Temporary Assistance for Needy Families	206,995
General Fund	Other governmental funds-Home Investment Partnership Program	10,417
General Fund	Other governmental funds-State and Community Highway Safety	118,726
General Fund	Other governmental funds-Public Assistance Grants (FEMA)	96,226
		<hr/>
Total:		\$ 814,389
		<hr/>

**2. Operating transfers:**

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

**MUNICIPALITY OF ISABELA**  
**NOTES TO FINANCIAL STATEMENTS**

**June 30, 2005**

**NOTE F - CAPITAL ASSETS**

Capital assets and depreciation activity as of and for the year ended June 30, 2005 is as follows:

	Balance July 1, 2004, as restated	Increases	Decreases	Balance June 30, 2005
<b>Governmental activities:</b>				
Capital assets, not being depreciated:				
Land	\$ 3,668,589	\$ 17,000	\$ -	\$ 3,685,589
Construction in progress	<u>3,267,674</u>	<u>2,128,851</u>	<u>2,279,381</u>	<u>3,117,144</u>
Total capital assets not being depreciated:	6,936,263	2,145,851	2,279,381	6,802,733
Capital assets, being depreciated:				
Buildings and building improvements	9,745,479	2,784,614	-	12,530,093
Infrastructure	9,750,997	343,217	4,393	10,089,821
Vehicles, machinery and equipment	<u>6,065,280</u>	<u>877,287</u>	<u>448,708</u>	<u>6,493,859</u>
Total capital assets being depreciated	25,561,756	4,005,118	453,101	29,113,773
Less accumulated depreciation for:				
Buildings and building improvements	1,078,827	198,723	-	1,277,550
Infrastructure	1,223,505	177,914	705	1,400,714
Vehicles, machinery and equipment	<u>2,068,041</u>	<u>358,910</u>	<u>300,951</u>	<u>2,126,000</u>
Total accumulated depreciation	4,370,373	735,547	301,656	4,804,264
Total capital assets being depreciated, net	<u>21,191,383</u>	<u>3,269,571</u>	<u>151,445</u>	<u>24,309,509</u>
Governmental activities capital assets, net	<u>\$ 28,127,646</u>	<u>\$ 5,415,422</u>	<u>\$ 2,430,826</u>	<u>\$ 31,112,242</u>

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

**Governmental activities:**

General government	\$ 48,186
Public works and sanitation	392,560
Public safety	64,246
Culture and recreation	188,798
Health	17,455
Welfare and community development	13,816
Education	<u>10,486</u>

Total depreciation expense, governmental activities \$ 735,547

**MUNICIPALITY OF ISABELA**  
**NOTES TO FINANCIAL STATEMENTS**

**June 30, 2005**

**NOTE G - LONG TERM DEBT**

**1. Summary of long-term debt activity**

The following summarizes activity in long-term debt for the fiscal year ended June 30, 2005:

	Balance at July 1, 2004, as restated	Increases	Decreases	Balance at June 30, 2005	Due within one year
General, Special Obligations Bonds and Notes	\$ 6,697,024	\$ 255,000	\$ 735,000	\$ 6,217,024	\$ 801,000
Note payable to CRIM- LIMS	416,394	-	45,525	370,869	48,275
Note payable to CRIM - Financing of delinquent accounts	332,275	-	179,951	152,324	-
Note payable to PR Department of Labor	-	432,781	126,639	306,142	76,946
Note payable to PR Aqueduct and Sewer Authority (PRASA)	58,923	-	41,663	17,260	17,260
Note payable to PR Solid Waste Authority	-	277,868	25,000	252,868	31,502
Landfill Obligation	3,722,789	197,708	-	3,920,497	-
Compensated absences	1,385,268	502,104	116,041	1,771,331	108,021
Christmas bonus	324,219	628,071	324,219	628,071	628,071
Claims and judgments	-	63,672	-	63,672	63,672
Payable to CRIM- excess of property tax advances over actual collections	-	33,613	-	33,613	-
	<u>\$ 12,936,892</u>	<u>\$ 2,390,817</u>	<u>\$ 1,594,038</u>	<u>\$ 13,733,671</u>	<u>\$ 1,774,747</u>

**MUNICIPALITY OF ISABELA**  
**NOTES TO FINANCIAL STATEMENTS**

June 30, 2005

**NOTE G - LONG TERM DEBT - Continued**

**2. General and special obligation bonds and notes**

The Municipality's outstanding general and special obligation bonds and notes at June 30, 2005 amount to \$ 6,217,024. All these bonds are serviced by the Governmental Development Bank of Puerto Rico (GDB) maturing at various dates. As required by law, the Commonwealth Government is obligated to levy and collect property taxes for payment of principal and interest on bonds and notes. A debt service fund has been established for the bonds and notes at GDB with the proceeds of those property taxes, whereby sufficient funds must be set aside in order to cover the projected debt service requirement, before any new bonds are issued. Principal and interest payments of long term debt issued for operational purposes are made through withholdings from the advances of property tax and amounts of municipal equalization fund send to the Municipality by the Municipal Revenue Collection Center (CRIM).

A detail of the general and special obligation bonds and notes as of June 30, 2005 follows:

	<u>Outstanding Amount</u>
1996 general obligation bonds of \$525,000 due in annual installments ranging from \$13,000 to \$36,000 through January 1, 2021; bearing interest at 4.50%	\$ 417,000
1999 general obligation notes of \$1,510,000 due in annual installments ranging from \$210,000 to \$300,000 through July 1, 2005; bearing interest at rates ranging from 2.80% to 7.81% (2.89% at June 30, 2005)	300,000
1999 general obligation bonds of \$410,000 due in annual installments ranging from \$11,000 to \$29,000 through January 1, 2024; bearing interest at 4.50%	375,024
2000 general obligation bonds of \$305,000 due in annual installments ranging from \$20,000 to \$40,000 through January 1, 2005; bearing interest at rates ranging from 2.70% to 7.81% (2.89% at June 30, 2005)	210,000
2001 general obligation notes of \$985,000 due in annual installments ranging from \$170,000 to \$230,000 through July 1, 2006; bearing interest at rates ranging from 2.70% to 5% (2.89% at June 30, 2005)	440,000

**MUNICIPALITY OF ISABELA**  
**NOTES TO FINANCIAL STATEMENTS**

**June 30, 2005**

**NOTE G - LONG TERM DEBT - Continued**

	Outstanding Amount
2001 general obligation bonds of \$3,455,000 due in annual installments ranging from \$45,000 to \$290,000 through July 1, 2026; bearing interest rates ranging from 5.00% to 7.50% (5.00% at June 30, 2005)	3,295,000
2005 general obligation bonds of \$255,000 due in annual installments ranging from \$5,000 to \$25,000 through July 1, 2029; bearing interest rates ranging from 4.37% to 5.50% (4.37% at June 30, 2005)	255,000
1993 special obligation note of \$505,000 due in annual installments ranging from \$20,000 to \$65,000 through July 1, 2009; bearing interest at rates ranging from 3.28% to 8.00% (4.37% at June 30, 2005)	245,000
1999 special obligation note of \$1,160,000 due in annual installments ranging from \$80,000 to 155,000 through July 1, 2009; bearing interest at rates ranging from 5.00% to 7.81% (5.00% at June 30, 2005)	680,000
	\$ 6,217,024

The annual requirement to amortize general and special obligation bonds and notes as of June 30, 2005 follows:

June 30	Principal	Interest
2006	\$ 801,000	\$ 294,903
2007	537,000	267,682
2008	329,000	245,493
2009	351,000	219,110
2010	387,000	196,370
2011-2015	813,000	828,175
2016-2020	1,071,000	515,875
2021-2025	1,283,000	271,800
2026-2029	645,024	32,200
Totals	\$ 6,217,024	\$ 2,871,608

**MUNICIPALITY OF ISABELA**  
**NOTES TO FINANCIAL STATEMENTS**

June 30, 2005

**NOTE G - LONG TERM DEBT - Continued**

**3. Other long-term liabilities**

Amount

**Note payable to CRIM (LIMS)** – On June 27, 2001 the Municipality entered into a financing agreement with the CRIM in the amount of \$519,187 for the payment of the Municipality's share of the cost of a management information system (LIMS) acquired by the CRIM for the management of taxpayer's properties located in Puerto Rico. The note is payable in semiannual installments of \$34,817, including interest of 5.95% and is due on November 28, 2011. Amount is financed with unrestricted funds through withholdings from the advances of property tax and amounts of municipal equalization fund send to the Municipality by the Municipal Revenue Collection Center (CRIM). Debt service requirements in future years are as follows:

\$ 370,869

June 30	Principal	Interest
2006	\$ 48,275	\$ 51,539
2007	51,190	18,804
2008	54,281	15,353
2009	57,559	12,075
2010	61,034	8,600
2011-2012	98,530	5,920
<b>Totals</b>	<b>\$ 370,869</b>	<b>\$ 112,291</b>

Amount

**Note payable to CRIM (Financing of delinquent accounts)**– On April 2, 2002, the Municipality entered into a financing agreement with the CRIM in the amount of \$471,041, to finance delinquent property tax accounts sold to private investors, under the provision of Law No. 146 of October 11, 2001. The agreement is in the form of a nonrevolving line of credit bearing interest of 6.5% for the first 5 years and variable for the next 25 years at 125 points over London Interbank Offered Rate (LIBOR) and is due on December 1, 2032. As described in Law No. 146, interest payments for the first 5 years will be financed through .48% of the net increase of subsidy provided by the Commonwealth of Puerto Rico's general fund. Also, during the first 5 years any collection from those delinquent accounts will be credited to the loan principal. After the 5 year period the loan outstanding balance will be restructured for a 25 years period. Debt service requirements in future years are as follows:

\$ 152,324

-42 -

ORTIZ, RODRIGUEZ, RIVERA & CO.

CERTIFIED PUBLIC ACCOUNTANTS • VALUE ADDED SERVICES

Suite 152, PO Box 70250, San Juan, P.R. 00936-7250 • Phone (787) 756-8524. Fax (787) 274-0562

**MUNICIPALITY OF ISABELA**  
**NOTES TO FINANCIAL STATEMENTS**

June 30, 2005

**NOTE G - LONG TERM DEBT - Continued**

June 30	Principal	Interest
2006	\$ -	\$ 9,901
2007	-	9,901
2008	-	9,901
2009	2,619	9,824
2010	2,795	9,649
2011-2015	17,043	45,172
2016-2020	23,568	38,647
2021-2025	32,590	29,625
2026-2030	45,066	17,149
2031-2033	28,643	2,465
Totals	<u>\$ 152,324</u>	<u>\$ 182,234</u>

**Note payable to Puerto Rico Aqueduct and Sewer Authority (PRASA)** - On October 31, 2003, the Municipality entered into a financing agreement with the PR Aqueduct and Sewer Authority for unpaid water and sewer service charges. The agreement requires monthly payments of \$3,471 and is due on November 15, 2005. The note is being paid from unrestricted funds.

Amount  
\$ 17,260

**Note payable to Puerto Rico Department of Labor** - On February 16, 2005, the Municipality entered into a financing agreement with the PR Department of Labor for a total amount of \$474,884 for unemployment benefits paid by the Commonwealth of Puerto Rico in behalf of the municipality. The agreement is in the form of a non-interest bearing note (imputed interest of 6%) payable in monthly installments of \$7,768 and due in February 15, 2009. The note balance as of June 30, 2005 is net of an unamortized discount of \$35,671 and is being paid from unrestricted funds.

\$ 306,142

June 30	Principal	Interest
2006	\$ 76,946	\$ 16,275
2007	81,692	11,529
2008	86,731	6,491
2009	60,773	1,376
Totals	<u>\$ 306,142</u>	<u>\$ 35,671</u>

**MUNICIPALITY OF ISABELA**  
**NOTES TO FINANCIAL STATEMENTS**

June 30, 2005

**NOTE G - LONG TERM DEBT - Continued**

		Amount
<p><b>Note payable to Puerto Rico Solid Waste Authority</b> - On September 17, 2004, the Municipality entered into a financing agreement with the PR Solid Waste Authority for a total amount of \$307,944 for unpaid operating lease charges related to equipment used in the Municipality's landfill. The agreement is in the form of a non-interest bearing note (imputed interest of 6%) payable in semiannual installments of \$20,000, a final payment of \$22,944 and due in January 1, 2012. The note balance as of June 30, 2005 is net of an unamortized discount of \$30,076 and is being paid from unrestricted funds.</p>	\$	252,868
June 30	Principal	Interest
2006	\$ 31,502	\$ 8,498
2007	33,842	6,158
2008	34,827	5,173
2009	35,842	4,158
2010	36,886	3,114
2011-2012	79,969	2,975
Totals	\$ 252,868	\$ 30,076
<p><b>Compensated absences</b> - includes accrued vacations, sick leave benefits and other benefits with similar characteristics such as compensatory time, represents the Municipality's commitment to fund such costs from future operations. Amount is paid with unrestricted funds</p>	\$	1,771,331
<p><b>Christmas Bonus</b> - represent the accrued portion corresponding to fiscal year 2004-2005 of the Christmas bonus to be paid in December 2005</p>	\$	628,071
<p><b>Claims and judgments</b> - represent the final settlement of one legal case in the amount of \$33,672 and a reasonable estimate of \$30,000 for a probable claim that has not yet been settled as of June 30, 2005. The total amount of \$63,672 has been appropriated in next fiscal year's budget.</p>	\$	63,672
<p><b>Landfill obligation</b> - represent the discounted balance of the estimated liability for landfill closure and post-closure care costs, based on a 6% interest rate and an 87% usage of the landfill. The total estimate for these costs amounts to \$4,320,000 as of June 30, 2005.</p>	\$	3,920,497

**MUNICIPALITY OF ISABELA**  
**NOTES TO FINANCIAL STATEMENTS**

**June 30, 2005**

**NOTE G - LONG TERM DEBT – Continued**

	<u>Amount</u>
<b>Payable to CRIM</b> - represents the balance owed to CRIM at June 30, 2005 for excess of advances of property tax and other subsidies over final amount of property tax collections for the fiscal years June 30, 2005. This amount will be repaid with unrestricted funds through withholdings from the advances of property tax and amounts of municipal equalization fund send to the Municipality by the Municipal Revenue Collection Center (CRIM).	\$ 33,613

**NOTE H - LANDFILL CLOSURE AND POSTCLOSURE CARE COSTS OBLIGATIONS**

State and Federal laws and regulations require the Municipality to perform certain closure procedures and establish monitoring and maintenance procedures 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 future 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 a 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 \$3,290,497 (based on a 6% discount rate), as of June 30, 2005, which is based on an 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 balance sheet date 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 (\$4,320,000) 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, 2005. 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, 2005, the Municipality has not made contributions to finance closure and post-closure care costs.

**NOTE I - PROPERTY TAXES**

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

**MUNICIPALITY OF ISABELA**  
**NOTES TO FINANCIAL STATEMENTS**

**June 30, 2005**

**NOTE I - PROPERTY TAXES - Continued**

The tax rates in force as of June 30, 2005 are 8.53% for real property (of which 8.33% is paid by the taxpayer and .20% is reimbursed by the Puerto Rico Treasury Department) and 6.53% for personal property (of which 6.33% is paid by the taxpayer and .20% is reimbursed by the Puerto Rico Treasury Department). For both tax rates 1.03% belongs to the Commonwealth and 7.50% and 5.50%, respectively, belongs to the Municipality. Of the portion belonging to the Municipality, 6% on real property and 4% on personal property represents the Municipality's portion which is appropriated for general purposes and accounted in the general fund. The remaining portion of 1.50% on both tax rates belonging to the Municipality is restricted for debt service and accounted in the debt service fund.

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

The CRIM advances funds to the Municipality based on an estimate of special governmental subsidies and the property taxes to be levied and which are collected in subsequent periods. This distribution includes advances of property tax and amounts of municipal equalization fund from the Commonwealth government. The CRIM is required by law to prepare a settlement statement on a fiscal year basis, whereby a comparison is made between the amounts advanced to the Municipality and amounts actually collected from taxpayers. The CRIM prepares a preliminary settlement not later than three months after fiscal year-end and a final settlement not later than six months after fiscal year-end. If actual collections exceed the advances a receivable from CRIM is recorded. However, if advances exceed actual collections, a payable to CRIM is recorded. The Municipality has a net payable to the CRIM of \$33,613 resulting from the preliminary settlement for fiscal year 2004-2005. The total amount is recorded as a long term debt in the government-wide statement since will not be paid with expendable available resources.

**NOTE J - MUNICIPAL LICENSE TAXES**

Municipal License taxes are assessed annually by the Municipality to all organizations or entities subject to the tax doing business in the Municipality's location except for entities totally or partially exempt pursuant to certain Commonwealth's statutes. This tax is based generally on volume of business or gross sales as shown in a tax return that should be submitted on or before April 15. During the fiscal year ended June 30, 2005 the tax rates were as follows:

Financial business - 1.50% of gross revenues  
Other non-financial business .50% of gross revenues  
Other organizations - as qualified as special areas under governmental construction projects:  
    Up to \$100,000 - .30%  
    From \$100,000 to \$200,000 - .40% of gross revenues  
    Over \$200,000 - .50% of gross revenues

The tax is due in two equal installments on July 1 and January 1 of each fiscal year. Tax revenue is recognized at that moment by the Municipality. A discount of 5% is allowed when full payment is made on or before April 15.

-46 -

**ORTIZ, RODRIGUEZ, RIVERA & CO.**

CERTIFIED PUBLIC ACCOUNTANTS • VALUE ADDED SERVICES

Suite 152, PO Box 70250, San Juan, P.R. 00936-7250 • Phone (787) 756-8524, Fax (787) 274-0562

**MUNICIPALITY OF ISABELA**  
**NOTES TO FINANCIAL STATEMENTS**

**June 30, 2005**

**NOTE J - MUNICIPAL LICENSE TAXES - Continued**

Municipal license taxes collected prior to June 30 but pertaining to the next fiscal year in the amount of \$1,665,724 are recorded as deferred revenues.

**NOTE K - INTERGOVERNMENTAL REVENUES**

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

	<u>Amount</u>
Amount of municipal subsidies and equalization fund send by CRIM	\$ 2,843,986
Compensation in lieu of tax from the Puerto Rico Electric Power Authority (PREPA)	1,313,702
Commonwealth Joint Resolutions grants	1,973,105
Reimbursement from Commonwealth Government of Christmas Bonus expenditure	258,154
Reimbursement from Commonwealth Government of Law 52 program expenditures	506,910
Reimbursement from Commonwealth government - other programs expenditures	266,052
	<u>\$ 7,161,909</u>

**NOTE L - RETIREMENT PLAN**

**1. Plan description**

Regular employees of the Municipality contribute to a cost sharing multiple employer defined benefit retirement plan, administered by the Employee's Retirement System of the Government of Puerto Rico an its Instrumentalities (ERS). ERS covers all regular full time public employees working for the central government, public corporations and the municipalities of Puerto Rico. The system provides retirement pensions, death and disability benefits.

Retirement benefits depend upon age at retirement and number of years of credited service. Disability retirement benefits are available to members of occupational and no occupational disabilities. Benefits vest after ten years of plan participation. The system was created under Act 447, approved on May 15, 1951, as amended, and became effective on January 1, 1952. Retirement benefits are determined by the application of stipulated benefit ratios to the member's average compensation. Average compensation is computed based on the highest 36 months of compensation recognized by ERS. The annuity, for which a plan member is eligible, is limited to a minimum of \$200 per month and a maximum of 75% of the average compensation. ERS issues a publicly financial report that includes financial statements and required supplementary information of the Plan, which may be obtained from the ERS.

-47 -

**ORTIZ, RODRIGUEZ, RIVERA & CO.**

CERTIFIED PUBLIC ACCOUNTANTS • VALUE ADDED SERVICES

Suite 152, PO Box 70250, San Juan, P.R. 00936-7250 • Phone (787) 756-8524, Fax (787) 274-0562

**MUNICIPALITY OF ISABELA**  
**NOTES TO FINANCIAL STATEMENTS**

June 30, 2005

**NOTE L - RETIREMENT PLAN - Continued**

Law No. 305 of September 24, 1999 amended the Act No. 447 of 1951 and was enacted with the purpose of establishing a new pension program (System 2000). The new pension program became effective on January 1, 2000. Employees participating in the current system as of December 31, 1999 may elect either to stay in the defined benefit plan or transfer to the new program. Persons joining the government on or after January 1, 2000 will only be allowed to become members of the new program.

System 2000 is a hybrid defined contribution plan, also known as a cash balance plan. There will be a pool of pension assets, which will be invested by the System, together with those of the current defined benefit plan. Benefits at retirement age will not be guaranteed by the State government and will be subjected to the total accumulated balance of the savings account. The annuity will be based on a formula, which assumes that each year the employee's contribution (with a minimum of 8.275% of the employee's salary up to a maximum of 10%) will be invested in an account which will either: (1) earn a fixed rate based on the two-year Constant Maturity Treasury Note or, (2) earn a rate equal to 75% of the return of the System's investment portfolio (net of management fees), or (3) earn a combination of both alternatives. If savings accounts balance is \$10,000 or less at time of retirement, the balance will be distributed by the System to the participant as a lump sum. Participants receive periodic account statements similar to those of defined contribution plans showing their accrued balances. Disability pensions are not been granted under the new program. The employer contributions (9.275% of the employee's salary) will be used to fund the current plan. Under System 2000 the retirement age is reduced from 65 years to 60 for those employees who joined the current plan on or after April 1, 1990.

**2. Funding policy**

The Act 447, as amended, is the authority under which obligations to contribute to the Plan by the Plan members, employers and other contributing entities are established or may be amended. Plan members are required to contribute 5.775% of gross salary up to \$6,600 plus 8.275% of gross salary in excess of \$6,600 except for the Mayor or employee under a supplementation plan, which contributes 8.275% of gross salary. The Municipality is required to contribute 9.275% of gross salary.

The Municipality's actual contribution for the current and the previous fiscal year, which is equal to the required contribution, follows:

Fiscal year ended:	Law No. 447	System 2000
2005	\$ 243,239	\$ 77,808
2004	\$ 236,643	\$ 55,344

**MUNICIPALITY OF ISABELA**  
**NOTES TO FINANCIAL STATEMENTS**

**June 30, 2005**

**NOTE M - COMMITMENTS**

**1. *Operating leases***

The Municipality leases office space and office equipment under operating lease agreements, which generally have terms of one year or less and are automatically renewed for the same terms. Management believes that the summary of the future minimum rental commitments under noncancelable equipment leases with terms exceeding one year is not significant.

**2. *Construction***

The Municipality has commitments at June 30, 2005 of approximately \$ 1,647,784 for construction, improvements or renovation of certain municipal facilities.

**NOTE N - CONTINGENCIES**

**1. *Federal and State grants***

Projects financed by Federal and State Grants are subject to audits by grantors and other governmental agencies in order to determine its expenditures to comply with the conditions of such grants. It is the Municipality's opinion that no additional material unrecorded liabilities will arise from audits previously performed or to perform.

**2. *Judgments and legal claims***

The Municipality is, at present, a defendant in a number of legal matters that arise in the ordinary course of the Municipality's activities. There are cases whereby the Municipality is a defendant or codefendant that will be covered by insurance, certain cases whereby the legal counsel has not determined an outcome and other cases that will not be covered by insurance. As a result of one case settled subsequent to June 30, 2005 and a legal claim in which an unfavorable outcome is probable and a reasonable estimate of the amount was determined, and not to be covered by insurance, the Municipality accrued \$ 63,672 in the government-wide statements. However, it is the opinion of the Municipality and the legal counsels that based on their experience, such actions and the potential liabilities will not impair the Municipality financial position.

**NOTE O- NET CHANGE IN FUND BALANCE - GENERAL FUND**

The Statement of revenues, expenditures and changes in fund balance reported a net change in fund balance for the general fund in the amount of \$1,826,105, which is composed of the following:

	<u>Amount</u>
Net change in fund balance, 01 Fund	\$ 1,069,050
Net change in fund balance, other special funds included as part of the general fund	757,055
	<u>\$ 1,826,105</u>

**MUNICIPALITY OF ISABELA**  
**NOTES TO FINANCIAL STATEMENTS**

June 30, 2005

**NOTE O- NET CHANGE IN FUND BALANCE - GENERAL FUND - Continued**

The composition of the net change in fund balance of the other governmental funds included in the general fund will be detailed in a supplementary schedule at the end of the basic notes to the financial statements.

**NOTE P - FUND BALANCE AND NET ASSETS RESTATEMENTS**

**1. Fund balances**

The beginning fund balance of the general fund has been restated to correct an overstatement of accounts payable to suppliers in the amount of \$89,889; an overstatement of amounts due to federal government \$12,722; an understatement of accounts receivable of \$54,298 and a net understatement of amounts due from other funds of \$282,300. In addition, in the special funds in general fund, the beginning balances were restated to correct an understatement of amounts due from Commonwealth governmental entities of \$102,880 and an understatement of \$309,504 in the amounts due to the general fund. The following schedule reconciles the fund balance at July 1, 2004 as previously reported to the beginning fund balance, as restated:

Fund	Prior period adjustments			Balance at beginning of year, as Restated
	Balance at beginning of year, as previously reported	Fund reclassifications	Correction of errors	
General Fund	\$ 10,116,785	\$ -	\$ 232,585	\$ 10,349,370
Head Start	(166,167)	-	166,167	-
Other governmental funds	478,418	-	163,155	641,573
<b>Total</b>	<b>\$ 11,211,418</b>	<b>\$ -</b>	<b>\$ 561,907</b>	<b>\$ 11,773,325</b>

**2. Net assets**

The following summarizes changes to the net assets as previously reported in the prior year government-wide statements:

Net assets at beginning of year as previously reported:	\$ 30,191,893
<b>Restatements:</b>	
Overstatement of accounts payable to suppliers	89,889
Overstatement of amounts due to federal government	12,722
Understatement of accounts receivable	54,298
Net understatement of amounts due from other funds-general fund	282,300
Understatement of amounts due from Commonwealth Governmental Entities-Special funds in general fund	102,880
Understatement of amounts due to general fund-Special Funds in General Fund	(309,504)

**MUNICIPALITY OF ISABELA**  
**NOTES TO FINANCIAL STATEMENTS**

**June 30, 2005**

**NOTE P - FUND BALANCE AND NET ASSETS RESTATEMENTS - Continued**

	Amount
Understatement of amounts due from federal government - Head Start	166,167
Overstatement of amounts due to general fund-Nonmajor funds	135,021
Understatement of cash balance - Nonmajor funds	28,134
Understatement of general obligation debt balance	(3,661)
Understatement of construction in progress	86,450
Understatement of machinery and equipment, net	178,684
 Net assets at beginning of year as restated	 \$ 31,015,273

**NOTE Q- SPECIAL ITEMS**

**1. *Property tax amnesty***

Law No. 74 of March 1, 2004 approved by the Commonwealth's Legislature (as amended by Law No. 131 of June 1, 2004) granted to taxpayers (for the period March 1, 2004 to June 30, 2005) an amnesty for payment of real and personal property tax debts. As a result, the CRIM distributed to the Municipality \$1,909 on property tax collections as of June 30, 2005 which were recorded in the debt service fund.

**2. *Proceeds from notes payable to Commonwealth Governmental Entities***

During the fiscal year, the Municipality entered into financing agreements with the Puerto Rico Department of Labor and with the Puerto Rico Solid Waste Authority. The agreements are in the form of non-interest bearing notes (imputed interest of 6%). The proceeds of \$432,781 and \$277,868 represent the present value of both notes as of the issue date, respectively.

**REQUIRED SUPPLEMENTARY INFORMATION**

-52-

**ORTIZ, RODRIGUEZ, RIVERA & CO.**

CERTIFIED PUBLIC ACCOUNTANTS • VALUE ADDED SERVICES

Suite 152, PO Box 70250, San Juan, P.R. 00936-7250 • Phone (787) 756-8524, Fax (787) 274-0562

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ISABELA  
REQUIRED SUPPLEMENTARY INFORMATION - BUDGETARY COMPARISON SCHEDULE -  
GENERAL FUND  
FOR THE FISCAL YEAR ENDED JUNE 30, 2005**

	<u>Budgeted Amounts</u>		<u>Actual Amounts (Budgetary Basis) (See Note 1)</u>	<u>Variance with Final Budget- Positive (Negative)</u>
	<u>Original</u>	<u>Final</u>		
<b>REVENUES</b>				
Property taxes	\$ 3,884,338	\$ 4,127,888	\$ 4,132,395	\$ 4,507
Municipal license taxes	1,830,000	2,138,179	2,146,076	7,897
Intergovernmental	4,208,398	4,508,299	4,544,991	36,692
Fees, fines, and charges for service	1,296,482	2,044,807	2,275,696	230,889
Interests	30,000	150,258	249,462	99,204
Miscellaneous		21,364	27,948	6,584
Total revenues	<u>11,249,218</u>	<u>12,990,795</u>	<u>13,376,568</u>	<u>385,773</u>
<b>EXPENDITURES</b>				
General government	5,864,151	5,925,522	5,757,708	167,814
Public safety	1,114,373	1,182,285	984,058	198,227
Public works and sanitation	2,238,023	2,579,107	2,298,907	280,200
Culture and recreation	482,872	699,372	644,955	54,417
Health	573,574	603,574	578,197	25,377
Housing, welfare, and community development	916,625	1,040,325	924,960	115,365
Total expenditures	<u>11,189,618</u>	<u>12,030,185</u>	<u>11,188,785</u>	<u>841,400</u>
Excess of revenues over expenditures	<u>59,600</u>	<u>960,610</u>	<u>2,187,783</u>	<u>1,227,173</u>
<b>OTHER FINANCING SOURCES (USES)</b>				
Transfer-in		102,200	102,200	-
Transfer-out	(59,600)	(1,062,810)	(1,053,296)	9,514
Other financing sources (uses)	<u>(59,600)</u>	<u>(960,610)</u>	<u>(951,096)</u>	<u>9,514</u>
Excess of revenues and other financing sources over expenditures and other financing uses	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,236,687</u>	<u>\$ 1,236,687</u>

See accompanying notes to required supplementary information.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ISABELA  
BUDGETARY COMPARISON SCHEDULE - GENERAL FUND (CONTINUED)  
NOTE TO REQUIRED SUPPLEMENTARY INFORMATION  
FOR THE FISCAL YEAR ENDED JUNE 30, 2005**

**1. BUDGET TO GAAP RECONCILIATION**

<b>Excess of revenues and other financing sources over expenditures and other financing uses (budgetary basis)</b>	<b>\$1,236,687</b>
<b>Budget to GAAP Timing Differences</b>	
<b>Entity differences</b>	
Non budgeted funds recorded as revenues for financial reporting purposes	5,483,763
Non budgeted funds recorded as expenditures for financial reporting purposes	(5,975,771)
Non budgeted proceeds from issuance of general obligation bonds	255,000
Non budgeted transfers in	1,096,263
Non budgeted transfers out	(102,200)
<b>Basis of accounting differences</b>	
Revenues recorded for financial reportin purposes but not in budgetary basis	763,860
Revenues recorded in budgetary basis but not for financial reporting purposes	43,026
Expenditures recorded for financial reporting purposes but not in the budgetary basis	(472,314)
Revenues recorded in budgetary basis but not for financial reporting purposes	(520,782)
<b>Timing differences</b>	
Current year encumbrances recorded as expenditures for budgetary reporting purposes	80,136
Prior year encumbrances recorded as expenditures for financial reporting purposes	<u>(61,563)</u>
<b>Net Change in Fund Balance</b>	<b><u>\$1,826,105</u></b>

**MUNICIPALITY OF ISABELA**

**NOTES TO REQUIRED SUPPLEMENTARY INFORMATION -**

**BUDGETARY COMPARISON SCHEDULE – GENERAL FUND**

**June 30, 2005**

**NOTE A – BUDGET PROCESS AND BUDGETARY BASIS OF ACCOUNTING**

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

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

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

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

**NOTE B - BUDGET TO GAAP RECONCILIATION**

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

**COMBINING FINANCIAL STATEMENTS  
GENERAL FUND**

**-56-**

**ORTIZ, RODRIGUEZ, RIVERA & CO.**

CERTIFIED PUBLIC ACCOUNTANTS • VALUE ADDED SERVICES

Suite 152, PO Box 70250, San Juan, P.R. 00936-7250 • Phone (787) 756-8524, Fax (787) 274-0562

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ISABELA  
COMBINED BALANCE SHEET  
SPECIAL FUNDS IN GENERAL FUND  
JUNE 30, 2005

<u>Assets</u>	<u>General Fund</u>	<u>Special Funds Unreserved</u>	<u>Special Funds Designated</u>	<u>Special Funds Reserved</u>	<u>Commonwealth Legislative Resolutions</u>	<u>Subtotal</u>	<u>Eliminations</u>		<u>Total General Fund</u>
Cash and Investments	\$ 4,193,368	\$ 2,255,817	\$ 2,133,286	\$ 573,040	\$ -	\$ 9,155,511	\$ -	\$ -	\$ 9,155,511
Receivables, net:									
Other	321,041	122,619		479	19,891	464,030			464,030
Due from (Note D):									
Commonwealth of Puerto Rico	661,719	439,120				1,100,839			1,100,839
Due from other funds	2,158,412		26,301		1,227,699	3,414,382	2,599,993		814,389
Inventories and supplies		216,160				216,160			216,160
Restricted assets:									
Cash				255,763	4,353,299	4,353,299			4,353,299
Cash with fiscal agent						255,783			255,783
<b>Total assets</b>	<b>\$ 7,334,540</b>	<b>\$ 3,033,716</b>	<b>\$ 2,161,587</b>	<b>\$ 829,302</b>	<b>\$ 5,600,859</b>	<b>\$ 18,960,004</b>	<b>\$ -</b>	<b>\$ 2,599,993</b>	<b>\$ 16,360,011</b>
<b>Liabilities and Fund Balance</b>									
<b>Liabilities</b>									
Account payable and accrued liabilities	\$ 717,052	\$ 326,461	\$ 73,586	\$ 1	\$ 339,592	\$ 1,456,672	\$ -	\$ -	\$ 1,456,672
Due to:									
Commonwealth of Puerto Rico	252,051					252,051			252,051
Other funds	1,227,699	902,557	40,483		429,304	2,599,993	2,599,993		-
Deferred revenues:									
Municipal license tax	1,665,724					1,665,724			1,665,724
Property taxes	88,500					88,500			88,500
Other	743,589					743,589			743,589
<b>Total liabilities</b>	<b>4,672,585</b>	<b>1,229,018</b>	<b>114,029</b>	<b>1</b>	<b>788,696</b>	<b>6,764,529</b>	<b>2,599,993</b>	<b>-</b>	<b>4,184,536</b>
<b>Fund Balance</b>									
Reserved for:									
Encumbrances	80,136					80,136			80,136
Inventories		216,160				216,160			216,160
Capital projects				681,132	4,831,963	5,493,095			5,493,095
Other specific purposes				156,269		156,269			156,269
Unreserved:									
Designated for future expenditures			2,047,558	11,900		2,059,458			2,059,458
Undersigned	2,581,819	1,586,538				4,170,357			4,170,357
<b>Total fund balance</b>	<b>2,861,955</b>	<b>1,604,896</b>	<b>2,047,558</b>	<b>629,301</b>	<b>4,831,963</b>	<b>12,175,475</b>	<b>-</b>	<b>-</b>	<b>12,175,475</b>
<b>Total liabilities and fund balance</b>	<b>\$ 7,334,540</b>	<b>\$ 3,033,716</b>	<b>\$ 2,161,587</b>	<b>\$ 829,302</b>	<b>\$ 5,600,859</b>	<b>\$ 18,960,004</b>	<b>\$ 2,599,993</b>	<b>\$ -</b>	<b>\$ 16,360,011</b>

The accompanying notes are an integral part of these basic financial statements.

ORTIZ, RODRIGUEZ, RIVERA & CO.

CERTIFIED PUBLIC ACCOUNTANTS • VALUE ADDED SERVICES

Suite 152, PO Box 70250, San Juan, P.R. 00936-7250 • Phone (787) 756-8524, Fax (787) 274-0562

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ISABELA  
COMBINED STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES - GENERAL FUND (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2005**

	General Fund	Special Funds Unreserved	Special Funds Designated	Special Funds Reserved	Commonwealth Legislative Resolutions	Subtotal	Eliminations		Total General Fund
<b>REVENUES</b>									
<b>Taxes:</b>									
Property taxes	\$ 4,299,937	\$ -	\$ -		\$ -	\$ 4,299,937	\$ -	\$ -	\$ 4,299,937
Municipal license taxes	2,146,076					2,146,076			2,146,076
<b>Intergovernmental:</b>									
Commonwealth government	4,415,842	694,241		78,721	1,973,105	7,161,909			7,161,909
Fees, fines, and charges for services	2,095,696	2,679,752				4,775,448			4,775,448
Interest	251,026	1,004		479	56,461	308,970			308,970
Other revenues	27,948					27,948			27,948
<b>Total revenues</b>	<u>13,236,525</u>	<u>3,374,997</u>	<u>-</u>	<u>79,200</u>	<u>2,029,566</u>	<u>18,720,288</u>	<u>-</u>	<u>-</u>	<u>18,720,288</u>
<b>EXPENDITURES</b>									
<b>Current:</b>									
General government	6,189,346	627,322	412,462			7,129,130			7,129,130
Public safety	943,949			1,368		945,315			945,315
Public works and sanitation	2,576,775	36,696	151,468	5,688	194,000	2,964,629			2,964,629
Culture and recreation	644,955					644,955			644,955
Health	578,197	2,331,972		8,327		2,918,496			2,918,496
Housing, welfare and community development	924,960			22,296	409,231	1,356,487			1,356,487
Capital outlays	54,075	176,830	556,887	16,451	1,122,756	1,926,999			1,926,999
<b>Debt service:</b>									
Debt issuance costs				2,017		2,017			2,017
<b>Total expenditures</b>	<u>11,912,257</u>	<u>3,072,822</u>	<u>1,120,817</u>	<u>56,145</u>	<u>1,725,987</u>	<u>17,888,028</u>	<u>-</u>	<u>-</u>	<u>17,888,028</u>
<b>Excess (deficiency) of revenues over expenditures before other sources (uses)</b>	<u>1,324,268</u>	<u>302,175</u>	<u>(1,120,817)</u>	<u>23,055</u>	<u>303,579</u>	<u>832,260</u>	<u>-</u>	<u>-</u>	<u>832,260</u>
<b>OTHER FINANCING SOURCES (USES)</b>									
General obligation bonds				255,000		255,000			255,000
Transfers in	118,417	19,408	1,003,210		73,645	1,214,680	1,124,818		89,862
Transfers out	(1,084,284)		(102,200)			(1,186,484)		1,124,818	(61,666)
<b>Total other financing sources (uses)</b>	<u>(965,867)</u>	<u>19,408</u>	<u>901,010</u>	<u>255,000</u>	<u>73,645</u>	<u>283,196</u>	<u>1,124,818</u>	<u>1,124,818</u>	<u>283,196</u>
<b>Excess (deficiency) of revenues over expenditures</b>	<u>358,401</u>	<u>321,583</u>	<u>(219,807)</u>	<u>278,055</u>	<u>377,224</u>	<u>1,115,456</u>	<u>1,124,818</u>	<u>1,124,818</u>	<u>1,115,456</u>
<b>SPECIAL ITEMS (Note Q)</b>									
Proceeds of note payable - PR Department of Labor	432,781					432,781			432,781
Proceeds of note payable - PR Waste Management Administration	277,868					277,868			277,868
<b>Total special items</b>	<u>710,649</u>					<u>710,649</u>			<u>710,649</u>
<b>Net change in fund balance</b>	<u>1,069,050</u>	<u>321,583</u>	<u>(219,807)</u>	<u>278,055</u>	<u>377,224</u>	<u>1,828,105</u>	<u>1,124,818</u>	<u>1,124,818</u>	<u>1,828,105</u>
<b>FUND BALANCES AT BEGINNING OF YEAR, AS RESTATED</b>	<u>1,592,905</u>	<u>1,483,115</u>	<u>2,267,365</u>	<u>551,246</u>	<u>4,454,739</u>	<u>10,349,370</u>			<u>10,349,370</u>
<b>FUND BALANCES AT END OF YEAR</b>	<u>\$ 2,661,955</u>	<u>\$ 1,804,698</u>	<u>\$ 2,047,558</u>	<u>\$ 829,301</u>	<u>\$ 4,831,963</u>	<u>\$ 12,175,475</u>	<u>\$ 1,124,818</u>	<u>\$ 1,124,818</u>	<u>\$ 12,175,475</u>

The accompanying notes are an integral part of these financial statements.

**PART II - SINGLE AUDIT SECTION**

**-59-**

**ORTIZ, RODRIGUEZ, RIVERA & CO.**

CERTIFIED PUBLIC ACCOUNTANTS • VALUE ADDED SERVICES

Suite 152, PO Box 70250, San Juan, P.R. 00936-7250 • Phone (787) 756-8524, Fax (787) 274-0562

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ISABELA  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2005**

<u>Federal Grantor/Program Title</u>	<u>Federal CFDA Number</u>	<u>Pass-Through Entity Identifying Number</u>	<u>Federal Disbursements/ Expenditures</u>
<b>U.S. Department of Agriculture</b>			
Pass-through Education Department:			
Child and Adult Care Food Programs	10.558	N/A	\$ 20,363
Subtotal U.S. Department of Agriculture			<u>20,363</u>
<b>U.S. Department of Housing and Urban Development (HUD)</b>			
Direct programs:			
Community Development Block Grants	14.218	N/A	251,782
Section 8 Housing Choice Vouchers Program	14.871	N/A	383,855
Indirect programs:			
Pass-through Puerto Rico Department of Housing - HOME Investment Partnership Program	14.239	N/A	10,417
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	681,961
Subtotal U.S. Department of HUD			<u>1,328,015</u>
<b>U.S. Department of Justice</b>			
Pass-through Department of Justice			
Local Law Enforcement Block Grant	16.592	N/A	194
Subtotal U.S. Department of Justice			<u>194</u>
<b>U.S. Department of Transportation - National Highway Traffic Safety Administration</b>			
Pass-through Department of Transportation (Traffic Safety Commission)			
State and Community Highway Safety	20.660	N/A	77,949
Subtotal U.S. Department of Transportation			<u>77,949</u>
<b>U.S. Department of Health and Human Services (HHS)</b>			
Head Start Program	93.600	N/A	1,477,806
Temporary Assistance for Needy Families	93.558	N/A	212,752
Subtotal U.S. Department of HHS			<u>1,690,558</u>
<b>U.S. Federal Emergency Management Administration (FEMA)</b>			
Pass-through the Puerto Rico Governor's Office-Public Assistance Grants	83.544	125-99-125	47,750
Subtotal U.S. Department of FEMA			<u>47,750</u>
<b>TOTAL</b>			<u>\$ 3,164,829</u>

The accompanying notes are an integral of this schedule.

-60-

**ORTIZ, RODRIGUEZ, RIVERA & CO.**

CERTIFIED PUBLIC ACCOUNTANTS • VALUE ADDED SERVICES

Suite 152, PO Box 70250, San Juan, P.R. 00936-7250 • Phone (787) 756-8524, Fax (787) 274-0562

MUNICIPALITY OF ISABELA

NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

June 30, 2005

NOTE A – BASIS OF PRESENTATION

The accompanying schedule of expenditures of federal awards includes the federal grant activity of the Municipality and is presented on the modified accrual basis of accounting. Expenditures are recognized when the related liability is incurred. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, "Audits of States, Local Governments and Nonprofit Organizations". Therefore, some amounts presented in this schedule may differ from the amounts presented in, or used in the preparation of, the basic financial statements.

NOTE B - FEDERAL CFDA NUMBER

The Catalog of Federal Domestic Assistance (CFDA) Number is a program identification number. The first two digits identify the federal department or agency that administers the program and the last three numbers are assigned by numerical sequence.

NOTE C – PASS-THROUGH ENTITY IDENTIFYING NUMBER

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

NOTE D – RECONCILIATION OF EXPENDITURES PRESENTED IN THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS TO THE EXPENDITURES PRESENTED IN THE BASIC FINANCIAL STATEMENTS

Description	Community Development Block Grant Fund	Child Care/Head Start Program Fund	Other Governmental Funds
10.558	\$ -	\$ -	\$ 20,363
14.218	251,781	-	-
14.228	681,961	-	-
14.239	-	-	10,417
14.871	-	-	383,855
16.592	-	-	194
20.600	-	-	77,949
83.544	-	-	47,750
93.558	-	-	212,752
93.575	-	-	158,310
93.600	-	1,477,806	-
Total federal awards expenditures	933,742	1,477,806	911,590
Total non federal awards expenditures	-	-	247,747
Total expenditures, fund statements	\$ 933,742	\$ 1,477,806	\$ 1,159,337



CPA Orlando Luis Ortiz Cabrera  
CPA Marco Antonio Rivera Zúñiga  
CPA Luis O. Rivera Zúñiga

Members:  
American Institute of Certified  
Public Accountants (AICPA)  
Puerto Rico Board of Certified  
Public Accountants  
Management Consulting  
Services Division

**ORTIZ, RODRIGUEZ, RIVERA & CO.**

CERTIFIED PUBLIC ACCOUNTANTS • VALUE ADDED SERVICES

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

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

We have audited the financial statements of the governmental activities, each major fund and the aggregate remaining fund information of the Municipality of Isabela as of and for the year ended June 30, 2005, which collectively comprise the Municipality of Isabela's basic financial statements, and have issued our report thereon dated November 30, 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 of Isabela's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. 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 of Isabela's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect of 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 test disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

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 the 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.

*Ortiz, Rodriguez, Rivera & Co*

San Juan, Puerto Rico  
November 30, 2005

The stamp 2101414 was affixed  
to the original of this report





**ORTIZ, RODRIGUEZ, RIVERA & CO.**  
CERTIFIED PUBLIC ACCOUNTANTS • VALUE ADDED SERVICES

CPA Orlando Luis Ortiz Cabrera  
CPA Marco Antonio Rivera Zúñiga  
CPA Luis O. Rivera Zúñiga

Members:  
American Institute of Certified  
Public Accountants (AICPA)  
Puerto Rico Board of Certified  
Public Accountants  
Management Consulting  
Services Division

**INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH REQUIREMENTS  
APPLICABLE TO EACH MAJOR PROGRAM AND ON INTERNAL CONTROL  
OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133**

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

Compliance

We have audited the compliance of Municipality of Isabela with the types of compliance requirements described in the *U. S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2005. Municipality of Isabela's major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of Municipality of Isabela's management. Our responsibility is to express and opinion on Municipality of Isabela'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 Municipality of Isabela'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 Municipality of Isabela' compliance with those requirements.

As described in items 05-1 and 05-2 in the accompanying schedule of findings and questioned costs, the Municipality of Isabela did not comply with requirements regarding Davis-Bacon Act that is applicable to its Head Start program and eligibility that is applicable to its Section 8 Housing Choice Voucher program. Compliance with such requirements is necessary, in our opinion, for the Municipality of Isabela to comply with requirements applicable to that programs.

In our opinion, except for the noncompliance described in the preceding paragraph, Municipality of Isabela complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2005.

### Internal Control over Compliance

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

We noted certain matters involving in 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 Municipality's ability to administer a major federal program in accordance with the applicable requirements of laws, regulations, contracts and grants. Reportable conditions are described in the accompanying schedule of findings and questioned costs as items 05-1 and 05-2.

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 the applicable requirements of laws, regulations, contracts and grants caused by error of fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that none of the reportable conditions described above is a material weaknesses.

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 the 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.

San Juan, Puerto Rico  
November 30, 2005

*Ortiz, Rodriguez, Rivera & Co*

The stamp 2101415 was affixed  
to the original of this report.



**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ISABELA  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2005**

**1. SUMMARY OF AUDIT RESULTS**

- a. The auditors' report expresses an unqualified opinion on the basic financial statements of the Municipality of Isabela.
- b. There were no reportable conditions on internal controls over financial reporting.
- c. No instances of noncompliance material to the financial statements of Municipality of Isabela were disclosed during the audit.
- d. There were reportable conditions on internal controls over major programs.
- e. The auditor's report on compliance with requirements applicable to federal award programs for Municipality of Isabela express a qualified opinion.
- f. There were audit findings relative to the major federal award programs for the Municipality of Isabela are reported in number 3 of this schedule.
- g. The programs tested as major programs included:
  - Head Start - CFDA No. 93.600
  - Section 8 Housing Choice Vouchers Program - CFDA No. 14.871.
- h. The threshold for distinguishing types A and B programs was \$300,000.
- i. Municipality of Isabela was determined to be a high-risk auditee.

**2. FINDINGS - FINANCIAL STATEMENTS AUDIT**

None.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ISABELA  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2005**

**3. FINDINGS AND QUESTIONED COSTS - MAJOR FEDERAL AWARD PROGRAM AUDIT**

**a. Head Start - CFDA No. 93.600**

• **Condition 05-1**

The Municipality does not have effective internal controls over compliance with the requirement to ensure that all laborers and mechanics employed by contractors or subcontractors to work on construction contracts in excess of \$2,000 financed by Federal assistance funds are paid wages not less than those established for the locality of the project (prevailing wage rates) by the Department of Labor (DOL) (40 USC 276a to 276a-7). For the construction projects selected for testing, we noted that the contracts do not have the prevailing wage rate clause updated. In addition, some of the contracts selected do not have the certified payrolls.

Criteria

The Davis Bacon Act requires that all laborers and mechanics employed by contractors or subcontractors to work on construction contracts in excess of \$2,000 financed by Federal assistance funds must be paid wages not less than those established for the locality of the project (prevailing wage rates) by the DOL (40 USC 276a to 276a-7).

Cause

The program's management failed to monitor the laborers employed by contractors to assure they are paid the prevailing wage rates and includes the certified payrolls.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ISABELA  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2005**

Effect

The continued failure to implement internal controls and ensure compliance with the above requirement may expose the Municipality to cost disallowances.

Recommendation

The Municipality should require to the construction contractors to make interviews to laborers to assure that wages paid are not less than those established by the DOL.

Management Response

The Director of Head Start Program implemented strict internal controls to make certain that the Office of the Municipal Secretary includes in all construction contracts to be paid with federal funds, that exceed \$2,000, the contract clauses required by the Department of Labor (DOL) (40 USC 276a to 276a-7) and the Davis Bacon Act. The accounting office of the Head Start Program was oriented about the Davis Bacon Act requirements and the Program's Fiscal Specialist was given instructions to verify the payroll documents of the contractors and subcontractors in accordance with the law.

Questioned Cost

None

**b. Section 8 - Housing Choice Voucher Program - CFDA No. 14.871**

● **Condition 05-2**

The Municipality's system of internal control over compliance with the documentation of participant files is not working effectively. During our audit of the participant files in the Section 8 programs, we noted that the Municipality was not maintaining the required documents and information in each file to support participant's eligibility as required

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ISABELA  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2005**

by Section 8 Program regulations. During our test of eligibility requirements we tested thirty (30) participant files and noted the following exceptions:

<u>Voucher No.</u>	<u>Condition</u>
00-01-005V	a
00-03-010V	a,b,c,f,g
95-02-013V	a,b,f,g
02-04-018V	a,b,d
87-03-023V	a,b
93-02-029V	a,b,f,g
93-02-030V	a
97-03-032V	a,f,g
00-03-036V	a,f,g
03-03-041V	a,f,g
88-02-042V	a,b,f
01-03-047V	a,c,e,f,g
03-01-049V	a
03-01-051V	a
04-02-02FSS	a,i
03-03-06FSS	a,b,f,g
04-02-005V	a,f
00-02-04FSS	a,f,g,e
98-02-07FSS	a
02-03-010FSS	a,f,g
00-03-12FSS	a,f,h
00-03-15FSS	a,b,f,g
03-02-017FSS	a,f,g,i
00-03-19FSS	a,f,g
03-02-020FSS	a,f,g
00-03-025FSS	a,f,g
00-02-01FSS	a
03-07V	a,f,g

- a. The privacy act notice form was not signed and was incomplete.
- b. The Form HUD 50058 was filled wrong in items 5h and 5i.
- c. Not observed that the rental unit has smoke detector.
- d. Not observed the evidence of a full time student for the year.
- e. The inspection report (form HUD 52580-A) was incomplete.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ISABELA  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2005**

- f. The re-inspection for the correction of deficiency exceed the 30 days calendar.
- g. We not observed evidence that the deficiency was corrected.
- h. No observed the evidence of a full time student elemental and intermediate level for the year.
- i. New tenants not included in the waiting list.

Criteria

24 CFR Sections 882-113, 882-209, 882-214, 882-412, 882-514, 882-515, 882-518, 883-711, 883-704, 889-103, 982.4, 982.54 (d) (15), 982.158 (f) (7), 982.158 (d), 982.405 (b), and 982.404 establish that the PHA is required to accept applications for admission to the projects, determine whether the applicants are initially eligible, and on a yearly basis, reexamine family income, composition, and contribution to rent, utilities reasonable rent and housing quality standards' inspections. In addition, the Municipality should verify that the information submitted by participants is reliable.

Cause

All of the above matters occur because the Municipality's system of internal control relating to the compliance requirements is not effectively identifying and correcting these matters through the proper review of participant files for completeness of documents, signatures and information, as well as for their accuracy. The current procedures do not effectively reduce the risk of ineligible participants receiving program benefits.

Effect

The continued failure to establish internal control over compliance with the above requirements exposes the Municipality to unauthorized user or disposition of the program's resources.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ISABELA  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2005**

Recommendation

The Municipality should design and adopt a checklist that includes all the related documents that must be completed for each participant file. The checklist should be completed during the initial processing and revised for changes during the annual review. Once completed, the participant files should then be reviewed for completeness by another official or supervisor prior to the final approval. These procedures will help to improve controls and documentation concerning the eligibility of participants and will reduce the possibility of cost disallowances.

Management Response

- a. The Section 8 Program unknowingly implemented the incorrect form, but immediately proceeded to implement the correct form. By January 31, 2006 all the participants will have signed the correct form.
- b. The information in items 5h and 5i of form 50058 have been verified and corrected.
- c. The Section 8 Program will proceed to re-inspect the housing units verify that it has a working smoke detector. The housing units will be photographed and will be completed on or before December 20, 2005.
- d. The Section 8 Program will precede to request a written statement from the participant. This matter will be completed and documented by December 31, 2005.
- e. To address this matter an additional housing inspector was assigned to the program on October 6, 2005 to immediately prepare the inspection reports.
- f. The Section 8 Program ispector was informed and orientated that the deficiency corrections were not to exceed the thirty (30)

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ISABELA  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2005**

calendar days. The audited cases will be re-inspected on or before January 31, 2005.

- g. The correction of all deficiencies in the audited housing units will be evidenced with photos and/or receipts of the completed corrections on or before January 31, 2005.
- h. The Section 8 Program requested that the participant submit the required school certifications, however, the individual is no longer a Section 8 participant and has yet to submit the necessary evidence. The program will attempt to contact the former participant.
- i. The cases were re-evaluated by the Section 8 Program and we certify that the new tenants do in fact appear on the waiting list which is prepared in accordance with the program administrative plan on a "First Come, First Serve" basis.

**Questioned Cost**

None

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ISABELA  
SCHEDULE OF STATUS OF PRIOR YEAR  
AUDIT FINDINGS AND QUESTIONED COSTS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2005**

During the current examination, follow-up was given to the findings informed to the Municipality in prior years. It was noted that corrective action has been taken, except for certain conditions that still exist and require further action. These are included in the accompanying Schedule of Prior Year Audits Findings and Questioned Costs.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ISABELA  
SCHEDULE OF STATUS OF PRIOR YEAR  
AUDIT FINDINGS AND QUESTIONED COSTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2005**

<u>Program</u>	<u>Finding/Noncompliance</u>	<u>Status</u>
Head Start CFDA No. 93.600	<b>Condition 04-111-01</b>  It was noted that the Municipality' 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 95) voucher did not have the invoices, and then (10) vouchers did not have a receiving report.	Condition was corrected.
State Block Grant Program CFDA No. 14.228	<b>Condition 04-111-02</b>  It was noted that the Municipality's internal control over disbursement process that supporting documents related to thirteen (13) issued checks were not stamped as paid.	Condition not observed.
Head Start CFDA No. 93.600	<b>Condition 04-111-03</b>  The Municipality did not perform interviews to ensure that contractors paid prevailing wages according to Department of Labor.	Condition still prevails.
Section 8 Housing Choice Voucher Program CFDA No. 14.871	<b>Condition 04-111-04</b>  Two participant files did not have evidence of the HUD-approved release and consent forms submitted by the family as required by federal regulation.	Condition still prevails.
Section 8 Housing Choice Voucher Program CFDA No. 14.871	<b>Condition 04-111-05</b>  The Municipality did not assure that participants submit a third parties verifications regarding the family income and the family composition.	Condition still prevails.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ISABELA  
SCHEDULE OF STATUS OF PRIOR YEAR  
AUDIT FINDINGS AND QUESTIONED COSTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2005**

<u>Program</u>	<u>Finding/Noncompliance</u>	<u>Status</u>
Section 8 Housing Choice Voucher Program CFDA No. 14.871	<b>Condition 04-111-06</b>  Seven (7) participants' files did not have evidence of the Certificate of No Penal Record submitted by the family.	Condition was corrected.
State Block Grant Program CFDA No. 14.228	<b>Condition 04-111-07</b>  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.	Condition still prevails.
Head Start CFDA No. 93.600	<b>Condition 04-111-08</b>  The records of the employees did not have evidence of a signed declaration that includes the required information related to child abuse.	Condition was corrected.
Section 8 Housing Choice Voucher Program CFDA No. 14.871	<b>Condition 04-111-09</b>  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.	Condition still prevails.
Section 8 Housing Choice Voucher Program CFDA No. 14.871	<b>Condition 04-111-10</b>  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.	Condition still prevails.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ISABELA  
SCHEDULE OF STATUS OF PRIOR YEAR  
AUDIT FINDINGS AND QUESTIONED COSTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2005**

<u>Program</u>	<u>Finding/Noncompliance</u>	<u>Status</u>
Section 8 Housing Choice Voucher Program CFDA No. 14.871	<b>Condition 04-111-11</b>  There is no evidence of unit inspection report or other verification report documenting that any PHA required repairs were completed.	Condition still prevails.
State Block Grant Program CFDA No. 14.228	<b>Condition 03-111-01</b>  Missing and not cancelled documents on vouchers payments.	Condition not observed.
Section 8 Housing Choice Voucher Program CFDA No. 14.871	<b>Condition 03-111-02</b>  Missing documentation (HUD-approved release and consent forms).	Condition was corrected.
Section 8 Housing Choice Voucher Program CFDA No. 14.871	<b>Condition 03-111-03</b>  Evidence of the determination of the reasonableness of the rent paid to the owners.	Condition still prevails.
Section 8 Housing Choice Voucher Program CFDA No. 14.871	<b>Condition 03-111-05</b>  Missing inspection reports.	Condition still prevails.
Section 8 Housing Choice Voucher Program CFDA No. 14.871	<b>Condition 03-111-06</b>  Missing verification documenting that any PHA-required repairs were completed.	Condition still prevails.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF ISABELA  
SCHEDULE OF STATUS OF PRIOR YEAR  
AUDIT FINDINGS AND QUESTIONED COSTS (CONTINUED)  
FOR THE FISCAL YEAR ENDED JUNE 30, 2005**

<u>Program</u>	<u>Finding/Noncompliance</u>	<u>Status</u>
Section 8 Housing Choice Voucher Program CFDA No. 14.871	<b>Condition 04-111-11</b> There is no evidence of unit inspection report or other verification report documenting that any PHA required repairs were completed.	Condition still prevails.
State Block Grant Program CFDA No. 14.228	<b>Condition 03-111-01</b> Missing and not cancelled documents on vouchers payments.	Condition not observed.
Section 8 Housing Choice Voucher Program CFDA No. 14.871	<b>Condition 03-111-02</b> Missing documentation (HUD-approved release and consent forms).	Condition was corrected.
Section 8 Housing Choice Voucher Program CFDA No. 14.871	<b>Condition 03-111-03</b> Evidence of the determination of the reasonableness of the rent paid to the owners.	Condition still prevails.
Section 8 Housing Choice Voucher Program CFDA No. 14.871	<b>Condition 03-111-05</b> Missing inspection reports.	Condition still prevails.
Section 8 Housing Choice Voucher Program CFDA No. 14.871	<b>Condition 03-111-06</b> Missing verification documenting that any PHA-required repairs were completed.	Condition still prevails.

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)

1. Fiscal period ending date for this submission

Month Day Year 06 / 30 / 2005

Fiscal Period End Dates Must Be In 2004, 2005, or 2006

2. Type of Circular A-133 audit

1 [X] Single audit 2 [ ] Program-specific audit

3. Audit period covered

1 [X] Annual 2 [ ] Biennial 3 [ ] Other - [ ] Months

4. FEDERAL GOVERNMENT USE ONLY

Date received by Federal clearinghouse

5. Auditee Identification Numbers

a. Primary Employer Identification Number (EIN)

66 - 0433796

b. Are multiple EINs covered in this report? 1 [ ] Yes 2 [X] No

c. If Part I, Item 5b = "Yes," complete Part I, Item 5c on the continuation sheet on Page 4.

d. Data Universal Numbering System (DUNS) Number

[ ] - [ ] - [ ]

e. Are multiple DUNS covered in this report? 1 [ ] Yes 2 [X] No

f. If Part I, Item 5e = "Yes," complete Part I, Item 5f on the continuation sheet on Page 4.

6. AUDITEE INFORMATION

a. Auditee name

MUNICIPALITY OF ISABELA

b. Auditee address (Number and street)

PO BOX 507

City

ISABELA

State

ZIP + 4 Code

PR

00662 - 0507

c. Auditee contact

Name

CPA JASON LEON ARROYO

Title

FINANCE DIRECTOR

d. Auditee contact telephone

(787) 872 - 2100

e. Auditee contact FAX

(787) 830 - 8045

f. Auditee contact E-mail

7. AUDITOR INFORMATION (To be completed by auditor)

a. Auditor name

ORTIZ, RODRIGUEZ, RIVERA & CO.

b. Auditor address (Number and street)

SUITE 152 PO BOX 70250

City

SAN JUAN

State

ZIP + 4 Code

PR

00936 - 7250

c. Auditor contact

Name

CPA LUIS RIVERA ZUÑIGA

Title

PARTNER

d. Auditor contact telephone

(787) 756 - 8524

e. Auditor contact FAX

(787) 274 - 0562

f. Auditor contact E-mail

9. 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 Date Month Day Year Jason D. Leon Arroyo 12/19/05

Printed Name of certifying official

JASON D. LEON ARROYO

Printed Title of certifying official

DIRECTOR DE FINANZAS

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 Date Month Day Year Ortiz, Rodriguez, Rivera & Co 12/19/05

**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))

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

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 Cleannghouse archives . . . . .
- and, if not marked above, the Federal cognizant agency . . . . .

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

FORM SF-SAC (5-2004)

**PART III FEDERAL PROGRAMS - Continued**

9. FEDERAL AWARDS EXPENDED DURING FISCAL YEAR								10. AUDIT FINDINGS	
CFDA Number		Research and development (c)	Name of Federal program (d)	Amount expended (e)	Direct award (f)	Major program		Type(s) of compliance requirement(s) <sup>4</sup> (a)	Audit finding reference number(s) <sup>5</sup> (b)
Federal Agency Prefix <sup>1</sup> (a)	Extension <sup>2</sup> (b)					Major program (g)	If yes type of audit report <sup>3</sup> (h)		
1	0	.558	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	CHILD AND ADULT CARE FOOD PROGRAMS	\$ 20,363 .00	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	O	N/A
1	4	.218	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	COMMUNITY DEVELOPMENT BLOCK GRANT PROGRAM	\$ 251,782 .00	<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	O	N/A
1	4	.871	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	SECTION 8 HOUSING CHOICE VOUCHER PROGRAM	\$ 383,855 .00	<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No	<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No	Q	E 05-2
1	4	.239	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	HOME INVESTMENT PARTNERSHIP PROGRAM	\$ 10,417 .00	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	O	N/A
1	4	.228	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	STATE BLOCK GRANT PROGRAM	\$ 681,961 .00	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	O	N/A
1	6	.592	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	LOCAL LAW ENFORCEMENT BLOCK GRANT	\$ 194 .00	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	O	N/A
2	0	.660	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	STATE AND COMMUNITY HIGHWAY SAFETY	\$ 77,949 .00	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	O	N/A
9	3	.600	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	HEAD START PROGRAM	\$ 1,477,806 .00	<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No	<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No	Q	D 05-1
9	3	.558	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	TEMPORARY ASSISTANCE FOR NEEDY FAMILIES	\$ 212,752 .00	<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	O	N/A
8	3	.544	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	PUBLIC ASSISTANCE GRANTS	\$ 47,750 .00	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	O	N/A
<b>TOTAL FEDERAL AWARDS EXPENDED</b>					\$ 3,164,829 .00	IF ADDITIONAL LINES ARE NEEDED, PLEASE PHOTOCOPY THIS PAGE, ATTACH ADDITIONAL PAGES TO THE FORM, AND SEE INSTRUCTIONS			

<sup>1</sup> See Appendix 1 of instructions for valid Federal Agency two-digit prefixes.

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

<sup>3</sup> 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.

<sup>4</sup> 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 | E. Eligibility                             | I. Procurement and suspension and debarment            | L. Reporting                    |
| B. Allowable costs/cost principles | F. Equipment and real property management  | J. Program income                                      | M. Subrecipient monitoring      |
| C. Cash management                 | G. Matching, level of effort, earmarking   | K. Real property acquisition and relocation assistance | N. Special tests and provisions |
| D. Davis - Bacon Act               | H. Period of availability of Federal funds |  | O. None                         |
| <sup>5</sup> N/A for NONE          |  |  | P. Other                        |

