

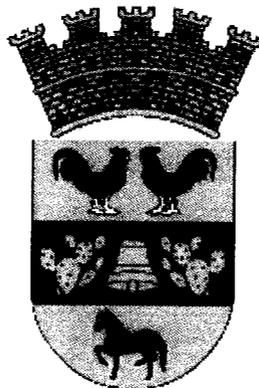


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**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

***FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT***

FISCAL YEAR ENDED JUNE 30, 2008



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

***Mrs. Marisol Rosa-Acevedo, CPA
Finance and Budget Director***

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

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FINANCIAL SECTION

VALDES, GARCIA, MARIN & MARTINEZ, LLP

CERTIFIED PUBLIC ACCOUNTANTS AND CONSULTANTS
MEMBER OF THE AICPA PRIVATE COMPANIES PRACTICE SECTION

P.O. BOX 364831
SAN JUAN, P.R. 00936-4831

TELEPHONE: (787) 725-1600
TELEFAX: (787) 721-2795

INDEPENDENT AUDITORS' REPORT

To the Honorable Mayor
and Members of the 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 (the Municipality), as of and for the year ended June 30, 2008, 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Municipality's internal control over financing reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly in all material respects, the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information of the Municipality of Isabela, as of June 30, 2008 and for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with Government Auditing Standards, we have also issued our report dated December 23, 2008, on our consideration of the Municipality's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.

The Management Discussion and Analysis on pages 3 through 15 and Budgetary Comparison Schedule - General Fund on page 53 are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

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, which is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, "Audits of States, Local Governments and Non-Profit Organizations", are not a required part of the basic financial statements. 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. The Financial Data Schedule supplementary information on pages 56 through 58 has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on it.

Valdés, García, Marina Martínez, LLP

San Juan, Puerto Rico
December 23, 2008

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to the original.

Management Discussion and Analysis

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

MANAGEMENT DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2008

The following discussion will provide an overview of the Municipality's financial activities for the fiscal year ended June 30, 2008 through an analysis of the financial performance of the Municipality of Isabela. 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 2008 by \$53,057,975 (net assets).
- Unrestricted net assets amount to \$1,820,749 in comparison to (\$134,502) on year 2007.
- Revenues decreased by 1% and expenses increased by 18% in comparison with year 2007.
- Net change in net assets amounted to \$4,075,589, a decrease of 50% with respect to prior year's net change.

Highlights for Fund Financial Statements

Detailed information about the Municipality's most significant funds is found in the funds financial statements, which use the current financial resources measurement focus and modified accrual basis of accounting:

- At June 30, 2008, a net change of \$2,399,281 in the fund balances of the Municipality's governmental funds resulted in combined ending fund balances of \$27,671,572. Approximately 47% of the total combined fund balances is unreserved.
- The General Fund reported an excess of revenues and other financing sources over expenditures and other financing uses of \$2,333,038 and an unreserved fund balance of \$13,137,246. Unreserved fund balance increased 20% from prior year.

General Financial Highlights

- The investment in capital assets as of June 30, 2008 was \$39,446,770 (net of depreciation).
- Long term debt increased to \$17,902,590.
- On a budgetary basis, actual revenues exceeded actual expenditures by \$1,623,624.

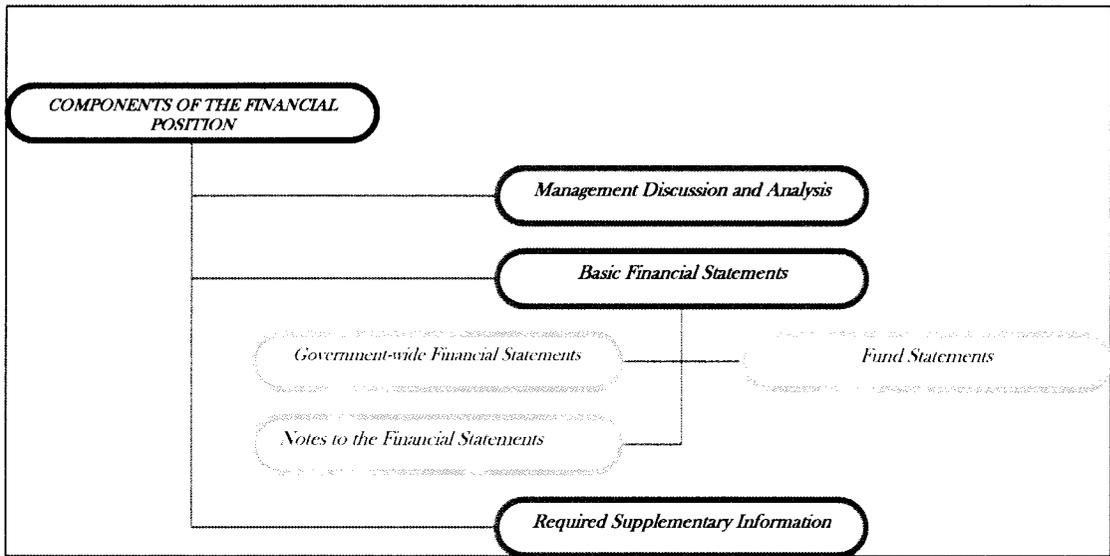
COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA

MANAGEMENT DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2008

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:

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 the 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 capital assets 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 the cash is received or paid.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA

MANAGEMENT DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2008

The government-wide statements report 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 comply 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.

- ***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.

Supplementary information

The supplementary information includes a Financial Data Schedule containing financial information of the Section 8 Housing Choice Voucher Program administered by the Municipality.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

MANAGEMENT DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2008

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, 2008 and 2007:

TABLE 1

	Governmental Activities	
	2008	2007
Assets		
Current and other assets	\$ 37,183,468	\$ 32,846,707
Capital assets	39,446,770	36,208,379
Total assets	\$ 76,630,238	\$ 69,055,086
Liabilities		
Current and other liabilities	\$ 5,669,673	\$ 3,852,461
Long term liabilities	17,902,590	16,220,239
Total liabilities	23,572,263	20,072,700
Net assets		
Invested in capital assets, net of related debt	36,295,097	34,864,145
Restricted	14,942,129	14,252,743
Unrestricted (deficit)	1,820,749	(134,502)
Total net assets	\$ 53,057,975	\$ 48,982,386

Net assets (assets over liabilities) may serve over the time as a useful indicator of a government's financial position. Net assets for the year increased 8% with respect to prior year.

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

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

Unrestricted net assets are the part of the net assets that can be used to finance day-to-day operations without constraints established by debt covenants, enabling legislation or other legal requirements. As of June 30, 2008 the Municipality presented a \$1,820,749 surplus due to positive net change in net assets results for the year then ended.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

MANAGEMENT DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2008

Changes in net assets

The following table summarizes the changes in net assets for the years ended June 30, 2008 and 2007:

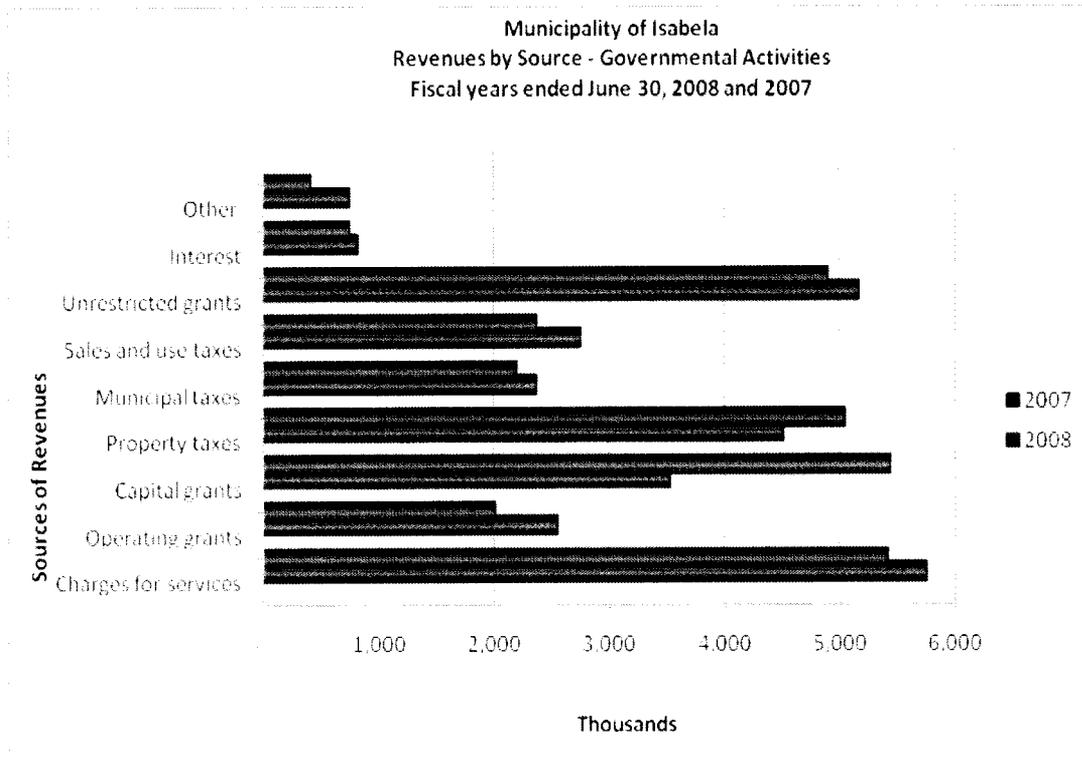
TABLE 2

<i>Summary of Changes in Net Assets As of June 30,</i>		
	Governmental Activities	
	2008	2007
Program revenues:		
Fees, fines and charges for services	\$ 5,750,742	\$ 5,418,106
Operating grants and contributions	2,556,358	2,016,548
Capital grants and contributions	3,534,768	5,442,558
General revenues:		
Property taxes	4,517,124	5,048,773
Municipal license taxes	2,374,984	2,205,503
Sales and use taxes	2,759,156	2,378,372
Grants and contributions not restricted to specific programs	5,169,102	4,902,541
Interest	828,434	755,918
Other	529,470	419,461
Gain on disposition of capital assets	226,487	-
Total revenues	28,246,625	28,587,780
Expenses:		
General government	10,105,115	8,024,365
Public works and sanitation	5,061,470	3,586,281
Public safety	1,077,097	1,038,655
Culture and recreation	1,140,508	971,763
Health	3,074,707	3,022,409
Housing, welfare and community development	2,149,553	2,554,922
Education	1,107,586	852,756
Interest on long term debt	455,000	444,449
Total expenses	24,171,036	20,495,600
Change in net assets	4,075,589	8,092,180
Net assets-beginning of year	48,982,386	40,890,206
Net assets-end of year	\$ 53,057,975	\$ 48,982,386

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA
MANAGEMENT DISCUSSION AND ANALYSIS**

Fiscal year ended June 30, 2008

FIGURE 1



Approximately 20% of the Municipality’s revenues came from fees and charges for services, 13% from capital grants, 16% from property taxes and 18% from unrestricted grants. The Municipality’s expenses cover a range of services. The largest expenses are general government representing approximately 42%, public works and sanitation with 21% and health with 13%. Program revenues of the Municipality covered 49% of total expenses.

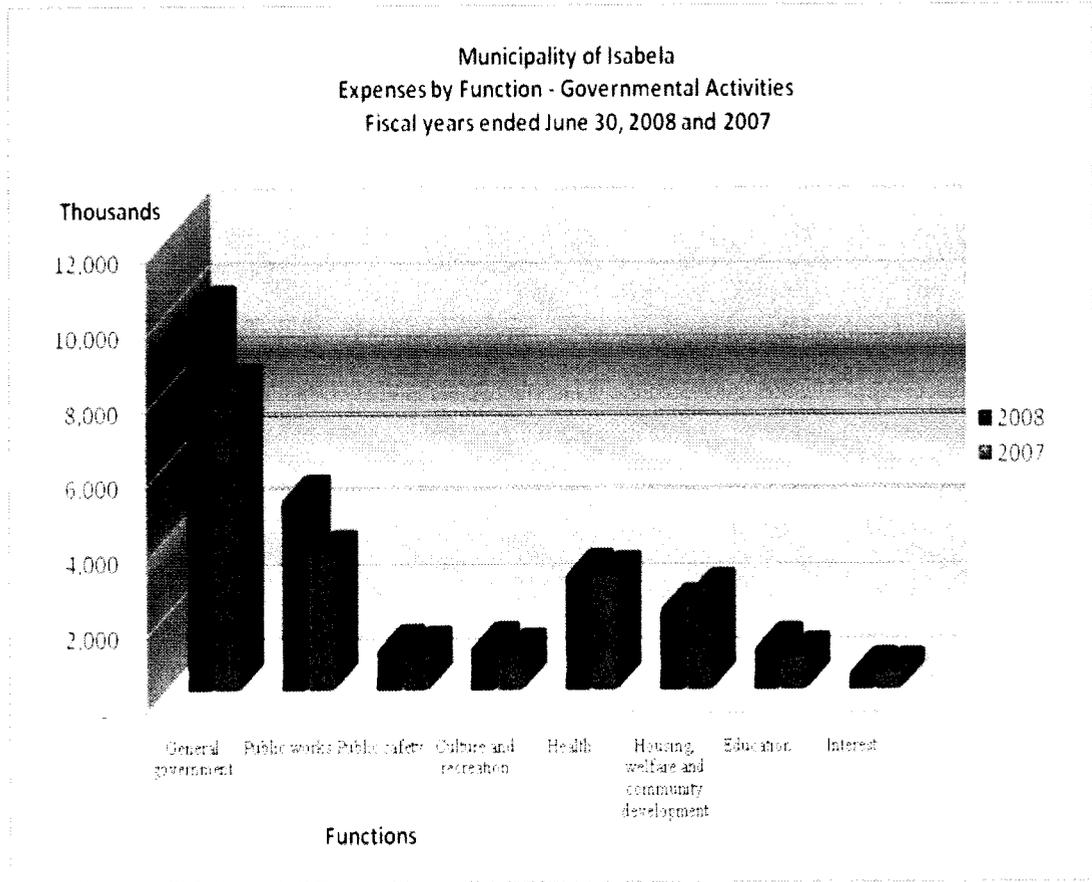
With respect to prior year, revenues reported a net decrease of approximately 1%. This net decrease is primarily the result of: (1) a 27 % increase in operating grants due to grants from P.R. Department of Transportation (for streets and roads maintenance) and additional Child Care grant revenues; (2) 16% increase in sales and use taxes; (3) 80% increase in other revenues including a gain on disposition of capital assets of \$226,487; (3) a 35% decrease in capital grants revenues due to the recognition in prior year of the moneys received from the \$575,000,000 in 2006 Series A Public Improvement Bonds issued by the Commonwealth Government and (4) an 11% decrease in property tax revenue.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

MANAGEMENT DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2008

FIGURE 2



Expenses increased 18% in comparison with 2007 year. Significant increases were registered on public works with 41%, education with 30%, and general government with 26%. Increases in those functions were caused mainly by greater capital assets maintenance costs, increase in Child Care and Head Start grants expenses and increases in salaries and related payroll expenses. Increase in salaries was caused by the implementation of the federal minimum wage and the uniform classification plan for employees.

As noted previously the decrease in revenues and the increase in expenses caused a decrease of 50% in the net change in net assets with respect to prior year net change.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

MANAGEMENT DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2008

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

Functions/Programs	Total Cost of Services		Net Cost of Services	
	2008	2007	2008	2007
General government	\$ 10,105,115	\$ 8,024,365	\$ 5,571,805	\$ 4,045,127
Public works and sanitation	5,061,470	3,586,281	2,065,304	(1,469,539)
Public safety	1,077,097	1,038,655	942,187	941,455
Culture and recreation	1,140,508	971,763	1,129,358	964,338
Health	3,074,707	3,022,409	1,107,697	834,683
Housing, welfare and community development	2,149,553	2,554,922	709,011	1,683,268
Education	1,107,586	852,756	348,806	174,607
Other	455,000	444,449	455,000	444,449
	<u>\$ 24,171,036</u>	<u>\$ 20,495,600</u>	<u>\$ 12,329,168</u>	<u>\$ 7,618,388</u>

FINANCIAL ANALYSIS OF THE MUNICIPALITY'S FUNDS

Some of the cost of governmental activities was paid by those who directly benefited from the programs (\$5,750,742) and other governments and organizations that subsidized certain programs with grants and contributions (\$6,091,126). The \$12,329,168 net cost of services was fully covered by other general revenues including taxes and other grants and contributions not restricted to specific programs.

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, 2008, the governmental funds reported combined ending fund balances of \$27,671,572, a net increase of \$2,399,281 in comparison with the prior year. This increase was caused primarily by a net change in the general fund of \$2,333,038 and \$1,103,939 in the debt service fund. Of total combined fund balances, \$13,137,246 (47%) constitutes unreserved fund balance. The remainder of the fund balance is reserved to indicate that it is not available for new spending.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

MANAGEMENT DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2008

The general fund is the operating fund of the Municipality. For the year ended June 30, 2008, the fund balance of the general fund increased by \$2,333,038 when compared with the prior year. Of this net change, \$307,196 pertains to special funds included as part of the general fund. The principal components of the net decrease of \$324,004 in revenues are a decrease of \$606,622 in property taxes; an increase of \$169,481 in municipal license tax; an increase of \$131,255 in sales and use tax; a decrease of \$276,327 in fees, fines and charges for services; and a \$25,471 decrease in interest. The significant decrease in property taxes is the result of a negative estimate adjustment \$410,436 made by the CRIM to the 2007-2008 advances and to the inclusion in the 2006-2007 financial statements of \$283,570 in property tax revenue from prior years. The decrease in fees, fines and charges for services is the result of a \$302,057 decrease in the revenues generated by the CIMA hospital. The net increase in expenditures of \$1,297,021 is due to an increase of \$1,152,283 in general government; an increase of \$285,673 in public works; an increase of \$207,350 in housing, welfare and community development; and a decrease of \$359,371 in capital outlays. The significant increase in general government is the result of the implementation of the federal minimum wage and the uniform classification plan for employees and an increase of \$308,134 in the energy utility service charges for the 2007-2008 fiscal year.

GENERAL FUND BUDGETARY HIGHLIGHTS

The general fund original budget for the fiscal year 2007-2008 presented an increase of 2% 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 \$1,800,997 due to additional collections of sales and use taxes, charges for services (mainly construction permits), municipal license tax and interest revenue. Budget expenditures were decreased by \$88,300; however, budget transfers-out were increased by \$1,889,297. Actual revenues exceeded the revised budgeted revenues by \$869,888 (net). The most significant variances were in property taxes, (\$410,436); sales and use taxes, \$131,305; intergovernmental revenue, \$672,269; and interest, \$410,605.

A positive variance of \$457,830 between revised budget and actual expenditures was due mainly to net decreases in the following functions: \$120,447 in general government, \$89,021 in public works and sanitation, \$105,787 in public safety, and \$106,419 in housing, welfare and community development expenditures. The Municipality reported less expenditure (net) than appropriations in those functions on payments for salaries and fringe benefits. Actual revenues exceeded actual expenditures by \$1,623,624.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital assets

At the end of the fiscal year, the Municipality has invested \$39,446,770 (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 approximately 9% over the prior year.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

MANAGEMENT DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2008

TABLE 4

<i>Capital Assets, net As of June 30,</i>			
	Governmental Activities		
	2008	2007	
Non-depreciable assets:			
Land	\$ 4,055,589	\$ 4,055,589	
Construction in progress	5,823,626	3,624,421	
Depreciable assets:			
Land improvements	14,479	-	
Leasehold improvements	383,519	421,411	
Buildings and buildings improvements	13,841,788	13,805,444	
Infrastructure	10,856,436	9,858,681	
Vehicles, machinery and equipment	4,471,333	4,442,833	
Total	<u>\$ 39,446,770</u>	<u>\$ 36,208,379</u>	

The Municipality's major capital projects that were still in construction as of June 30, 2008 are as follows:

- Renovation of City Hall - \$1,521,536
- Improvements to the downtown electrical infrastructure - \$1,429,746
- Construction of Youth Sport and Educational Center - \$325,000
- Construction of "Parque Urbano" - \$881,001
- Construction of "Parque Lineal" - \$1,028,092
- Road Improvements "Florida" Community- \$314,277

Construction in progress increased significantly due to the construction costs incurred in the renovation of City Hall, "Parque Urbano" and "Paseo Lineal" projects, whose total additions for 2007-2008 amounted to \$2,554,913.

The Municipality reported approximately \$1,724,774 in infrastructure additions during the year, which are composed mainly of capital improvements.

The Municipality acquired a total of \$708,429 of equipment during the fiscal year 2007-2008, including several compactor trucks, four vans, air conditioning equipment and a significant number of computers for a total amount of \$548,575.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA

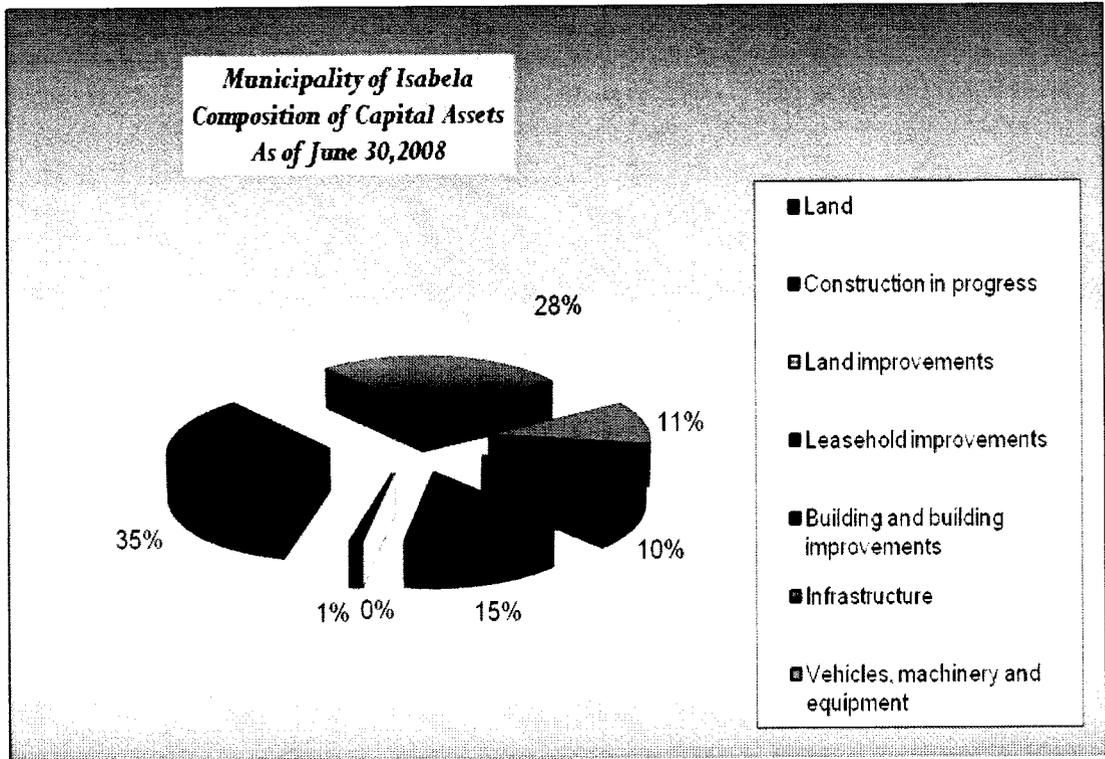
MANAGEMENT DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2008

The Municipality's fiscal year 2008-2009 consolidated capital budget calls for a significant amount of new and continuous projects including the renovation of the City Hall, construction of "Parque Urbano," construction of a new Youth Sport and Educational Center, construction of a central park (an ecological sanctuary), construction of "Paseo Lineal," construction of a skate park and capital improvements to municipal streets and roads. These projects will be financed through Federal and Commonwealth grants, funds from the Commonwealth Legislature, general obligation bonds and Municipal funds.

Capital assets composition as of June 30, 2008 follows:

FIGURE 3



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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

MANAGEMENT DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2008

Long-term debt

At year-end, the Municipality had \$7,680,024 in general and special bonds and notes, a decrease of 3% with respect to prior year. The following is a summary of the Municipality's outstanding debt as of June 30, 2008 and 2007:

TABLE 5

<i>Outstanding Long-term Debt As of June 30,</i>			
	Governmental Activities		
	2008	2007	
General and special obligation bonds and notes	\$ 7,680,024	\$ 7,894,024	
Note payable to CRIM – LIMS	217,123	271,404	
Note Payable to CRIM – prior years delinquent accounts	69,128	72,008	
Note payable to Puerto Rico Department of Labor	59,619	141,145	
Note payable to Puerto Rico Solid Waste Authority	134,905	170,236	
Note payable to Puerto Rico Treasury Department	458,778	597,065	
Note payable to PR Employee Retirement System Administration	114,554	195,732	
Note payable-Section 108 Loan Guarantee	1,200,000	-	
Landfill obligation	4,649,489	4,377,357	
Compensated absences	2,545,681	2,102,208	
Christmas Bonus	361,016	360,253	
Claims and judgments	150,000	-	
Payable to CRIM – property tax advances	50,514	38,807	
Payable to PREPA	211,759	-	
Total	\$ 17,902,590	\$ 16,220,239	

The increase in the notes payable-Section 108 Loan Guarantee corresponds to the loan advances given to the Municipality by the U.S. Department of Housing and Urban Development (HUD) under this assistance agreement during the fiscal year 2007-2008. The agreement, for a maximum commitment of \$4,850,000 will finance the construction of a Youth Sports and Education Center. In addition, the increase in the notes payable with Puerto Rico Electric Power Authority (P.R.E.P.A.) is the result of an excess of the annual energy charges incurred by the Municipality over the contribution in lieu of taxes ("CELI") for the fiscal year 2006-2007, which was recorded both a long-term debt and an account receivable from the agency. More detailed information about the Municipality's long-term liabilities is presented in Note I to the financial statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

MANAGEMENT DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2008

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

The Municipality's selected and appointed officials considered many factors when setting the fiscal year 2008-2009 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 12.0%, which compares with the Commonwealth rate of 11.8%.

The Municipality applied a conservative approach in development budget estimates. Amounts available for appropriations in the General Fund for the fiscal year 2008-2009 are \$15,122,965, an increase of approximately 4% with respect to prior year estimates. Budgeted expenditures are expected to rise accordingly to the increase of budgeted revenues. In addition to the estimated budget for the general fund, the Municipality has submitted Federal and Commonwealth funds proposals for welfare and community development as well as for capital improvements and public works funds.

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 at PO Box 507, Isabela, Puerto Rico 00602.

Basic Financial Statements

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

**STATEMENT OF NET ASSETS
JUNE 30, 2008**

ASSETS	Governmental Activities
Cash and investments	\$ 16,025,552
Receivables, net:	
Sales and use taxes (note M)	289,488
Other (note D)	352,756
Due from:	
Commonwealth Government (note E)	1,837,561
Federal Government (note E)	2,738,714
Restricted assets:	
Cash and investments	8,792,449
Cash with fiscal agent	4,722,266
Investment held with fiscal agent (note C)	2,230,809
Deferred charges	43,818
Inventories and Supplies	142,287
Other assets	7,768
Capital Assets (note G):	
Land and construction in progress	9,879,215
Other capital assets, net	29,567,555
	39,446,770
Total assets	\$ 76,630,238
LIABILITIES	
Accounts payable and accrued liabilities	\$ 3,020,229
Interest payable	171,040
Due to:	
Commonwealth Government (note E)	271,411
Deferred revenues:	
Municipal license taxes	2,019,203
Commonwealth Government	85,920
Other	101,870
Long-term liabilities (note I):	
Due within one year	1,280,552
Due in more than one year	16,622,038
Total liabilities	23,572,263
NET ASSETS	
Invested in capital assets, net of related debt	36,295,097
Restricted for:	
Capital projects	10,147,333
Debt service	4,051,077
Other specified purposes	743,719
Unrestricted	1,820,749
Total net assets	\$ 53,057,975

The accompanying notes are an integral part of this statement.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA

STATEMENT OF ACTIVITIES
FISCAL YEAR ENDED JUNE 30, 2008

Functions	Expenses	Program Revenues		Net (Expenses) Revenues and Change in Net Assets
		Fees, Fines and Charges for services	Operating Grants and Contributions	
Governmental Activities:				
General government	\$ 10,105,115	\$ 3,764,307	\$ 489,220	\$ (5,571,805)
Public works and sanitation	5,061,470	14,075	391,229	(2,065,304)
Public safety	1,077,097	-	134,910	(942,187)
Culture and recreation	1,140,508	5,350	5,800	(1,129,358)
Health	3,074,707	1,967,010	-	(1,107,697)
Housing, welfare and community development	2,149,553	-	776,419	(709,011)
Education	1,107,586	-	758,780	(348,806)
Interest on long-term debt	455,000	-	-	(455,000)
Total	\$ 24,171,036	\$ 5,750,742	\$ 2,556,358	\$ (12,329,168)

General revenues:

Taxes:	
Property taxes	4,517,124
Municipal license taxes	2,374,984
Sales and use taxes	2,759,156
Grants and contributions not restricted to specific programs	5,169,102
Interest	828,434
Gain on disposition of capital assets	226,487
Other	529,470
Total general revenues	16,404,757
Change in net assets	4,075,589
Net assets-beginning	48,982,386
Net assets-ending	\$ 53,057,975

The accompanying notes are an integral part of this statement.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**
BALANCE SHEET
GOVERNMENTAL FUNDS
JUNE 30, 2008

	Major Funds						
	General	Community Development Block Grant	Head Start	Debt Service	Commonwealth Legislature Resolutions	Other Governmental Funds	Total Governmental Funds
ASSETS							
Cash and investments	\$ 16,025,552	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 16,025,552
Receivables, net:							
Sales and use taxes	252,596	-	-	36,892	-	-	289,488
Other	333,340	-	-	-	11,393	7,824	352,557
Due from:							
Commonwealth Government (note E)	946,416	-	161,817	26,865	430,965	433,315	1,837,561
Federal Government (note E)	-	2,189,091	-	-	-	387,806	2,738,714
Other funds (note F)	1,278,834	-	-	-	-	9,068	1,287,902
Advances to other funds (note F)	-	-	-	-	1,307,497	-	1,307,497
Inventories and Supplies	142,287	-	-	-	-	-	142,287
Restricted assets:							
Cash and investments	105,424	2,552	9,042	-	3,414,024	5,261,407	8,792,449
Cash with fiscal agent	-	-	-	4,157,284	-	564,982	4,722,266
Investment held with fiscal agent	-	-	-	-	-	2,230,809	2,230,809
Other assets	7,768	-	-	-	-	-	7,768
Total assets	\$ 19,092,417	\$ 2,191,643	\$ 170,859	\$ 4,221,041	\$ 5,163,879	\$ 8,895,211	\$ 39,735,050

Liabilities and Fund Balances

Liabilities:							
Accounts payable and accrued liabilities	\$ 621,373	\$ 253,979	\$ 45,860	\$ -	\$ 922,224	\$ 1,176,793	\$ 3,020,229
Unearned revenue	-	-	-	344,326	-	-	344,326
Due to:							
Commonwealth Government	271,411	-	-	-	-	-	271,411
Other funds	9,068	84,729	124,999	-	-	1,069,106	1,287,902
Advances from other funds	1,307,497	-	-	-	-	-	1,307,497
Deferred revenues (notes H, I, and M):							
Municipal license taxes	2,019,203	-	-	-	-	-	2,019,203
Sales and use tax	36,180	-	-	-	-	-	36,180
Commonwealth Government	704,936	-	-	-	433,315	433,315	1,138,251
Federal grants	-	2,133,715	-	-	323,121	3,967	2,456,836
Other	175,213	-	-	344,326	2,463	3,066,302	181,643
Total liabilities	\$ 5,144,881	\$ 2,472,423	\$ 170,859	\$ 344,326	\$ 924,687	\$ 3,066,302	\$ 12,063,478
Fund balances (deficit):							
Reserves for:							
Inventories	142,287	-	-	-	-	-	142,287
Encumbrances	572,525	-	-	3,876,715	-	-	572,525
Debt service	-	(280,780)	-	-	2,801,968	5,784,295	3,876,715
Capital projects	-	-	-	-	129,727	104,614	8,305,483
Other specific purposes	95,478	-	-	-	1,307,497	-	329,819
Advances	-	-	-	-	-	-	1,307,497
Unreserved:							
Designated for future years expenditures	3,704,934	-	-	-	-	-	3,704,934
Undesignated	9,432,312	(280,780)	-	3,876,715	4,239,192	5,885,909	9,432,312
Total fund balances (deficit)	\$ 13,947,536	\$ (280,780)	\$ -	\$ 3,876,715	\$ 4,239,192	\$ 5,885,909	\$ 27,671,572
Total liabilities and fund balances	\$ 19,092,417	\$ 2,191,643	\$ 170,859	\$ 4,221,041	\$ 5,163,879	\$ 8,895,211	\$ 39,735,050

The accompanying notes are an integral part of this statement.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

**RECONCILIATION OF TOTAL GOVERNMENTAL FUND BALANCES
TO NET ASSETS OF GOVERNMENTAL ACTIVITIES
JUNE 30, 2008**

Total governmental fund balances: **\$ 27,671,572**

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

Capital assets used in governmental activities are not financial
resources and therefore are not reported in the funds: 39,446,770

Other assets used in governmental activities are not financial
resources and therefore are not reported in the funds:
Deferred charges: 43,818

Other assets are not available to pay for current-period
expenditures and therefore are deferred in the funds:

Receivables:

Property taxes- General Fund	\$	13,352	
Charges for services		71,656	
Interest		8,117	
Sales and use tax - Municipal Development Fund		36,180	

Due from Commonwealth Government:

P.R. Department of Labor (Law No. 52 and 82)		28,715	
P.R. Department of Education		140,000	
P.R. Electric Power Authority (PREPA)		211,759	
OCAM - Public Order Code		30,674	
Christmas Bonus Reimbursement		167,680	
Grant from P.R. Solid Waste Authority		6,005	
Grant from P.R. Department of Transportation		286,328	
Grant from Rural Development Corporation		167,818	

Due from Federal Government:

Federal Grant-HOME		118,788	
Federal Grant- Homeland Security		40,745	
Federal Grant-State and Community Highway Safety		21,681	
Federal Grant-Child Care		141,907	
Federal Grant-CDBG		2,133,714	

3,625,119

Interest liabilities are not due and payable in the current period
and therefore, are not reported in the funds: (16,714)

Long-term liabilities, including bonds payable, are not due
and payable in the current period and therefore, are not
reported in the funds:

General obligation bonds and notes		7,490,024	
Note payable to CRIM-LIMS		217,123	
Note payable to CRIM-financing of delinquent accounts		69,128	
Note payable to P.R. Department of Labor		59,619	
Note payable to P.R. Solid Waste Authority		134,905	
Note payable to P.R. Treasury Department		458,778	
Note payable to Employees Retirement System		114,554	
Note payable to HUD-Section 108 Loan Guarantee		1,200,000	
Payable to PREPA		211,759	
Compensated absences		2,545,681	
Judgments and legal claims		150,000	
Christmas Bonus		361,016	
Estimated solid waste landfill closure and post-closure costs		4,649,489	
Payable to CRIM-excess of property tax advances		50,514	

(17,712,590)

Net assets of governmental activities: **\$ 53,057,975**

The accompanying notes are an integral part of this statement.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA

STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES-
GOVERNMENTAL FUNDS
FISCAL YEAR ENDED JUNE 30, 2008

	Major Funds					Total Governmental Funds
	General	Community Development Block Grant	Head Start	Debt Service	Commonwealth Legislature Resolutions	
Revenues:						
Taxes:						
Property taxes (note K)	\$ 3,038,358	-	\$ -	\$ 1,508,671	\$ -	\$ 4,547,029
Municipal license taxes (note L)	2,374,984	-	-	-	-	2,374,984
Sales and use taxes (note M)	2,509,627	-	-	213,349	-	2,722,976
Intergovernmental:						
Commonwealth government (note N)	7,629,087	-	-	-	732,483	9,439,588
Federal government	-	1,950,144	758,780	-	-	3,791,383
Fees, fines and charges for services	3,646,293	-	-	-	-	3,646,293
Interest	353,268	-	-	109,188	119,861	849,917
Other	337,920	-	-	-	-	339,413
Total revenues	<u>19,889,537</u>	<u>1,950,144</u>	<u>758,780</u>	<u>1,831,208</u>	<u>852,344</u>	<u>27,711,583</u>
Expenditures:						
Current:						
General government	8,659,099	279,976	-	-	-	8,986,625
Public works and sanitation	2,857,148	46,459	-	-	193,056	4,291,159
Public safety	879,455	-	-	-	-	942,708
Culture and recreation	522,757	-	-	-	-	541,180
Health	3,039,359	-	-	-	-	3,039,359
Housing, welfare and community development	1,206,634	196,713	-	-	-	2,114,926
Education	-	-	742,383	-	-	301,008
Capital outlays	700,221	1,535,192	16,397	-	-	1,774,124
Debt service:						
Principal	-	-	-	224,000	-	224,000
Interest	-	-	-	394,757	-	394,757
Total expenditures	<u>17,864,673</u>	<u>2,058,340</u>	<u>758,780</u>	<u>618,757</u>	<u>1,221,927</u>	<u>26,632,910</u>
Excess (deficiency) of revenues over expenditures	<u>2,024,864</u>	<u>(108,196)</u>	<u>-</u>	<u>1,212,451</u>	<u>(369,583)</u>	<u>1,078,673</u>
Other financing sources (uses):						
Proceeds from Section 108 Loan Guarantee advances - CDBG	-	-	-	-	-	1,200,000
Proceeds from debt settlement - P.R. Department of Treasury	226,487	-	-	-	-	226,487
Payment of PREPA debt	(105,879)	-	-	-	-	(105,879)
Transfers in	193,550	-	-	-	-	5,984
Transfers out	(5,984)	-	-	(108,512)	(30,859)	(199,534)
Total other financing sources (uses)	<u>308,174</u>	<u>-</u>	<u>-</u>	<u>(108,512)</u>	<u>(30,859)</u>	<u>1,320,608</u>
Net change in fund balances	<u>2,333,038</u>	<u>(108,196)</u>	<u>-</u>	<u>1,103,939</u>	<u>(400,442)</u>	<u>2,399,281</u>
Fund balances (deficit) at beginning of year	<u>11,614,498</u>	<u>(172,584)</u>	<u>-</u>	<u>2,772,776</u>	<u>4,639,634</u>	<u>25,272,291</u>
Fund balances (deficit) at end of year	<u>\$ 13,947,536</u>	<u>\$ (280,780)</u>	<u>\$ -</u>	<u>\$ 3,876,715</u>	<u>\$ 4,239,192</u>	<u>\$ 27,671,572</u>

The accompanying notes are an integral part of this statement.

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA

RECONCILIATION OF STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN
FUND BALANCES OF GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES
FISCAL YEAR ENDED JUNE 30, 2008

Net change in fund balances-total governmental funds:	\$	2,399,281
Amounts reported for governmental activities in the Statement of Activities are different because:		
Governmental funds report capital assets outlays as expenditures. However, in the Statement of Activities, the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense:		
Expenditures for capital assets:	\$ 5,088,777	
Less: current year depreciation	(1,489,165)	3,599,612
Governmental funds only report the proceeds received in the disposal of assets. In the Statement of Activities, a gain or loss is reported for each disposal. Thus, the change in net assets differs from the change in fund balance by the cost of the disposed asset:		
		(570,874)
Revenues in the Statement of Activities that do not provide current financial resources are not reported as revenues in the funds:		
Property taxes-General Fund (current year)	13,352	
P.R. Department of Labor (Law No. 52 and 82)	28,715	
P.R. Department of Education	140,000	
P.R. Department of Transportation	265,497	
P.R. Electric Power Authority (PREPA)	211,759	
Rural Development Corporation	167,818	
OCAM - Public Order Code	30,674	
Christmas Bonus Reimbursement (current year)	167,680	
Sales and use tax- Municipal Development Fund	36,180	
Federal Grant- Homeland Security	40,745	
Federal Grant-State and Community Highway Safety	21,681	
Federal Grant-HOME	27,821	
Federal Grant-Child Care	141,907	
Federal Grant-CDBG (net change)	(608,089)	
Charges for services	47,294	
Interest	8,117	
Donated capital assets	159,383	900,534
Revenues reported in funds which are not reported as revenues in the Statement of Activities:		
Property taxes-General Fund (prior year)	(11,707)	
Property taxes-Debt Service Fund (prior year)	(31,550)	
P.R. Department of Education (prior year)	(105,000)	
P.R. Department of Labor (Law No. 52 and 82)	(44,466)	
Grant from P.R. Department of Transportation	(10,276)	
Construction permits	(18,600)	
Charges for services	(65,113)	
Interest (prior year)	(29,600)	
Federal Grant-Child Care	(108,341)	
Christmas Bonus Reimbursement (prior year)	(167,326)	(591,979)
Proceeds from Section 108 Loan Guarantee advances - CDBG and other long-term debt are other financing sources in the governmental funds, but an increase of long-term liabilities in the Statement of Net Assets:		
		(1,200,000)
Expenditures reported in funds which are not reported as expenses in the Statement of Activities:		
Matured bonds principal payments-Debt Service Fund (net change)		10,000
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	214,000	
Other long-term liabilities	859,615	1,073,615
Governmental funds report 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:		
Amortization of bond issuance costs		(2,503)
Some expenses reported in the Statement of Activities do not require the use of current financial resources and therefore, are not reported as expenditures in the governmental funds:		
Compensated absences	(443,473)	
Municipal solid waste landfill	(272,132)	
Judgment and legal claims	(150,000)	
Christmas bonus	(361,016)	
P.R. Electric Power Authority (PREPA)	(317,638)	
Accrued interest (net change)	2,162	(1,542,097)
Change in net assets of governmental activities:	\$	<u>4,075,589</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

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 exists between the primary government and the potential component unit.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

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 the Management Discussion and Analysis (MD&A), the 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 the analysis the private sector provides in their annual reports.

Basic financial statements

The 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.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

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 focuses 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 and sales and use 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.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

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 or based on the Municipality's official's criteria, if the fund is particularly important to financial statement users (for Head Start Program Fund).

The Municipality reports the following major governmental funds:

General Fund: This is the operating fund of the Municipality and accounts for all financial resources, except those required to be accounted for 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.

Head Start Program Fund: Head Start fund 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 through the provisions of comprehensive health, educational, nutritional, social and other services.

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.

Commonwealth Legislature Resolutions Fund: The Commonwealth Legislative Resolutions Fund is used to account for grants from the Commonwealth's Legislature.

Governmental funds, reported in the fund statements, are accounted for using the current financial resources measurement focus and the modified accrual basis of accounting. Under this method of accounting, revenues are recognized when they are susceptible to accrual (i.e. 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, except for reimbursement-based (expenditure-driven) grants for which the availability period is 90 days.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Revenues susceptible to accrual include property taxes, recognized as revenues in the year for which they are levied; municipal license taxes and sales and use taxes, recognized when the underlying exchange has occurred and time requirements are met, and interest. In applying the susceptible to accrual concept to intergovernmental revenues, revenues are recognized when all eligibility requirements (including time requirements) imposed by the provider have been met and revenue becomes available. There are, however, essentially two types of these revenues. In the first case, on expenditure-driven grants, monies must be expended on the specific project or purpose (eligibility requirement), before any amounts are paid to the Municipality. Revenue is, therefore, recognized as expenditures are incurred to the extent available. In the other cases, monies are virtually unrestricted and are generally revocable only for failure to comply with prescribed compliance requirements. In these cases revenues are recognized as the time of receipt or earlier if the susceptible to accrual criteria is met. Licenses and permits, charges for services, rent, fines and miscellaneous revenues are generally recorded as revenues when received or are recognized earlier if the susceptible to accrual criteria is met.

The Municipality reports in the governmental funds statements deferred revenues 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) and (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, a 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.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

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 and investments and restricted cash with fiscal agents*

Cash consist of cash on hand, demand deposits and short term investments with original maturities of three months or less from the date of acquisition. Investments consist of nonnegotiable certificates of deposits with original maturity of more than three months. 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 investments 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 and sales 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 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 revenues of current fiscal year collected by the CRIM (property tax) on the subsequent fiscal year.

5. *Interfund receivables and payables*

Activity among the 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 among the funds are reported as "due from/to other funds".

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

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 \$142,287 are included in the financial statements.

7. *Capital assets*

Capital assets of the primary government, 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 and construction in progress, 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
Leasehold improvements	Lease term
Infrastructure	10-50
Vehicles, machinery and equipment	5-10

In accordance with current accounting standards capital assets are reviewed for impairment. Impairment occurs when there is a significant decline in asset service utility due to the occurrence of a prominent event or change in circumstances affecting the asset. Current standards provide guidance for accounting and reporting for impairment and for insurance recoveries.

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.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

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.

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.

Pursuant to Law No. 152 of August 20, 1996 effective July 1, 1997 the Municipality is required to pay any excess of vacations and sick leave accumulated over 90 days as of December 31 of each year. Payments should be made on or before March 31 of the following year.

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

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:	Represent 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.
Advances:	Represent the non-current portion of interfund loans.

Fund balance unreserved-designated represents amounts that Management has identified for future spending and not legally segregated.

b. Net assets:

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

Invested in capital assets, net of related debt:	Consist 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:	Represent net assets (restricted assets net of related debt) 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.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

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

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 \$23,020,831.

Deposits in governmental banks (all of which are uninsured and uncollateralized), are exposed to custodial credit risk. At year-end the Municipality's bank balance in governmental banks amounts to \$6,953,075.

NOTE C - INVESTMENT HELD WITH FISCAL AGENT

The investment held with fiscal agent consists of a non-participating investment contract (non-rated guaranteed investment contract, "GIC"). This represents the investment of the undisbursed proceeds of the \$3,010,000 general obligation bond under custody of GDB, the Municipality's fiscal agent, pursuant to the bond purchase agreement. The GIC, with an outstanding balance of \$2,230,809 as of June 30, 2008 earns interest at a variable rate (LIBOR minus .125%, 4.668% as of June 30, 2008) and matures on November 3, 2008. GIC outstanding balance is valued at cost.

NOTE D - RECEIVABLES

Accounts receivable as of June 30, 2008 follows:

	Amount
Construction permits	\$ 101,870
Healthcare providers billings	167,446
Interest	82,115
Others	1,325
	<hr/>
	\$ 352,756

Certain amounts receivable are recorded as deferred revenue in the governmental funds statements since they are not available as required by current standards. See related note H.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

NOTE E – DUE FROM (TO) GOVERNMENTAL ENTITIES

1. Amounts due from governmental entities as of June 30, 2008 follows:

	Commonwealth Government	Federal Government
Municipal Revenue Collection Center (CRIM) – property taxes and intergovernmental subsidy (general fund)	\$ 234,832	\$ -
P.R. Electric Power Authority (PREPA)	211,759	
P.R. Department of Treasury - Christmas bonus reimbursement	167,680	-
P.R. Department of Education	140,000	-
P.R. Department of Justice - Public Order Code	30,674	-
Municipal Revenue Collection Center (CRIM) – property taxes (debt service fund)	26,865	-
P.R. Department of Health	85,920	-
P.R. Department of Labor-Law No. 52	28,715	-
P.R. Department of Labor-Law No. 82	20,000	-
P.R. Department of Transportation	286,328	-
Rural Development Corporation	167,818	-
Office of Commissioner of Municipal Affairs – Commonwealth Legislature Resolutions	430,965	-
Office of Commissioner of Municipal Affairs – CDBG	-	571,241
U.S. Department of Housing and Urban Development – CDBG	-	1,617,850
U.S. Department of Health and Human Services – Head Start	-	161,817
P.R. Department of Family – Child Care	-	167,535
P.R. Department of Housing – Home Investment Partnership Program (HOME)	-	155,003
Others	6,005	65,268
	\$ 1,837,561	\$ 2,738,714

See note H for detail of amounts due from governmental entities recorded as deferred revenue.

2. Amounts due to governmental entities as of June 30, 2008 follows:

	Commonwealth Government
P.R. Employees Retirement System (special laws and current debt)	\$ 173,396
P.R. General Services Administration	42,160
State Insurance Fund Corporation	35,258
Others	20,597
	\$ 271,411

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

NOTE F - INTERFUND TRANSACTIONS

1. Due from/to other funds:

Amounts due from/to other funds represent advances to other funds for payroll and payroll taxes expenditures, as follows:

Receivable Fund	Payable Fund	Amount
General Fund	Major funds:	
	CDBG	\$ 84,729
	Head Start	124,999
	Other governmental funds:	
	Public Order Code	272,624
	Child Care	193,206
	TANF	175,712
	Traffic Safety Commission	164,330
	Section 8 HCV	99,104
	Office of Public Safety Affairs	40,745
	P.R. Dept. of Transportation	36,838
	Others	86,547
		\$ 1,278,834
Other governmental funds: WIA	Major funds: General Fund	\$ 9,068

2. Advances from other funds:

Advances from other funds in the amount of \$1,307,497 represent long-term advances by the Commonwealth Legislature Resolutions Fund to the General Fund in previous years to cover operational expenditures.

3. Transfers in (out):

Transfers among individual funds were made for operational purposes. Transfers include (1) interest earned on restricted cash with fiscal agent in the debt service fund and operating and capital improvement loans in other governmental funds which are transferred to the general fund (2) interest in Commonwealth Legislature Resolutions funds which is transferred to the general fund and, (3) principal and interest payments of long-term debt transferred from the general fund to the debt service fund.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

NOTE G – CAPITAL ASSETS

Capital assets and depreciation activity as of and for the year ended June 30, 2008 are as follows:

	<u>Balance July 1, 2007</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance June 30, 2008</u>
<u>Governmental activities:</u>				
Capital assets, not being depreciated:				
Land	\$ 4,055,589	\$ -	\$ -	\$ 4,055,589
Construction in progress	3,624,421	3,139,151	939,946	5,823,626
Total capital assets not being depreciated	7,680,010	3,139,151	939,946	9,879,215
Capital assets, being depreciated:				
Land improvements	-	14,650	-	14,650
Buildings and building improvements	15,743,483	651,371	-	16,394,854
Leasehold improvements	505,233	-	-	505,233
Infrastructure	11,599,117	1,724,774	649,992	12,673,899
Vehicles, machinery and equipment	7,462,862	708,430	223,714	7,947,578
Total capital assets being depreciated	35,310,695	3,099,225	873,706	37,536,214
Less accumulated depreciation for:				
Land improvements	-	171	-	171
Buildings and building improvements	1,938,040	615,026	-	2,553,066
Leasehold improvements	83,822	37,892	-	121,714
Infrastructure	1,740,435	215,361	138,333	1,817,463
Vehicles, machinery and equipment	3,020,029	620,715	164,499	3,476,245
Total accumulated depreciation	6,782,326	1,489,165	302,832	7,968,659
Total capital assets being depreciated, net	28,528,369	1,610,060	570,874	29,567,555
Governmental activities capital assets, net	<u>\$ 36,208,379</u>	<u>\$ 4,749,211</u>	<u>\$ 1,510,820</u>	<u>\$ 39,446,770</u>

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

<u>Governmental activities:</u>	
General government	\$ 89,127
Public works and sanitation	591,469
Public safety	75,071
Culture and recreation	599,328
Health	35,348
Welfare and community development	72,519
Education	26,303
Total depreciation expense, governmental activities	<u>\$ 1,489,165</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

NOTE H – DEFERRED REVENUES – GOVERNMENTAL FUNDS

Deferred revenues - Commonwealth Government and Other represent revenues not available as required by current standards and for Federal Grants represent resources received before allowable expenditures are incurred or not available as required by current standards. A detail of these balances follows:

	Commonwealth Government	Federal Grants	Other
<u>Major fund - general fund:</u>			
Municipal Revenue Collection Center (CRIM) – property taxes (general fund)	\$ 13,352	\$ -	\$ -
P.R. Department of Treasury – Christmas bonus reimbursement	167,680	-	-
P.R. Department of Education	140,000	-	-
P.R. Department of Health	85,920	-	-
P.R. Department of Labor – Law No. 52	28,715	-	-
P.R. Department of Justice – Public Order code	30,674	-	-
P.R. Electric Power Authority (PREPA)	211,759	-	-
Others	26,836	-	-
Construction permits	-	-	101,870
Healthcare providers billings	-	-	73,343
<u>Major fund – Community Development Block Grant fund:</u>			
Office of Commissioner of Municipal Affairs –CDBG	-	521,027	-
U.S. Department of Housing and Urban Development – CDBG	-	1,612,688	-
<u>Major fund – Commonwealth Legislature resolutions fund:</u>			
Commonwealth Legislative Resolutions	-	-	2,463
<u>Other governmental funds:</u>			
P.R. Department of Transportation	265,497	-	-
Rural Development Corporation	167,818	-	-
P.R. Department of Family – Child Care	-	141,907	-
P.R. Department of Housing – Home Investment Partnership Program (HOME)	-	118,788	-
Office of Public Safety Affairs	-	40,745	-
Traffic Safety Commission	-	21,681	-
Others	-	-	3,967
	\$ 1,138,251	\$ 2,456,836	\$ 181,643

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

NOTE I – 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, 2008:

	<u>Balance at July 1, 2007</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance at June 30, 2008</u>	<u>Due within one year</u>
General, Special Obligations Bonds and Notes	\$ 7,894,024	\$ -	\$ 214,000	\$ 7,680,024	\$ 226,000
Note payable to CRIM- LIMS	271,404	-	54,281	217,123	57,559
Note payable to CRIM –Financing of delinquent accounts	72,008	-	2,880	69,128	2,880
Note payable to PR Department of Labor	141,145	-	81,526	59,619	59,619
Note payable to P.R. Solid Waste Authority	170,236	-	35,331	134,905	36,360
Note Payable to P.R. Treasury Department	597,065	-	138,287	458,778	145,362
Note payable to ERS	195,732	-	81,178	114,554	55,444
Note payable – Section 108 Loan Guarantee	-	1,200,000	-	1,200,000	-
Landfill Obligation	4,377,357	272,132	-	4,649,489	-
Compensated absences	2,102,208	622,452	178,979	2,545,681	179,919
Christmas bonus	360,253	361,016	360,253	361,016	361,016
Claims and judgments	-	150,000	-	150,000	-
Payable to CRIM- excess of property tax advances over actual collections	38,807	11,707	-	50,514	50,514
Payable to PREPA	-	317,638	105,879	211,759	105,879
	<u>\$ 16,220,239</u>	<u>\$ 2,934,945</u>	<u>\$ 1,252,594</u>	<u>\$ 17,902,590</u>	<u>\$ 1,280,552</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

NOTE I – 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, 2008 amount to \$7,680,024. 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 collect property taxes for payment of principal and interest on bonds and notes. In addition, .2% of the .5% municipal sales and use tax collected by the P.R. Department of Treasury is deposited in a "Municipal Redemption Fund" to finance loans to Municipalities subject to restrictions imposed by law. Debt service fund has been established for the bonds and notes at GDB with the proceeds of those property and sales and use taxes, whereby sufficient funds must be set aside in order to cover the projected debt service requirement, before any new bonds are issued.

A detail of the general and special obligation bonds and notes as of June 30, 2008 follows:

	Outstanding Amount
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%	\$ 360,000
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%	335,024
2000 general obligation bonds of \$305,000 due in annual installments ranging from \$20,000 to \$40,000 through January 1, 2006; bearing interest at rates ranging from 2.70% to 7.81% (3.88% at June 30, 2008)	115,000
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% (6.23% at June 30, 2008)	3,085,000
2006 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 5.31% (4.24% at June 30, 2008)	240,000
2006 general obligation bonds of \$600,000 due in annual installments ranging from \$25,000 to \$60,000 through July 1, 2021; bearing interest rates ranging from 6.60% to 7.25% (6.48% at June 30, 2008)	575,000

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

NOTE I – LONG-TERM DEBT – Continued

	Outstanding Amount
2006 general obligation bonds of \$3,010,000 due in annual installments ranging from \$40,000 to \$260,000 through July 1, 2031; bearing interest rates ranging from 5.69% to 6.75% (6.75% at June 30, 2008)	2,970,000
	\$ 7,680,024

The annual requirement to amortize general and special obligation bonds and notes as of June 30, 2008 follows:

June 30,	Principal	Interest
2009	\$ 226,000	\$ 506,026
2010	242,000	490,690
2011	259,000	474,138
2012	231,000	458,498
2013	253,000	441,324
2014-2018	1,552,000	1,916,708
2019-2023	2,003,000	1,288,159
2024-2028	1,954,024	549,790
2029-2032	960,000	93,723
Totals	\$ 7,680,024	\$ 6,219,056

3. Other long-term liabilities

	Outstanding 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 repaid with unrestricted funds through withholdings from the advances of property tax and amounts of municipal equalization fund sent to the Municipality by the Municipal Revenue Collection Center (CRIM). Debt service requirements in future years are as follows:	\$ 217,123

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

NOTE I – LONG-TERM DEBT – Continued

<u>June 30,</u>	<u>Principal</u>	<u>Interest</u>
2009	\$ 57,559	\$ 12,075
2010	61,034	8,599
2011	64,719	4,914
2012	33,811	1,006
Totals	<u>\$ 217,123</u>	<u>\$ 26,594</u>

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 provisions of Law No. 146 of October 11, 2001. The agreement is in the form of a non-revolving 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 were 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 was credited to the loan principal. After the 5 year period the loan outstanding balance was restructured for a 25 years period. The amount is repaid with unrestricted funds through withholdings from the advances of property tax and amounts of municipal equalization fund sent to the Municipality by the Municipal Revenue Collection Center (CRIM). Debt service requirements in future years are as follows:

\$ 69,128

<u>June 30,</u>	<u>Principal</u>	<u>Interest</u>
2009	\$ 2,880	\$ 4,254
2010	2,880	4,075
2011	2,880	3,897
2012	2,880	3,717
2013	2,880	3,538
2014-2018	14,402	15,004
2019-2023	14,402	10,525
2024-2028	14,402	6,047
2029-2032	11,522	1,612
Totals	<u>\$ 69,128</u>	<u>\$ 52,669</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

NOTE I – LONG-TERM DEBT – Continued

Note payable to Puerto Rico Department of Labor – On February 16, 2006, the Municipality entered into a financing agreement with the PR Department of Labor for a total amount of \$401,505 for unemployment benefits paid by the Commonwealth of Puerto Rico in behalf of the municipality. The agreement is payable in monthly installments of \$7,768, including interest of 11.19% and due in February 15, 2009. The note is being paid from unrestricted funds. Debt service requirements in future years are as follows:

\$ 59,619

June 30,	Principal	Interest
2009	\$ 59,619	\$ 2,529

Note payable to Puerto Rico Solid Waste Authority – 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, 2008 is net of an unamortized discount of \$8,039 and is being paid from unrestricted funds. Debt service requirements in future years are as follows:

\$ 134,905

June 30,	Principal	Interest
2009	\$ 36,360	\$ 3,640
2010	37,419	2,581
2011	38,509	1,491
2012	22,617	327
Totals	\$ 134,905	\$ 8,039

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

NOTE I – LONG-TERM DEBT – Continued

Note Payable–Puerto Rico Treasury Department- On February 16, 2007 the Municipality settled a legal case for \$825,000 and refinanced this debt on a long-term basis through a \$728,622 non-interest bearing note (imputed interest rate is 5.00%), from the Puerto Rico Department of the Treasury. The note is payable in monthly installments of \$13,750 (including interest) through June 30, 2011. The note balance as of June 30, 2008 is net of an unamortized discount of \$36,222 and will be repaid with unrestricted funds through withholdings from the advances of property tax and amounts of municipal equalization fund sent to the Municipality by the Municipal Revenue Collection Center (CRIM). Debt service requirements in future years are as follows:

\$ 458,778

June 30,	Principal	Interest
2009	\$ 145,362	\$ 19,638
2010	152,799	12,201
2011	160,617	4,383
Totals	\$ 458,778	\$ 36,222

Note payable to Employee’s Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS).

– On June 29, 2007 the Board of Trustees of the Employee’s Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS) approved Resolution No. 2007-02 authorizing the ERS to establish payment plans with employers related to the application of certain “Special Laws” issued by the Commonwealth Government. Those Special Laws granted increases in pensions to retired employees of the Municipality. This obligation was recognized by the Municipality prior to June 30, 2007. On November 30, 2007 the Municipality refinanced this debt on a long-term basis through a \$201,060 non-interest bearing note with the ERS. The note has an imputed interest rate of 6.48% and was recorded at its present value of \$195,732 net of an unamortized discount of \$14,328. The note, payable in annual installments of \$63,018 (including interest), is due on February 26, 2010 and will be repaid with unrestricted funds. Debt service requirements in future years are as follows:

\$ 114,554

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

NOTE I – LONG-TERM DEBT – Continued

<u>June 30,</u>	<u>Principal</u>	<u>Interest</u>
2009	\$ 55,444	\$ 7,574
2010	59,110	3,908
Totals	<u>\$ 114,554</u>	<u>\$ 11,482</u>

Note payable Section 108 Loan Guarantee – The Municipality entered into a financing agreement with the US Department of Housing and Urban Development (HUD) through a contract for Loan Guarantee Assistance under Section 108 of the Housing and Community Act of 1974, as amended. The agreement, for a maximum commitment of \$4,850,000, will finance the construction of a Youth Sports and Education Center. On October 1, 2007 the Municipality received \$1,200,000 on advance funds under a \$1,345,000 variable/fixed rate note dated July 12, 2007, bearing interest at LIBOR + .20% and due on August 1, 2013. The VRF Note is designed to convert to a fixed rate note on its Conversion Date. The following Commitment Schedule to the Note represents the agreed-upon repayment schedule referred to in the Section 108 commitment against which the Municipality requests advances when funds are needed. The schedule of principal and interest to the fixed rate Note will be filed out as of the Conversion Date based on the cumulative amount of advances per principal due date that the Municipality has received on or before such date. The Note will be repaid from appropriation of funds from the Community Development Block Grant Program (Entitlement). Interest payments on fiscal year 2007-2008 amounts to \$30,924. Debt service requirements in future years are as follows:

\$ 1,200,000

<u>June 30,</u>	<u>Principal</u>
2009	\$ -
2010	269,000
2011	269,000
2012	269,000
2013	269,000
2014	124,000
Totals	<u>\$ 1,200,000</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

NOTE I – LONG-TERM DEBT – Continued

Landfill obligation – represents the outstanding balance of the estimated liability for landfill closure and post-closure care costs, based on a 96% usage of the landfill. The total estimate for these costs amounts to \$4,800,000 as of June 30, 2008.	\$ 4,649,489
Compensated absences – includes accrued vacations, sick leave benefits and other benefits with similar characteristics such as compensatory time; represents the Municipality’s commitment to fund such costs from future operations. The amount is repaid with unrestricted funds.	\$ 2,545,681
Christmas Bonus – represents the accrued portion corresponding to fiscal year 2007-2008 of the Christmas bonus to be paid in December 2008.	\$ 361,016
Claims and judgments - represents amounts accrued for estimated settlements on legal cases based on the opinion of the Municipality’s legal counsels. Amounts will be paid with unrestricted funds.	\$ 150,000
Payable to CRIM – represents the balance owed to CRIM at June 30, 2008 for excess of advances of property tax and other subsidies over final amount of property tax collections for the fiscal years ended 2007 and 2008. This amount will be repaid with unrestricted funds through withholdings from the advances of property tax and amounts of municipal equalization fund sent to the Municipality by the Municipal Revenue Collection Center (CRIM).	\$ 50,514
Payable to PREPA - As required by Act No. 83 of May 2, 1941 the Puerto Rico Electric Power Authority (“PREPA”) should annually pay to the Municipalities of Puerto Rico a contribution in lieu of tax (“CELI”) based on certain requirements as specified by the mentioned Act. The amount of CELI obligation is used by the Municipalities to finance the annual electric utility expense payment to PREPA. For Fiscal year 2006-2007 the Municipality’s annual energy charges amounts to \$1,480,096 but the CELI obligation determined by PREPA amounted to \$1,162,458. As communicated by PREPA the excess amount of \$317,638 was recorded as a payable to the Municipality and will be amortized over a 3-year period against the corresponding receivable for the same amount. As of June 30, 2008 the outstanding amount of \$211,759 is recognized by the Municipality as a receivable and a liability to PREPA. Debt service requirements in future years are as follows:	\$ 211,759

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

NOTE I – LONG-TERM DEBT – Continued

June 30	Principal
2009	\$ 105,879
2010	105,880
Totals	\$ 211,759

NOTE J – LANDFILL CLOSURE AND POST-CLOSURE CARE COSTS OBLIGATIONS

Commonwealth and Federal laws and regulations require the Municipality to place a final cover on its landfill when it stops accepting waste and perform certain maintenance and monitoring functions 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 an outstanding balance of \$4,649,489 as of June 30, 2008, which is based on a 96% usage of the landfill. It is estimated that an additional \$149,984 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 (\$4,800,000) 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, 2008. 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, 2008, the Municipality has not made contributions to finance closure and post-closure care costs.

NOTE K – 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 generally assessed on January 1 on all taxable property located within the Municipality and is based on the current value existing in the year 1957. For personal property the tax is due with the return filed on or before May 15. Taxes on real property may be paid on two equal installments, July 1st and January 1st. Total tax rates in force as of June 30, 2008 are 7.03% for personal property and 9.03% for real property. The distribution of these rates follows:

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

NOTE K – PROPERTY TAXES – Continued

<u>Description</u>	<u>Personal Property</u>	<u>Real Property</u>
Basic property tax rate, which is appropriated for general purposes and accounted in the Municipality's general fund	4.00%	6.00%
Percent that belongs to the Commonwealth's debt service fund	1.03%	1.03%
Percent that belongs to the Municipality's debt service fund	2.00%	2.00%
Total tax rate	<u>7.03%</u>	<u>9.03%</u>
Discount granted by law to the taxpayers but reimbursed to the Municipality by the P.R. Treasury Department	<u>(.20%)</u>	<u>(.20%)</u>
Total percent to be paid by taxpayers	<u><u>6.83%</u></u>	<u><u>8.83%</u></u>

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. For the fiscal year 2006-2007 the CRIM prepared the final settlement and determined that the Municipality has a net debt of \$50,514. The payable amount is recorded as a long-term debt in the government-wide statement since it will not be paid with expendable available resources. For the fiscal year 2007-2008 the CRIM prepared the preliminary settlement and determined that the Municipality has a net receivable of \$13,352, which is recorded in the governmental funds as deferred revenue since the amount is not available as required by current standards.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

NOTE L – 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, 2008 the tax rates were as follows:

Financial business – 1.50% of gross revenues

Other organizations – .50% of gross revenues, except organizations in "Special Development Urban Area" which apply:

Up to \$100,000 - .30% of gross revenues

Up 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. Municipal license taxes collected prior to June 30 but pertaining to the next fiscal year in the amount of \$2,019,203 are recorded as deferred revenues.

NOTE M – SALES AND USE TAXES

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

Section 6189 of the Puerto Rico Internal Revenue Code of 1994, as amended, authorizes the Municipalities in Puerto Rico to impose a sales and use tax to consumers. This tax must be imposed in conformity with the base, exemptions and limitations contained in Subtitle BB of the Code. The municipal sales and use tax is specifically imposed over all sales transactions of taxable items and combined transactions (as defined by the municipal internal regulation) taken place within municipal limits. The municipal sales and use tax is also specifically imposed over the purchase price for the use, storage or consumption of taxable transactions (as defined by the municipal internal regulation) taken place within Municipal limits. The Municipal Legislature approved the imposition of the municipal sales and use tax, effective on November 15, 2006.

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

NOTE M – SALES AND USE TAXES - Continued

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

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

The Municipal Legislature approved the Municipal Ordinance No. 15 Series 2007-2008 to conform to dispositions of Act 80.

Individuals, organizations and entities subject to collect the municipal sales and use tax must file a tax return to the Municipality. The tax is due each 20th day of each month based on the tax collected in the preceding month. The total \$183,182 sales and use tax receivable represents the tax collected on June by individuals, organizations and entities but reported and paid to the Municipality on or before July 20, net of uncollectible accounts; \$69,414 and \$36,892 represents amounts of “Municipal Development Fund” and “Municipal Redemption Fund”, respectively, collected on June by individuals, organizations and entities but paid by the PRDT subsequent to June 30. The amount of \$36,180 (related to Municipal Development Fund) is recorded as deferred revenue since is not available as required by current standards.

NOTE N – INTERGOVERNMENTAL REVENUES

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

	<u>Amount</u>
Amount of municipal subsidies and equalization fund sent by CRIM	\$ 4,873,567
Compensation in lieu of tax from the Puerto Rico Electric Power Authority (PREPA)	1,894,109
Reimbursement from Commonwealth Government of Law 52 and Law 82 program expenditures	502,797
Reimbursement from Commonwealth Government of Christmas Bonus expenditure	280,484
Reimbursement from Commonwealth Government – other programs expenditures	78,130
	<u>\$ 7,629,087</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

NOTE O – 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 and its Instrumentalities (ERS). ERS covers all regular full time public employees working for the central government, the municipalities and certain public corporations not having their own retirement systems. 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.

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 the 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.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

NOTE O – RETIREMENT PLAN - Continued

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 three fiscal years, which is equal to the required contribution, follows:

<u>Fiscal year ended:</u>	<u>Law No. 447</u>	<u>System 2000</u>
2008	\$ 241,665	\$ 148,108
2007	\$ 225,455	\$ 108,140
2006	\$ 236,085	\$ 90,305

NOTE P – POSTEMPLOYMENT BENEFITS

In addition to the pension benefits described in Note O, the Municipality is required to cover annually the 3% increase in the retirement plan of its retired employees, as required by Commonwealth's laws. Also, the Municipality is required to finance costs related to the application of certain "Special Laws" issued by the Commonwealth Government. Those Special Laws granted increases in pensions and other benefits to retired employees of the Municipality such as medicines bonus, Christmas bonus and death benefits. For the fiscal year ended, costs related to these post-employment benefits amounted to \$96,026.

NOTE Q – 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. Rental expenses amounted to approximately \$280,834. 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, 2008 of approximately \$2,584,455 for construction, improvements or renovation of certain capital assets.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

NOTE R – CONTINGENCIES

1. *Federal and Commonwealth grants*

Projects financed by Federal and Commonwealth's 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. *Litigations*

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 and certain cases whereby the legal counsel has not determined an outcome. Of those not to be covered by insurance, the legal counsel has determined that it would be probable that in one case there may be an unfavorable outcome with an estimated loss of \$150,000 which is accrued 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's financial position.

NOTE S – FUND BALANCE DEFICITS

The Community Development Block Grant Program fund and certain special funds included as other governmental funds in the fund statements disclosed fund balance deficits as follows:

	<u>Amount</u>
Major Fund:	
CDBG	<u>\$ 280,780</u>
Other Governmental Funds:	
Permanent Improvements	<u>\$ 228,659</u>
Child Care	<u>\$ 141,907</u>
Home Investment Program	<u>\$ 118,788</u>
DTOP	<u>\$ 36,838</u>
Office of Public Safety Affairs	<u>\$ 40,735</u>
Rural Development Corporation	<u>\$ 42,914</u>

The deficits result from the accrual of expenditures without accruing intergovernmental revenues for the reimbursement of expenditures. As required by current standards, the Municipality records intergovernmental revenues for reimbursement-based (expenditure-driven) grants on fund statements when all applicable eligibility requirements have been met and the resources are available.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA

NOTES TO FINANCIAL STATEMENTS

June 30, 2008

NOTE T – SUBSEQUENT EVENTS

1. *Debt issuance*

On September 19, 2008 the Municipality issued a \$1,325,000 General Obligation Note through the Governmental Development Bank of P.R. (GDB) for acquisition of equipment and vehicles. The Note will bear interest ranging from 5.4% to 7.5% and will be due on July 1, 2015.

2. *Property Lien*

The Municipality entered into a financing agreement with the US Department of Housing and Urban Development (HUD) through a contract for Loan Guarantee Assistance under Section 108 of the Housing and Community Act of 1974, as amended. The agreement, for a maximum commitment of \$4,850,000 will finance the construction of a Youth Sports and Education Center. The repayment of funds is guaranteed through appropriation of funds from the Community Development Block Grant Program (Entitlement). As part of the contract agreement between HUD and the Municipality, additional guarantees are required. The Municipality should agree to declare and furnish to HUD, a property lien, satisfactory to HUD in form and substance of HUD's ownership interest in the property to be constructed (including land), specifying an estimate of fair market value of not less than \$6,062,500.

In December 2008 the Municipality submitted for HUD's approval a deed of a voluntary first mortgage in the amount of \$6,062,500 in favor of HUD of all of its estate, right, title and interest in and to the Mortgaged Property, which includes the parcel of land on which the project is located and the property to be constructed. During a 20-year Section 108 note repayment term, it will not be permitted or suffered the use of any of the property for any purpose other than the use for which the same as intended at the time the Mortgage be executed. Upon default under the Contract for Loan Guarantee Assistance under Section 108, HUD, at its options, may declare the whole indebtedness secured to be due and payable, in which event HUD shall have the right immediately to foreclose the Mortgage. The Municipality is currently pending for mortgage deed approval from HUD.

Required Supplementary Information

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA

BUDGETARY COMPARISON SCHEDULE - GENERAL FUND
FISCAL YEAR ENDED JUNE 30, 2008

	Budgeted amounts		Actual Amounts (Budgetary Basis) (See Note A)	Variance with Final Budget Positive (Negative)
	Original	Final		
Revenues:				
Taxes:				
Property taxes	\$ 4,826,977	\$ 4,826,977	\$ 4,416,541	\$ (410,436)
Municipal license taxes	1,976,317	2,366,317	2,374,984	8,667
Sales and use taxes	1,875,735	2,434,735	2,566,040	131,305
Intergovernmental	4,972,647	4,670,349	5,342,618	672,269
Fees, fines and charges for services	747,000	1,645,000	1,672,807	27,807
Interest	100,000	185,295	595,900	410,605
Other	25,000	196,000	225,671	29,671
Total revenues	14,523,676	16,324,673	17,194,561	869,888
Expenditures:				
Current:				
General government	8,253,553	7,843,010	7,722,533	120,477
Public works and sanitation	2,415,424	2,553,965	2,464,944	89,021
Public safety	983,475	988,075	882,288	105,787
Culture and recreation	452,982	553,768	522,915	30,853
Health	603,254	617,154	611,882	5,272
Housing, welfare and community development	1,183,290	1,247,706	1,141,286	106,420
Total expenditures	13,891,978	13,803,678	13,345,848	457,830
Excess of revenues over expenditures	631,698	2,520,995	3,848,713	1,327,718
Other financing sources (uses):				
Transfers out	(631,698)	(2,520,995)	(2,225,089)	295,906
Total other financing sources (uses)	(631,698)	(2,520,995)	(2,225,089)	295,906
Excess of revenues and other financing sources over expenditures and other financing uses	\$ -	\$ -	\$ 1,623,624	\$ 1,623,624

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

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

June 30, 2008

NOTE A – BUDGET PROCESS AND BUDGETARY BASIS OF ACCOUNTING

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

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

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

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

NOTE B - BUDGET TO GAAP RECONCILIATION

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

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

June 30, 2008

NOTE B - BUDGET TO GAAP RECONCILIATION - Continued

Excess of revenues and other financing sources over expenditures and other financing uses (budgetary basis):	\$	1,623,624
Budget to GAAP differences:		
Entity differences:		
Non budgeted funds recorded as revenues for financial reporting purposes:		2,694,171
Non budgeted funds recorded as expenditures for financial reporting:		(4,567,437)
Non budgeted transfers in:		2,298,369
Non budgeted transfers out:		(117,907)
Basis of accounting differences:		
Revenues recorded for financial reporting purposes but not in budgetary basis:		965,889
Expenditures recorded for financial reporting purposes but not in budgetary basis:		(332,526)
Revenues recorded in budgetary basis but not for financial reporting purposes:		(494,731)
Timing differences:		
Current year encumbrances recorded as expenditures for budgetary reporting purposes:		297,695
Prior year encumbrances recorded as expenditures for financial reporting purposes:		(34,109)
Net change in fund balance (GAAP basis):	\$	<u>2,333,038</u>

Supplementary Information

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA

SUPPLEMENTARY INFORMATION - FINANCIAL DATA SCHEDULE
BALANCE SHEET AND STATEMENT OF REVENUES AND EXPENSES INFORMATION
AS OF AND FOR THE FISCAL YEAR ENDED JUNE 30, 2008

Line Item No.	Description	Housing Choice Vouchers	
		14.871	
		<u>(Unaudited)</u>	
	Balance Sheet		
111	Cash - unrestricted	\$	186,832
113	Cash - other restricted		95,396
100	Total cash		<u>282,228</u>
121	Accounts receivable - PHA projects		843
122	Accounts receivable - HUD other projects		2,842
125	Accounts receivable - miscellaneous		483
120	Total receivables, net of allowance for doubtful accounts		<u>4,168</u>
150	Total Current Assets		<u>286,396</u>
164	Furniture, equipment and machinery - administration		23,742
166	Accumulated depreciation		(7,499)
160	Total capital assets, net of accumulated depreciation		<u>16,243</u>
180	Total Non-current Assets		<u>16,243</u>
190	Total Assets	\$	<u>302,639</u>
312	Accounts payable <= 90 days	\$	2,094
322	Accrued compensated absences - current portion		1,416
345	Other current liabilities		15,497
347	Inter-program - due to		99,104
310	Total Current Liabilities		<u>118,111</u>
300	Total Liabilities		<u>118,111</u>
508.1	Invested in Capital Assets, Net of Related Debt		16,243
511.1	Restricted Net Assets		93,392
512.1	Unrestricted Net Assets		74,893
513	Total Equity/Net Assets		<u>184,528</u>
600	Total Liabilities and Equity/Net Assets	\$	<u>302,639</u>
	Income Statement		
70600-010	Housing assistance payments	\$	280,564
70600-020	Ongoing administrative fees earned		48,982
70600-070	Admin fee calculation description		
70600	HUD PHA operating grants		<u>329,546</u>
71500	Other revenue		10,290
700	Total Revenue		<u>339,836</u>
91100	Administrative salaries		27,744
91200	Auditing fees		5,500
91500	Employee benefit contributions- administrative		5,797
91600	Office expenses		5,845
91000	Total Operating - Administrative		<u>44,886</u>
96200	Other general expenses		504
96000	Total Other General Expenses		<u>504</u>
96900	Total Operating Expenses		<u>45,390</u>
97000	Excess Revenue Over Operating Expenses		<u>294,446</u>
97300	Housing assistance payments		271,467
97350	HAP Portability-in		8,797
97400	Depreciation expense		1,381
900	Total Expenses		<u>327,035</u>
10000	Excess (Deficiency) of Revenue Over (Under) Expenses	\$	<u>12,801</u>

The accompanying note is an integral part of this schedule

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA

SUPPLEMENTARY INFORMATION - FINANCIAL DATA SCHEDULE
BALANCE SHEET AND STATEMENT OF REVENUES AND EXPENSES INFORMATION
AS OF AND FOR THE FISCAL YEAR ENDED JUNE 30, 2008

Line Item No.	Description	Housing Choice Vouchers
		14,871
		<u>(Unaudited)</u>
11030	Beginning equity	\$ 171,727
11770-001	Administrative Fee Equity - Beginning Balance	87,432
11170-010	Administrative Fee Revenue	48,982
11170-050	Other Revenue	10,290
		This amount corresponds to the administrative fees earned on the portability-in vouchers administered by the Municipality (\$1,493) plus the reimbursement received from the initial PHAs of the HAP rent payments made on behalf of the portability-in units during 07-
11170-051	Comment For Other Revenue	08 (\$8,797)
11170-060	Total Admin Fee Revenues	59,272
11170-080	Total Operating Expenses	45,390
11170-090	Depreciation	1,381
11170-095	Housing Assistance Portability In	8,797
11170-110	Total Expenses	55,568
11170-002	Net Administrative Fee	3,704
11170-003	Administrative Fee Equity - Ending Balance	91,136
11170	Administrative Fee Equity	\$ 91,136
11180-001	Housing Assistance Payments Equity - Beginning Balance	84,295
11180-010	Housing Assistance Payments Revenues	280,564
11180-030	Total HAP Revenues	280,564
11180-080	Housing Assistance Payments	271,467
11180-100	Total Housing Assistance Payments Expenses	271,467
11180-002	Net Housing Assistance Payments	9,097
11180-003	Housing Assistance Payments Equity - Ending Balance	93,392
11180	Housing Assistance Payments Equity	\$ 93,392
11190-210	Total ACC HCV Units	1,032
11190	Unit Months Available	1,032
11210	Unit Months Leased	959

The accompanying note is an integral part of this schedule.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

NOTE TO SUPPLEMENTARY INFORMATION - FINANCIAL DATA SCHEDULE

June 30, 2008

NOTE A – BASIS OF PRESENTATION

The accompanying financial data schedule (FDS) is a trial balance of the Section 8 Housing Choice Voucher Program administered by the Municipality. The FDS was created in order to standardize the financial information reported by Public Housing Authorities (PHA) to the Real Estate Assessment Center (REAC), as required by the Uniform Financial Reporting Standards (UFRS). REAC is the US Department of Housing and Urban Development (HUD) national management center created to assess the condition of HUD owned and assisted properties. The UFRS are rules to implement requirements of 24 CFR, Part 5, Subpart H, for the electronic filing of financial information to HUD.

In accordance with the guidelines for reporting and attestation requirements of UFRS, the accompanying FDS is included as information supplementary to the financial statements. It was prepared using the accrual basis of accounting, as required by REAC regulations.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA

COMBINED BALANCE SHEET-
SPECIAL FUNDS IN GENERAL FUND
JUNE 30, 2008

Assets	Special Funds			Eliminations	Subtotal	Total General Fund
	General Fund (01)	Unreserved-GF	Designated-GF			
Cash and investments	\$ 9,434,033	\$ 2,828,607	\$ 3,762,912	\$ -	\$ 16,025,552	\$ 16,025,552
Receivables, net:						
Sales and use taxes	252,596	-	-	-	252,596	252,596
Other	164,407	169,133	-	-	333,540	333,540
Due from:						
Commonwealth Government	790,950	155,466	-	-	946,416	946,416
Other funds	2,279,327	-	400,000	-	2,679,327	1,278,834
Inventories and Supplies	-	142,287	-	-	142,287	142,287
Restricted assets:						
Cash	-	-	-	-	105,424	105,424
Other assets	7,768	-	-	-	7,768	7,768
Total assets	\$ 12,929,081	\$ 3,295,493	\$ 4,162,912	\$ -	\$ 20,492,910	\$ 19,092,417

Liabilities and Fund Balances

Liabilities:						
Accounts payable and accrued liabilities	\$ 272,045	\$ 238,400	\$ 110,050	\$ 878	\$ 621,373	\$ 621,373
Due to:						
Commonwealth Government	271,411	-	-	-	271,411	271,411
Other funds	-	1,052,565	347,928	9,068	1,409,561	1,409,561
Advances from other funds	1,307,498	-	-	-	1,307,498	1,307,497
Deferred revenues:						
Municipal license taxes	2,019,202	-	-	-	2,019,202	2,019,203
Sales and use tax	36,180	-	-	-	36,180	36,180
Commonwealth Government	569,470	135,466	-	-	704,936	704,936
Other	101,870	73,343	-	-	175,213	175,213
Total liabilities	4,577,676	1,499,774	457,978	9,946	6,545,374	5,144,881
Fund balance:						
Reserved for:						
Inventories	-	142,287	-	-	142,287	142,287
Encumbrances	572,525	-	-	-	572,525	572,525
Other specific purposes	-	-	-	95,478	95,478	95,478
Unreserved:						
Designated for future years expenditures	7,778,880	-	3,704,934	-	3,704,934	3,704,934
Undesignated	-	1,653,432	-	-	9,432,312	9,432,312
Total fund balances	8,351,405	1,795,719	3,704,934	95,478	13,947,536	13,947,536
Total liabilities and fund balances	\$ 12,929,081	\$ 3,295,493	\$ 4,162,912	\$ 105,424	\$ 20,492,910	\$ 19,092,417

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA

**COMBINED STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES-
SPECIAL FUNDS IN GENERAL FUND
FISCAL YEAR ENDED JUNE 30, 2008**

	General Fund (01)	Special Funds Unreserved-GF	Special Funds Designated-GF	Special Funds Reserved	Subtotal	Eliminations	Total General Fund
Revenues:							
Taxes:							
Property taxes	\$ 3,038,358	\$ -	\$ -	\$ -	\$ 3,038,358	\$ -	\$ 3,038,358
Municipal license taxes	2,374,984	-	-	-	2,374,984	-	2,374,984
Sales and use taxes	2,509,627	-	-	-	2,509,627	-	2,509,627
Intergovernmental:							
Commonwealth government	7,048,160	517,421	-	63,506	7,629,087	-	7,629,087
Fees, fines and charges for services	1,583,365	2,062,928	-	-	3,646,293	-	3,646,293
Interest	302,952	50,316	-	-	353,268	-	353,268
Other	337,920	-	-	-	337,920	-	337,920
Total revenues	17,195,366	2,630,665	-	63,506	19,889,537	-	19,889,537
Expenditures:							
Current:							
General government	7,691,156	531,330	436,613	-	8,659,099	-	8,659,099
Public works and sanitation	2,448,165	(23,516)	432,499	-	2,857,148	-	2,857,148
Public safety	879,455	-	-	-	879,455	-	879,455
Culture and recreation	521,109	1,648	-	-	522,757	-	522,757
Health	611,882	2,427,477	-	-	3,039,359	-	3,039,359
Housing, welfare and community development	1,141,286	-	18,228	47,120	1,206,634	-	1,206,634
Capital outlays	4,183	283,598	406,948	5,492	700,221	-	700,221
Total expenditures	13,297,236	3,220,537	1,294,288	52,612	17,864,673	-	17,864,673
Excess (deficiency) of revenues over expenditures	3,898,130	(589,872)	(1,294,288)	10,894	2,024,864	-	2,024,864
Other financing sources (uses):							
Proceeds from settlement-P.R. Department of Treasury	226,487	-	-	-	226,487	-	226,487
Payment of P.R.E.P.A. debt	(105,879)	-	-	-	(105,879)	-	(105,879)
Transfers in	243,866	629,781	1,668,588	-	2,542,235	2,348,685	193,550
Transfers out	(2,236,762)	(50,316)	(67,591)	-	(2,354,669)	(2,348,685)	(5,984)
Total other financing sources (uses)	(1,872,288)	579,465	1,600,997	-	308,174	2,348,685	308,174
Net change in fund balances	2,025,842	(10,407)	306,709	10,894	2,333,038	(2,348,685)	2,333,038
Fund balances at beginning of year	6,325,563	1,806,126	3,398,225	84,584	11,614,498	-	11,614,498
Fund balances at end of year	\$ 8,351,405	\$ 1,795,719	\$ 3,704,934	\$ 95,478	\$ 13,947,536	\$ (2,348,685)	\$ 13,947,536

SINGLE AUDIT SECTION

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FISCAL YEAR ENDED JUNE 30, 2008**

Federal Grantor/Pass-Through Grantor/Program Title	Federal CFDA Number (note B)	Pass-Through Entity Identifying Number (note C)	Federal Expenditures (note A)
<u>U.S. Department of Agriculture</u>			
Passed through the P.R. Department of Education: Child and Adult Care Food Program	10.558	CCC-205	\$ 83,721
<u>U.S. Department of Housing and Urban Development</u>			
Community Development Block Grant - Entitlement Grants	14.218	N/A	1,390,290
Passed through the Office of Commissioner of Municipal Affairs: Community Development Block Grant - State's Program	14.228	FD-32, AB-32 FC-32, AF-32	668,050
Passed through the P.R. Department of Housing: Home Investment Partnership Program	14.239	N/AV	361,090
Section 8 Housing Choice Vouchers	14.871	N/A	321,911
Subtotal U.S. Department of Housing and Urban Development			<u>2,741,341</u>
<u>U.S. Department of Justice</u>			
Passed through the PR Department of Justice: Edward Byrne Justice Assistance Program	16.738	2005-DJ-BX-0072	40,745
<u>U.S. Department of Transportation - National Highway Traffic Safety Administration</u>			
Passed through the P.R. Department of Transportation - (Traffic Safety Commission) State and Community Highway Safety	20.600	N/AV	88,252
<u>U.S. Department of Health and Human Services</u>			
Passed through the P.R. Department of Family - Families and Children Administration: Child Care and Development Block Grant	93.575	N/AV	301,008
Head Start Program	93.600	N/A	758,780
Subtotal U.S. Department of Health and Human Services			<u>1,059,788</u>
Total Expenditures of Federal Awards			<u>\$ 4,013,847</u>

The accompanying notes are an integral part of this schedule.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

June 30, 2008

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 subrecipient. 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

<u>Description</u>	<u>Community Development Block Grant Fund</u>	<u>Head Start Program Fund</u>	<u>Other Governmental Funds</u>
10.558	\$ -	\$ -	\$ 83,721
14.218	1,390,290	-	-
14.228	668,050	-	-
14.239	-	-	361,090
14.871	-	-	321,911
16.738	-	-	40,745
20.600	-	-	88,252
93.575	-	-	301,008
93.600	-	758,780	-
Total federal awards expenditures	<u>2,058,340</u>	<u>758,780</u>	<u>1,196,727</u>
Total nonfederal awards expenditures	<u>-</u>	<u>-</u>	<u>2,913,706</u>
Total expenditures, fund statements	<u>\$ 2,058,340</u>	<u>\$ 758,780</u>	<u>\$ 4,110,433</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

June 30, 2008

NOTE E – OTHER: LOAN GUARANTEE PROGRAM

The Municipality received on October 1, 2007 \$1,200,000 on advance funds under a \$1,345,000 variable/fixed rate note dated July 12, 2007 to finance the construction of a Youth Sports and Education Center. Proceeds from loan have not been expended as of June 30, 2008:

<u>CFDA No.</u>	<u>Program Name</u>	<u>Amount Received</u>
14.248	Community Development Block Grants_ Section 108 Loan Guarantees	<u>\$ 1,200,000</u>

VALDES, GARCIA, MARIN & MARTINEZ, LLP

CERTIFIED PUBLIC ACCOUNTANTS AND CONSULTANTS
MEMBER OF THE AICPA PRIVATE COMPANIES PRACTICE SECTION

P.O. BOX 364831
SAN JUAN, P.R. 00936-4831

TELEPHONE: (787) 725-1600
TELEFAX: (787) 721-2795

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

To the Honorable Mayor and
Members of the Municipal Legislature
Municipality of 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 (the Municipality) as of and for the year ended June 30, 2008, which collectively comprise the Municipality's basic financial statements, and have issued our report thereon dated December 23, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

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

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and other matters

As part of obtaining reasonable assurance about whether the Municipality's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed 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 Municipality's management, the Honorable Mayor and Members of the Municipal Legislature, the Commonwealth of Puerto Rico and Federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Valdez, Garcia, Marin & Marting, LLP

San Juan, Puerto Rico
December 23, 2008

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affixed to the original.

VALDES, GARCIA, MARIN & MARTINEZ, LLP

CERTIFIED PUBLIC ACCOUNTANTS AND CONSULTANTS
MEMBER OF THE AICPA PRIVATE COMPANIES PRACTICE SECTION

P.O. Box 364831
SAN JUAN, P.R. 00936-4831

TELEPHONE: (787) 725-1600
TELEFAX: (787) 721-2795

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

Compliance

We have audited the compliance of Municipality of Isabela (the Municipality) with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement that are applicable to each of its major federal programs for the year ended June 30, 2008. The Municipality's major federal programs are identified in the summary of audit results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the Municipality's management. Our responsibility is to express an opinion on the Municipality's compliance based on our audit.

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

In our opinion, the 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, 2008. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as item 2008-1.

Internal Control Over Compliance

The management of the Municipality is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the Municipality's internal control over compliance with the 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, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Municipality's internal control over compliance.

A control deficiency in an entity's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that non-compliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material non-compliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

The Municipality's response to the finding identified in our audit is described in the accompanying schedule of findings and questioned costs. We did not audit the Municipality's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the Municipality's management, the Honorable Mayor and Members of the Municipal Legislature, the Commonwealth of Puerto Rico and Federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Valdes, Garcia, Marin & Martinez, LLP

San Juan, Puerto Rico
December 23, 2008

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**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

Section I - Summary of Auditors' Results

FISCAL YEAR ENDED JUNE 30, 2008

I. Summary of auditors' results:

Part I - Financial Statements

1. Type of auditors' report issued: Unqualified opinion Qualified opinion
 Adverse opinion Disclaimer of opinion

Internal control over financial reporting:

2. Significant deficiencies identified? Yes No
3. Significant deficiencies reported as material weaknesses? Yes None reported
4. Financial statements material noncompliance noted? Yes No

Part II - Federal Awards

Internal control over major programs:

1. Significant deficiencies identified? Yes No
2. Significant deficiencies reported as material weaknesses? Yes None reported
3. Type of auditors' report issued on compliance of major programs: Unqualified opinion Qualified opinion
 Adverse opinion Disclaimer of opinion
4. Any audit findings required to be reported under Section 510(a) of OMB Circular A-133? Yes No

5. Identification of major programs (Section 520 (h) (i) of OMB Circular A-133):

CFDA Number(s)	Name of Federal Program or Cluster
14.218	Community Development Block Grants - Entitlement Grants
14.228	Community Development Block Grants - State's Program
14.871	Section 8 Housing Choice Vouchers

6. Dollar threshold used to distinguish between Type A and Type B programs: \$300,000
7. Auditee qualified as Low-risk auditee? Yes No



ESTADO LIBRE ASOCIADO DE PUERTO RICO
Gobierno Municipal de Isabela



P.O. Box 507
 Isabela, Puerto Rico 00662
 Tel. (787) 872-2100

Carlos C. Delgado Altieri
 ALCALDE

3 de marzo de 2009

Oficina del Comisionado de
 Asuntos Municipales
 Att: Sr. Omar Negrón Judice
 Comisionado
 PO Box 70167
 San Juan, PR 00936-8167

292-627-767

UNIDAD DE CORREO

09 MAR 11 10:52 AM

Estimado señor Negrón:

Adjunto se incluye el Single Audit del Municipio de Isabela para el año fiscal 2007-2008.

Favor de enviar confirmación en el sobre pre dirigido que se acompaña.

De tener alguna pregunta puede comunicarse conmigo.

Cordialmente,

Marisol Rosa Acevedo

Marisol Rosa Acevedo, CPA
 Administradora Municipal

09 MAR 11 10:52 AM

UNIDAD DE CORREO

Isabela. Ciudad Turística

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

Section II - Financial statements Findings

Fiscal year ended June 30, 2008

Finding	No matters reported.
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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

Section III Major Federal Findings and Questioned Costs

Fiscal year ended June 30, 2008

Reference Number – 2008-1

Agency: Department of Housing and Urban Development

Program: Section 8 Housing Choice Vouchers

CFDA Number: 14.871

Compliance Requirement: Special Test and Provisions: Utility Allowance Schedule

Condition

In testing compliance procedures for utilities allowance, we found that the utility allowance schedule has not been reviewed since 2003 to accommodate the increase in the cost of power and gas during fiscal year 2007-2008. This condition was reported in the Single Audit Report for fiscal year 2006-2007.

Criteria

24 CFR Subpart K Section 982.517 (4) (c) establishes the following:

c) *Revisions of utility allowance schedule* (1) a public housing agency (PHA) must review its utility allowance schedule of each year, and must revise its allowance for a utility category if there has been a change of 10 percent or more in the utility rate since the last time the utility allowance schedule was revised. The PHA must maintain information supporting its annual review of utility allowances and any revisions made in its utility allowance schedule.

Effect

The PHA Municipality's office could be paying an incorrect allowance to the program participants. As this condition was reported in prior year Single Audit Report, the Municipality should correct this condition during fiscal year 2008-2009.

Cause

The PHA Municipality's Program has not reviewed the utility data schedule since various years.

Recommendation

The PHA Office should review the utility allowance schedule of every year and must adjust its utility allowance schedule if there has been a rate change of 10% or more as established by management in Schedule of Status of Prior Year Audit Findings and Questioned Costs.

View of responsible officials and planned corrective action

See corrective action plan submitted by Program's management on the Schedule of Status of Prior Year audit Findings and Questioned Costs.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA

SCHEDULE OF STATUS OF PRIOR YEAR AUDIT FINDINGS AND QUESTIONED COSTS
FISCAL YEAR ENDED JUNE 30, 2008

Finding Number	Program	Noncompliance	Corrective Action Plan	Questioned Costs	Status
07-1	Section 8 Housing Choice Voucher Program (CFDA No. 14.871)	Special Test and Provisions – Utility Allowance Schedule	<p>Program's management has been instructed to follow the program requirements regarding this and any other compliance. The Finance and Section 8 Program Directors are under direct supervision to the municipality program's officers in charge of the study for the final completion and submission of the Utility Data Schedule to US HUD. In addition, annual updates have been programmed in the months of November of each year if there is a change above of 10% cost benchmark. This monitoring process will be performed by municipality program's officers.</p>	None	<p>Program's Management submitted a new Utility Allowance Schedule, effective on October 1, 2008 and this action was accepted by HUD in letter dated October 28, 2008.</p>