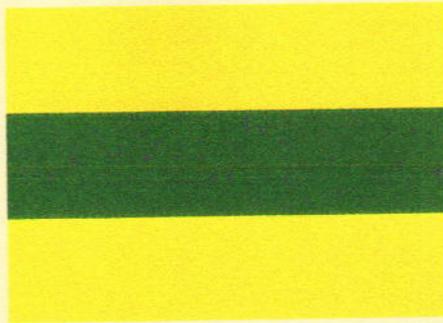


OFICINA DEL COMISIONADO DE ASUNTOS MUNICIPALES
ÁREA DE ASESORAMIENTO, REGLAMENTACIÓN E INTERVENCIÓN FISCAL
ÁREA DE ARCHIVO DIGITAL

MUNICIPIO DE ISABELA
AUDITORÍA 2010-2011
30 DE JUNIO DE 2011



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

***BASIC FINANCIAL STATEMENTS, REQUIRED SUPPLEMENTARY
INFORMATION AND INDEPENDENT
AUDITORS' REPORT
(WITH ADDITIONAL REPORTS REQUIRED
UNDER THE OMB CIRCULAR A-133)***

***AS OF AND FOR THE FISCAL YEAR ENDED
JUNE 30, 2011***



**Hon. Carlos Delgado-Altieri
Mayor**

**Mrs. Rosario M. Villanueva-Bravo
Finance and Budget Director**

INDEPENDENT AUDITORS' REPORT

The Honorable Mayor, Members of the
Municipal Legislature of
the 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 of the Commonwealth of Puerto Rico (the "Municipality"), as of and for the year ended June 30, 2011, which collectively comprise the Municipality's basic financial statements as listed in the table of contents. We have also audited the accompanying statement of revenues and expenditures - budget and actual - budgetary basis - general fund of the municipality for the fiscal year then ended, which is presented as part of the basic financial statements. These financial statements are the responsibility of 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 Governmental Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information of the Autonomous Municipality of Isabela of the Commonwealth of Puerto Rico, as of June 30, 2011, and the respective changes in financial position, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statements referred to above present fairly, in all material respects, the budgetary results of the general fund for the fiscal year then ended in conformity with the budgetary (statutory) basis of accounting, as described in Note 1 to the accompanying basic financial statements

In accordance with Government Auditing Standards, we have also issued our report dated March 1, 2012, on our consideration of the Municipality's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.

INDEPENDENT AUDITORS' REPORT (CONTINUED)

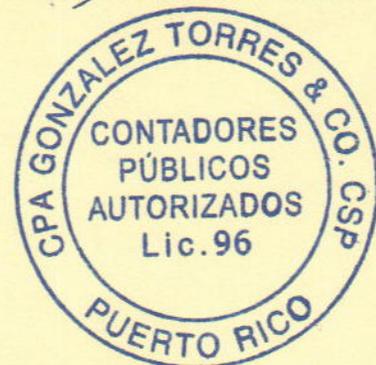
Accounting principles generally accepted in the United States of America require that the management's discussion on pages 13 through 29 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Municipality's financial statements as a whole. The introductory section, combining and individual nonmajor fund financial statements and statistical section, are presented for purposes of additional analysis and are not a required part of the financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations, and is also not a required part of the financial statements. The combining and individual nonmajor fund financial statements and the schedule of expenditures of federal awards are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole. The introductory and statistical sections have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we do not express an opinion or provide any assurance on them.

González Torres
GONZÁLEZ TORRES & CO. CPA, PSC

San Juan, Puerto Rico
February 29, 2012

Stamp No. 2632029 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the original of this report.



MANAGEMENT'S DISCUSSION AND ANALYSIS

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

MANAGEMENT'S DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2011

The discussion and analysis of the Municipality of Isabela's financial performance provides an overall view of the Municipality's financial activities for the year ended June 30, 2011. The intent of this Management's Discussion and Analysis is to look at the Municipality's financial performance as a whole. This section should be read in conjunction with the basic financial statements to obtain a better understanding of the financial position and the results of operations of the Municipality. Our analysis follows this section.

FINANCIAL HIGHLIGHTS

Highlights for Government-wide Financial Statements

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

- The assets of the Municipality, on a government-wide basis, exceeded its liabilities at the close of fiscal year 2011 by \$67,106,060 (net assets).
- Unrestricted net assets amount to \$13,148,839 in comparison to \$5,767,279 on fiscal year 2010.
- Revenues decreased by 4.2% and expenses increased 6.1% in comparison with fiscal year 2010.
- Net change in net assets amounted to \$2,752,667, a decrease of 51% with respect to prior year's net change, as restated.

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:

- During the year 2011 the Municipality implemented GASB Statement No. 54 *Fund Balance Reporting and Governmental Fund Type Definitions* ("GASB No. 54"). Certain information from the year 2010 has been restated.
- A net change (decrease) of \$1,077,006 in the fund balances of the Municipality's governmental funds resulted in total ending fund balances of \$34,332,928 in the fiscal year 2011. Approximately 66% of the total fund balances is unrestricted (committed, assigned or unassigned).
- For the fiscal year 2011 the General Fund reported an excess of revenues and other financing sources over expenditures and other financing uses of \$7,199,005. The unassigned fund balance amounts to \$11,611,036, or 58.9% of total General Fund Expenditures.

General Financial Highlights

- The investment in capital assets as of June 30, 2011 was \$52,202,880 (net of depreciation).
- Long-term debt increased to \$22,562,297.
- On a budgetary basis, actual revenues exceeded actual expenditures by \$967,964.

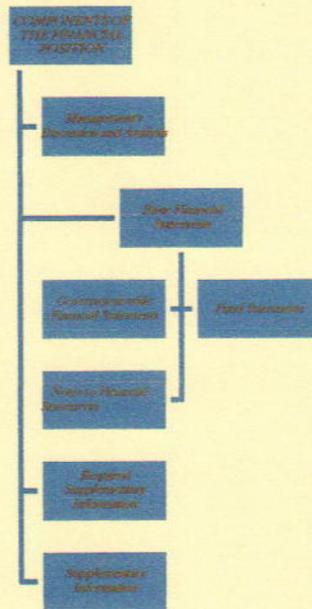
COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA

MANAGEMENT'S DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2011

OVERVIEW OF THE FINANCIAL STATEMENTS

The Municipality's financial report comprises four components: (1) management's discussion and analysis (presented here), (2) basic financial statements (3) required supplementary information and (4) 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 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 cash is received or paid.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

MANAGEMENT'S DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2011

The government-wide statements reports as governmental activities the Municipality's basic services such as public works and sanitation, public safety, culture and recreation, health, 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 as 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 as 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 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'S DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2011

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, 2011 and 2010:

TABLE 1

<i>Summary Statement of Net Assets As of June 30,</i>		
	Governmental Activities	
	2011	2010 (as restated)
Assets		
Current and other assets	\$ 42,589,571	\$ 42,545,067
Capital assets	52,202,880	48,026,690
Total assets	\$ 94,792,451	\$ 90,571,757
Liabilities		
Current and other liabilities	\$ 5,124,094	\$ 4,349,961
Long term liabilities	22,562,297	21,868,403
Total liabilities	27,686,391	26,218,364
Net assets		
Invested in capital assets, net of related debt	41,503,133	39,465,266
Restricted	12,454,088	19,120,848
Unrestricted	13,148,839	5,767,279
Total net assets	\$ 67,106,060	\$ 64,353,393

Net assets (assets over liabilities) may serve over time as a useful indicator of a government's financial position. Net assets for the year increased 4.3% 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, 2011 the Municipality presented a \$13,148,839 surplus due to positive net change in net assets results for the year then ended.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

MANAGEMENT'S DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2011

Changes in net assets

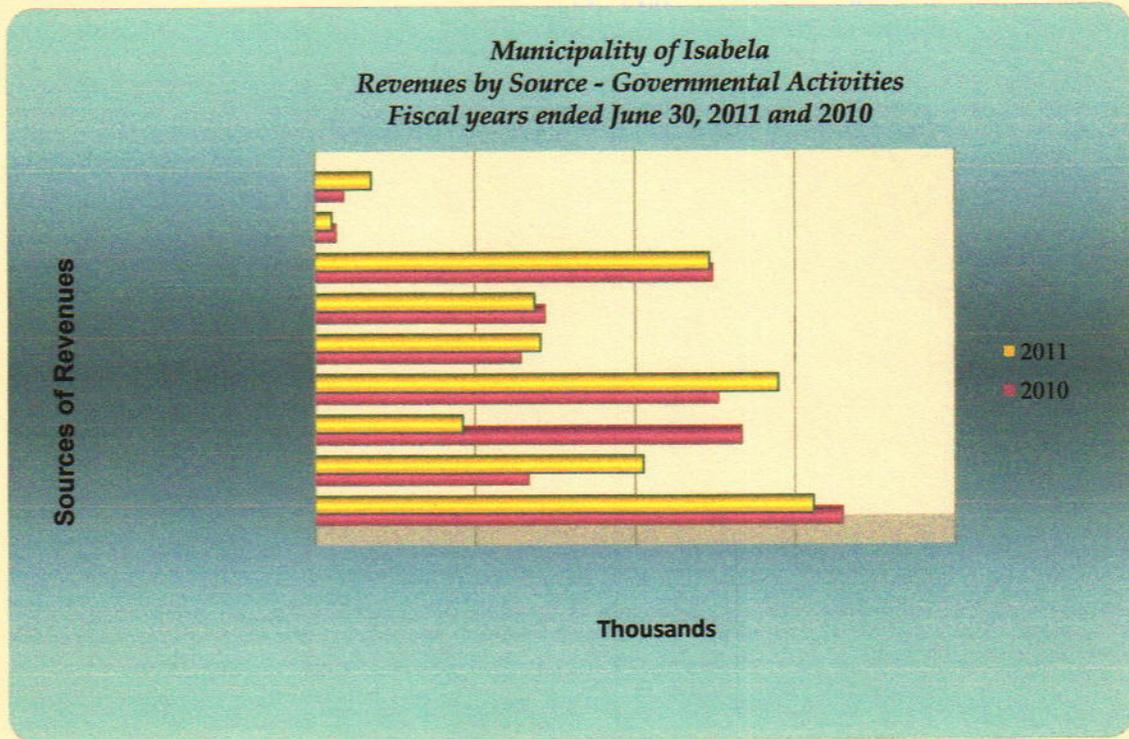
The following table summarizes the changes in net assets for the years ended June 30, 2011 and 2010:

TABLE 2

<i>Summary of Change in Net Assets As of June 30,</i>		
	Governmental Activities	
	2011	2010 (as restated)
Program revenues:		
Fees, fines and charges for services	\$ 6,231,642	\$ 6,590,673
Operating grants and contributions	4,101,296	2,666,982
Capital grants and contributions	1,843,156	5,328,876
General revenues:		
Property taxes	5,788,812	5,038,888
Municipal license taxes	2,816,522	2,570,979
Sales and use taxes	2,741,583	2,868,357
Grants and contributions not restricted to specific programs	4,932,368	4,967,871
Interest	210,666	261,006
Other	704,159	357,449
Total revenues	29,370,204	30,651,081
Expenses:		
General government	10,024,719	9,908,944
Public works and sanitation	5,166,691	5,113,603
Public safety	1,179,150	1,145,766
Culture and recreation	1,355,516	1,275,873
Health	3,107,488	3,131,460
Housing, welfare and community development	3,049,318	2,942,614
Education	2,484,718	1,393,628
Interest on long term debt	249,937	174,932
Total expenses	26,617,537	25,086,820
Change in net assets	2,752,667	5,564,261
Net assets-beginning of year	64,353,393	58,789,132
Net assets-end of year	\$ 67,106,060	\$ 64,353,393

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA
MANAGEMENT'S DISCUSSION AND ANALYSIS
Fiscal year ended June 30, 2011**

FIGURE 1



Approximately 21% of the Municipality's revenues came from fees and charges for services, 20% property taxes, 17% from unrestricted grants and 14% from operating grants and contributions. The Municipality's expenses cover a range of services. The largest expenses are general government representing approximately 38%, public works and sanitation with 19%, health with 12%, and housing, welfare and community development with 11%. Program revenues of the Municipality covered 46% of total expenses.

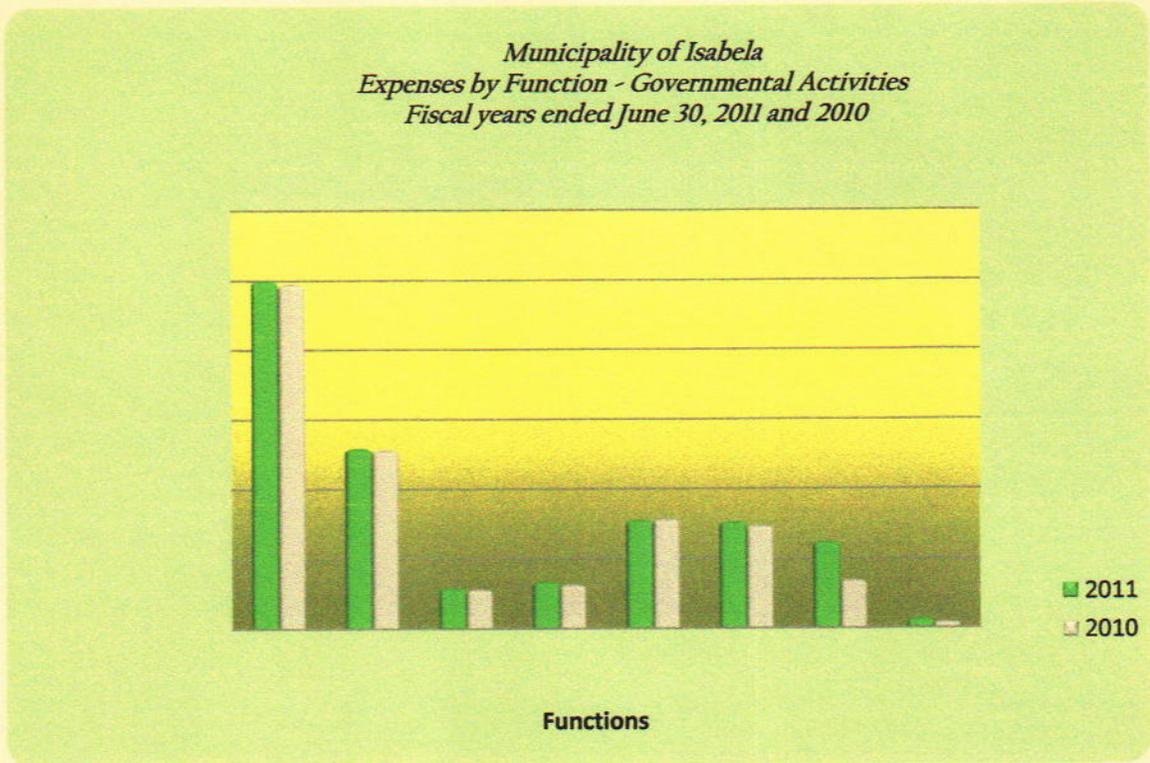
With respect to prior year, revenues reported a net decrease of approximately 4.2%. This net decrease is primarily the result of: (1) a 65% decrease in capital grants because in the prior year the Municipality received a significant amount Commonwealth's stimulus plan funds from the P.R. Infrastructure Financing Authority and significant amount of P.R. Department of Transportation funds to finance local projects. These funds are non-recurring funds. This significant decrease was partially offset by; (1) a 53% increase in operating grants due to the additional federal funds received for the Early Head Start and Head Start Expansion programs (\$1,231,086); (2) a 15% increase in property taxes, partially influenced by a property tax amnesty; (3) a 10% increase in license taxes revenues; and (4) finally, a 97% increase in other revenue due to miscellaneous revenues collected by the Municipality (increase of \$346,710).

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA

MANAGEMENT'S DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2011

FIGURE 2



Expenses increased 6.1% in comparison with 2010 year. Significant increases were registered on education with 78%, and interest paid on long term debt with 52%. The increase in those functions are related to the increase in the operational expenses of the Early Head Start program, financed with operational grants received, and the overall increase in long term debt. Other increases were noted in culture and recreation with 6% and housing, welfare and community development with 4%. The increases in those functions were caused mainly by increases in expenses in salaries and other expenses necessary to finance cultural activities, and increases in expenses to finance welfare and community development programs. These last welfare and community development programs were financed by some state and federal funds such as Homeless Prevention Grant, Emergency Shelter Grant, Housing Opportunities for Persons with AIDS Grant and other miscellaneous grants received.

As noted previously, the 4.2% decrease in revenues with the 6.1% increase in expenses caused a decrease of 51% in the net change in net assets with respect to prior fiscal year net change.

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

Fiscal year ended June 30, 2011

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

<i>Net Cost of Municipality's Governmental Activities Fiscal years ended June 30,</i>				
Functions/Programs	Total Cost of Services		Net Cost of Services	
	2011	2010 (as restated)	2011	2010 (as restated)
General government	\$ 10,024,719	\$ 9,908,944	\$ 5,747,169	\$ 5,064,830
Public works and sanitation	5,166,691	5,113,603	4,509,365	417,729
Public safety	1,179,150	1,145,766	1,074,555	1,075,996
Culture and recreation	1,355,516	1,275,873	1,055,577	1,261,662
Health	3,107,488	3,131,460	618,446	1,081,779
Housing, welfare and community development	3,049,318	2,942,614	1,023,486	1,062,407
Education	2,484,718	1,393,628	162,908	360,954
Other	249,937	174,932	249,937	174,932
	<u>\$ 26,617,537</u>	<u>\$ 25,086,820</u>	<u>\$ 14,441,443</u>	<u>\$ 10,500,289</u>

Some of the cost of governmental activities was paid by those who directly benefited from the programs (\$6,231,642) and other governments and organizations that subsidized certain programs with grants and contributions (\$5,944,452). The \$14,441,443 net cost of services was fully covered by other general revenues including taxes and other grants and contributions not restricted to specific programs.

FINANCIAL ANALYSIS OF THE MUNICIPALITY'S FUNDS

Governmental funds

The focus of the Municipality's governmental funds is to provide information on near-term inflows, outflows and balances of resources available for spending. Such information is useful in assessing the Municipality's financing requirements. In particular, unassigned fund balance may serve as a useful measure of a Municipality's net resources available at the end of a fiscal year.

During the year 2011 the Municipality implemented GASB Statement No. 54 *Fund Balance Reporting and Governmental Fund Type Definitions* ("GASB No. 54"). This statement establishes accounting and reporting standards for all governments that report governmental funds. It also establishes criteria for classifying fund balances into specially defined classifications and clarifies definitions for governmental fund types. Previously classified reserved and unreserved fund balances are now reported as non-spendable, restricted, committed, assigned or unassigned. As a result of the implementation special funds (Law No. 52 and Law No. 82 Funds) were reclassified from the general fund to other governmental funds.

For the fiscal year ended June 30, 2011, the governmental funds reported ending fund balances of \$34,332,928, a net decrease of \$1,077,006 in comparison with the prior year. This decrease was caused primarily by decreases of \$2,056,627, \$4,409,911, \$1,517,805 and \$404,601 in the Community Development Block Grant Program, the debt service fund, the Commonwealth Legislature Resolutions and other governmental funds, respectively. They were partially offset by an increase of \$7,199,005 in the general fund.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

MANAGEMENT'S DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2011

Of the total fund balances, \$22,700,161 (66%) constitutes unrestricted fund balance, which is comprised of funds committed by the Mayor and the Municipal Legislature, funds assigned by the Mayor or the Finance Director as well as unassigned funds. The remainder of the fund balance is restricted to indicate that it is not available for new spending. Unassigned fund balance represents 30% of total fund balance.

The general fund is the operating fund of the Municipality. The fund balance of the general fund represents approximately 71% of total ending fund balances. The amount of \$195,236 of the fund balance of the general fund is no spendable and represents the inventory on hand of the CIMA health facility at year end. The amount of \$241,712 of the fund balance of the general fund is restricted. Most of it (\$232,324) is restricted for the operation of the Elderly People Center of the Municipality. Committed and assigned portions of the unrestricted fund balance of the general fund are distributed as follows:

- \$1,505,347 committed for capital outlays
- \$863,792 committed for general public works and sanitation
- \$810,983 committed for general government and other purposes
- \$327,580 committed for housing, welfare and community development
- \$50,000 committed for health
- \$21,125 committed for sports, culture and recreation
- \$6,250,028 assigned for capital outlays
- \$1,741,032 assigned for health
- \$171,436 assigned for general public works and sanitation
- \$581,979 assigned for general government and other purposes
- \$1,000 assigned for sports, culture and recreation

The remainder of the unrestricted fund balance or \$11,611,036 is unassigned fund balance, which represents 48% of the fund balance of the general fund and 59% of total general fund expenditures.

For the year ended June 30, 2011, the fund balance of the general fund increased by \$7,199,005 when compared with the prior year. Of this net change, \$6,041,902 pertains to special funds included as part of the general fund. The principal components of the increase are transfers of \$5,960,294 received from the debt service fund during the year. The increase was also influenced by an increase of \$423,913 in property tax revenue, an increase of \$240,769 in municipal license tax revenue, and an increase of \$346,548 in other revenues. The increase in the resources of the general fund, as described above, was partially offset by an increase of \$799,101 in expenditures.

The net increase in expenditures of \$799,101 was due to an increase of \$587,374 in general government; an increase of \$50,589 in public works and sanitation; a \$26,701 increase in public safety; a \$20,850 increase in culture and recreation, an increase of \$156,430 in capital outlays and decreases of \$20,760 and \$22,083 in health and housing, welfare and community development, respectively. The significant increase in general government is the result of a \$235,800 increase in expenses for the premature retirement plan of the Municipality, an increase of \$111,189 in utilities, an increase of \$136,486 in professional services, and an increase of \$57,669 in the expenditure for the state insurance fund.

GENERAL FUND BUDGETARY HIGHLIGHTS

The general fund original budget for the fiscal period 2011 presented an increase of 10% with respect to prior fiscal year budget. Amendments to the original budget are approved by the Municipal Legislature. During the fiscal year 2011, budget revenues were increased by \$1,236,908 due to additional collections of property tax, municipal license taxes, sales and use taxes, intergovernmental revenues and other revenue.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

MANAGEMENT'S DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2011

However, budgeted transfers-out was increased basically by the same amount. Actual revenues exceeded the revised budgeted revenues by \$356,938 (net). The most significant variances were in property taxes, \$140,084, municipal license taxes \$129,412 and fees, fines and charges for services \$103,698.

A positive variance of \$600,468 between revised budget and actual expenditures was due mainly to net positive variances in general government for \$286,004, public works and sanitation for \$172,757 and housing, welfare and community development for \$78,181. Actual revenues exceeded actual expenditures by \$967,964.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital assets

At the end of the fiscal year, the Municipality has invested \$52,202,880 (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.

TABLE 4

<i>Capital Assets, net As of June 30,</i>		
	Governmental Activities	
	2011	2010 (as restated)
Non-depreciable assets:		
Land	\$ 4,560,148	\$ 4,247,389
Construction in progress	9,178,845	5,297,655
Depreciable assets:		
Land improvements	845,281	81,179
Leasehold improvements	321,558	323,633
Buildings and buildings improvements	17,761,378	18,471,857
Infrastructure	14,822,283	14,759,095
Vehicles, machinery and equipment	4,713,387	4,845,882
Total	\$ 52,202,880	\$ 48,026,690

The Municipality's major capital projects that were still in construction as of June 30, 2011 are as follows:

- Construction of Youth Sport and Educational Center - \$4,558,099
- Improvements to the downtown electrical infrastructure - \$2,696,730
- Construction of "Parque Lineal Zona Costera" Phase II- \$1,747,391

Construction in progress increased due to the current year additions to the projects described above. This increase was partially offset by the transfer of \$849,892 of finished project to land improvements and infrastructure.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

MANAGEMENT'S DISCUSSION AND ANALYSIS

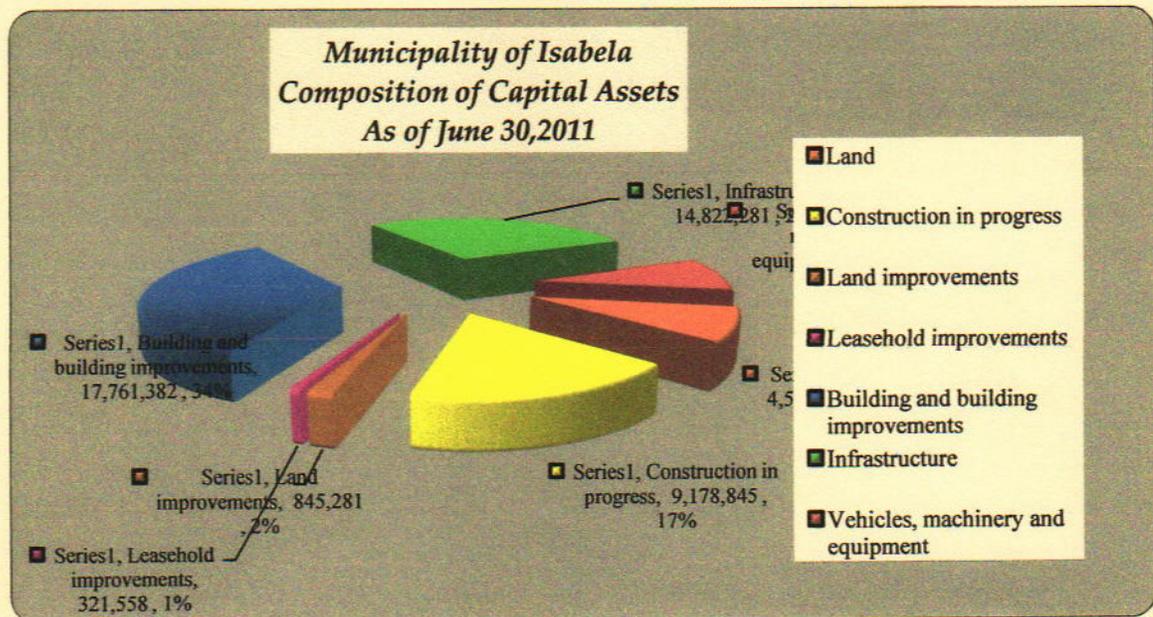
Fiscal year ended June 30, 2011

The Municipality acquired a total of \$942,494 of vehicles and machinery and equipment during the fiscal year 2011, including two trucks for \$279, 990, three heavy equipment items for \$169,899 and twelve vehicles for \$315,325. Also, additions include \$17,983 of equipment acquired for the Early Head Start Program.

The Municipality's fiscal year 2012 consolidated capital budget calls for a significant amount of new and continuous projects including the completion of Phase II of the "Parque Lineal Zona Costera" project, the completion of the construction of the Youth Sport and Educational Center, and the improvements to the downtown electrical infrastructure projects, the continuance of the first "green" project to be located in the "San Antonio de la Tuna" sector which will include the use of solar energy and recycling of water, and the recreational facilities in the "Urb. Isla Azul". The Municipality is also in the planning process for the construction of the new building for its Head Start program, the construction of a new centralized emergency management center, the design of the Phase III of the "Parque Lineal Zona Costera Project", and the creation of a "poblado" in the Planas Community. 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, 2011 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'S DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2011

Long term debt

At year-end, the Municipality had \$8,387,024 in general and special bonds and notes, an increase of 11% with respect to prior year. The following is a summary of the Municipality's outstanding debt as of June 30, 2011 and 2010:

TABLE 5

<i>Outstanding Long-term Debt As of June 30,</i>			
	Governmental Activities		
	2011	2010 (as restated)	
General and special obligation bonds and notes	\$ 9,318,024	\$	8,387,024
Note payable to CRIM – LIMS	33,811		159,564
Note Payable to CRIM – prior years delinquent Accounts	60,488		63,368
Note payable to Puerto Rico Solid Waste Authority	22,617		61,126
Note payable to Puerto Rico Treasury Department	-		160,617
Note payable-Section 108 Loan Guarantee	4,312,000		4,581,000
Landfill obligation	4,799,473		4,581,315
Compensated absences	2,876,818		2,934,663
Christmas Bonus	396,869		413,223
Claims and judgments	40,000		-
Payable to CRIM – property tax advances	88,364		45,490
Payable to PREPA	613,833		542,047
Total	\$ 22,562,297	\$	21,868,403

The Municipality reported an increase in general and special obligation bonds and notes. This increase was the result of the issue of the \$1,350,000 bond during the year. The Municipality reported a net decrease of \$237,106 in the other long-term debts during the year. This decrease was mostly affected by the net effect of decreases of \$269,000, \$160,617 and \$125,753 in the Section 108-Loan Guarantee note, the note payable with the Puerto Rico Treasury Department, and the LIMS Note payable to CRIM, respectively. These decreases were partially offset by increases of \$218,158, \$71,786, and \$42,874 in the Landfill Obligation, the amount payable to PREPA, and the payable to CRIM from property tax advances, respectively. 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'S DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2011

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

The Municipality's selected and appointed officials considered many factors when setting the fiscal year 2012 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 15.7%, which compares with the Commonwealth rate of 15.2%.

The Municipality applied a conservative approach in development budget estimates. Amount available for appropriations in the General Fund for the fiscal year 2012 total \$16,554,019, an increase of approximately 2.3% with respect to prior fiscal year estimates. Budgeted expenditures are expected to be reduced accordingly to the decrease 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, 2011**

		<u>Governmental Activities</u>
ASSETS		
Cash and investments	\$	24,163,070
Receivables, net:		
Municipal License Taxes		3,871
Sales and use taxes (note M)		258,437
Other (note C)		503,165
Due from:		
Commonwealth Government (note D)		2,032,257
Federal Government (note D)		1,074,138
Restricted assets:		
Cash and investments		9,705,194
Cash with fiscal agent		4,414,602
Investment held with fiscal agent (note B)		193,335
Deferred bond issuance costs, net of accumulated amortization of \$36,524		46,266
Inventories and Supplies		195,236
Capital Assets (note G):		
Land and construction in progress		13,738,993
Other capital assets, net		38,463,887
		<u>52,202,880</u>
Total assets	\$	<u>94,792,451</u>
LIABILITIES		
Accounts payable and accrued liabilities	\$	2,648,907
Interest payable		97,211
Due to:		
Commonwealth Government (note D)		117,151
Deferred revenues:		
Municipal license taxes		2,001,048
Federal grants		259,777
Long-term liabilities (note I):		
Due within one year		1,960,406
Due in more than one year		20,601,891
Total liabilities		<u>27,686,391</u>
NET ASSETS		
Invested in capital assets, net of related debt		41,503,133
Restricted for:		
Capital projects		9,318,628
Debt service		2,193,087
Other specified purposes		942,373
Unrestricted		13,148,839
Total net assets	\$	<u>67,106,060</u>

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, 2011

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	\$ 10,024,719	\$ 3,610,354	\$ 104,973	\$ (5,747,169)
Public works and sanitation	5,166,691	78,746	92,459	(4,509,365)
Public safety	1,179,150	-	104,595	(1,074,555)
Culture and recreation	1,355,516	53,500	17,055	(1,055,577)
Health	3,107,488	2,489,042	-	(618,446)
Housing, welfare and community development	3,049,318	-	1,460,404	(1,023,486)
Education	2,484,718	-	2,321,810	(162,908)
Interest on long-term debt	249,937	-	-	(249,937)
Total	\$ 26,617,537	\$ 6,231,642	\$ 4,101,296	\$ (14,441,443)

General revenues:

Taxes:

Property taxes	5,788,812
Municipal license taxes	2,816,522
Sales and use taxes	2,741,583
Grants and contributions not restricted to specific programs	4,932,368
Interest	210,666
Other	704,159
Total general revenues	17,194,110

Change in net assets

Net assets-beginning	2,752,667
Net assets-ending	64,353,393
\$	67,106,060

The accompanying notes are an integral part of this statement.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA

BALANCE SHEET -
GOVERNMENTAL FUNDS
JUNE 30, 2011

Assets	Major Funds						Total Governmental Funds
	General	Community Development Block Grant Program	Head Start Program	Debt Service	Commonwealth Legislature Resolutions	Other Governmental Funds	
Cash and investments	\$ 24,163,070	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 24,163,070
Receivables, net:							
Municipal License Taxes	3,871	-	-	-	-	-	3,871
Sales and use taxes	225,555	-	-	32,882	-	-	258,437
Other (note C)	296,172	5,301	-	-	9,065	45,293	355,832
Due from:							
Commonwealth Government	1,078,226	-	-	140,885	27,529	785,617	2,032,257
Federal Government	-	170,649	359,743	-	-	543,746	1,074,138
Other funds (note E)	3,383,790	-	-	-	40,379	-	3,433,237
Advances to other funds (note E)	-	-	-	-	1,307,497	9,068	1,307,497
Inventories and Suppl les	195,236	-	-	-	-	-	195,236
Restricted assets:							
Cash and investments	255,014	1,710,783	1,560	-	2,903,415	4,834,422	9,705,194
Cash with fiscal agent	-	-	-	2,283,008	-	2,131,594	4,414,602
Investment held with fiscal agent	-	-	-	-	-	193,335	193,335
Total assets	\$ 29,600,934	\$ 1,886,733	\$ 361,303	\$ 2,456,775	\$ 4,287,885	\$ 8,543,075	\$ 47,136,706
Liabilities and fund balances (deficit)							
Liabilities:							
Accounts payable and accrued liabilities	\$ 745,536	\$ 1,003,389	\$ 54,806	\$ -	\$ 432,629	\$ 412,547	\$ 2,648,907
Matured bonds and interest payable	-	-	-	463,927	-	-	463,927
Due to:							
Commonwealth Government	117,151	-	-	-	-	-	117,151
Other funds	10,613	-	306,497	-	31,972	-	3,433,237
Advances from other funds	1,307,497	-	-	-	-	-	1,307,497
Deferred revenues (notes H, L and M):							
Municipal license taxes	2,001,048	-	-	-	-	-	2,001,048
Sales and use tax	24,494	-	-	-	-	-	24,494
Intergovernmental - Commonwealth Government	988,543	-	-	114,460	27,529	785,617	1,916,149
Intergovernmental - Federal grants	-	97,993	109,358	-	-	640,356	847,707
Other	33,766	-	-	-	9,065	830	43,661
Total liabilities	\$ 5,228,648	\$ 1,137,634	\$ 470,661	\$ 578,387	\$ 501,195	\$ 4,867,252	\$ 12,803,778
Fund balances (deficit):							
Nonspendable	195,236	-	-	-	1,307,497	-	1,502,733
Restricted	241,712	827,091	-	1,878,388	2,479,193	4,703,650	10,130,034
Committed	3,578,827	-	-	-	-	-	3,578,827
Assigned	8,745,475	-	-	-	-	-	8,745,475
Unassigned	11,611,036	(97,992)	(109,358)	-	-	(1,027,827)	10,375,859
Total fund balances (deficit)	\$ 24,372,286	\$ 729,099	\$ (109,358)	\$ 1,878,388	\$ 3,786,690	\$ 3,675,823	\$ 34,332,928
Total liabilities and fund balances (deficit)	\$ 29,600,934	\$ 1,886,733	\$ 361,303	\$ 2,456,775	\$ 4,287,885	\$ 8,543,075	\$ 47,136,706

The accompanying notes are an integral part of this statement.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA

RECONCILIATION OF THE BALANCE SHEET - GOVERNMENTAL FUNDS TO THE
STATEMENT OF NET ASSETS
JUNE 30, 2011

Total governmental fund balances:	\$	34,332,928
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:		52,202,880
Other assets used in governmental activities are not financial resources and, therefore, are not reported in the funds:		
Deferred charges - bond issuance costs	\$ 46,266	
Other Receivable (from sale of trucks)	<u>147,333</u>	193,599
Other assets are not available to pay for current-period expenditures and, therefore, are deferred in the funds:		
Receivables:		
Property taxes-Debt Service Fund (current year)	114,460	
Charges for services	61,683	
Fines	2,466	
Interest	9,895	
Sales and use tax - Municipal Development Fund	24,494	
Due from Commonwealth Government:		
P.R. Department of Labor (Law No. 52 and 82)	169,593	
P.R. Department of Education	140,000	
P.R. Electric Power Authority (PREPA)	613,833	
P.R. Infrastructure Financing Authority - "PINI Funds"	81,535	
Christmas Bonus Reimbursement	184,333	
Grant from P.R. Solid Waste Authority	176,181	
Grant from P.R. Department of Transportation	66,097	
Grant from Rural Development Corporation	105,097	
Grant from P.R. Department of Family - "Pres"	122,699	
Other	111,938	
Due from Federal Government:		
Federal Grant-State and Community Highway Safety	10,938	
Federal Grant-Child Care	247,821	
Federal Grant-Head Start	109,358	
Federal Grant-CDBG	97,863	
Federal Grant-ARRA-EECBG	28,084	
Federal Grant-Federal Transportation Act	49,000	
Federal Grant-Emergency Shelter Grant	14,476	
Federal Grant-Others	<u>30,390</u>	2,572,234
Interest liabilities are not due and payable in the current period and, therefore, are not reported in the funds:		(13,284)
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	(8,938,024)	
Note payable to CRIM-LIMS	(33,811)	
Note payable to CRIM-financing of delinquent accounts	(60,488)	
Note payable to P.R. Solid Waste Authority	(22,617)	
Note payable to HUD-Section 108 Loan Guarantee	(4,312,000)	
Payable to PREPA	(613,833)	
Compensated absences	(2,876,818)	
Judgments and legal claims	(40,000)	
Christmas Bonus	(396,869)	
Estimated solid waste landfill closure and post-closure costs	(4,799,473)	
Payable to CRIM-excess of property tax advances	<u>(88,364)</u>	(22,182,297)
Net assets of governmental activities:		<u>\$ 67,106,060</u>

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 (DEFICIT) -
GOVERNMENTAL FUNDS
FISCAL YEAR ENDED JUNE 30, 2011

	Major Funds						Total Governmental Funds
	General	Community Development Block Grant Program	Head Start Program	Debt Service	Commonwealth Legislature Resolutions	Other Governmental Funds	
Revenues:							
Taxes:							
Property taxes (note K)	\$ 3,894,155	-	-	\$ 1,869,495	\$ -	-	\$ 5,763,650
Municipal license taxes (note L)	2,816,522	-	-	-	-	-	2,816,522
Sales and use taxes (note M)	2,479,381	-	-	261,239	-	-	2,740,620
Intergovernmental:							
Commonwealth government (note N)	7,552,621	-	-	-	100,000	250,763	7,903,384
Federal government	3,870,388	1,406,499	2,349,463	-	-	1,485,746	5,241,708
Fees, fines and charges for services	55,347	30,008.00	-	6,545	23,516	19,638	3,890,026
Interest	646,703	-	-	-	-	87,455	202,871
Other	21,315,117	1,436,507	2,349,463	2,137,279	123,516	9,656	656,359
Total revenues							29,215,140
Expenditures:							
Current:							
General government	9,191,723	220,772	-	-	-	153,186	9,565,681
Public works and sanitation	3,860,610	153,569	-	-	4,985	173,521	4,192,685
Public safety	1,013,396	-	-	-	-	45,956	1,059,352
Culture and recreation	610,602	33,601.00	-	-	-	26,838	671,041
Health	3,065,114	565,428	-	-	3,264	898,635	3,065,114
Housing, welfare and community development	1,513,953	-	2,059,382	-	-	337,775	2,981,280
Education	471,570	2,178,313	177,148	-	1,645,827	1,891,075	2,397,157
Capital outlays	-	269,000	-	419,000	-	-	688,000
Debt service:	-	72,451	-	167,896	-	-	240,347
Principal	-	-	-	-	-	6,467	6,467
Interest	-	-	-	-	-	-	-
Bond issuance costs	19,726,968	3,493,134	2,236,530	586,896	1,654,076	3,533,453	31,231,057
Total expenditures	1,588,149	(2,056,627)	112,933	1,550,383	(1,530,560)	(1,680,195)	(2,015,917)
Excess (deficiency) of revenues over expenditures							
Other financing sources (uses):							
Proceeds from general obligation bonds	-	-	-	-	-	1,350,000	1,350,000
Proceeds from Section 108 Loan Guarantee note - Fixed Rate Note	73,667	4,312,000	-	-	-	-	4,312,000
Proceeds from sale of machinery and equipment	-	(4,312,000)	-	-	-	-	(4,312,000)
Payment of Section 108 Loan Guarantee - Variable/Fixed Rate Note	(484,756)	-	-	-	-	-	(484,756)
Payment of debt - PREPA	6,021,945	-	-	(5,960,294)	15,258	2,503	6,039,706
Transfers in	-	-	-	(5,960,294)	(2,503)	(76,909)	(6,039,706)
Transfers out	5,610,856	-	-	(5,960,294)	12,755	1,275,594	938,911
Total other financing sources (uses)							
Net change in fund balances (deficit)	7,199,005	(2,056,627)	112,933	(4,409,911)	(1,517,805)	(404,601)	(1,077,006)
Fund balances at beginning of year, as restated (note S)	17,173,281	2,785,726	(222,291)	6,288,299	5,304,495	4,080,424	35,409,934
Fund balances (deficit) at end of year	\$ 24,372,286	\$ 729,099	\$ (109,358)	\$ 1,878,388	\$ 3,786,690	\$ 3,675,823	\$ 34,332,928

Handwritten signature and date: 11/25/2011

The accompanying notes are an integral part of this statement.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA

RECONCILIATION OF STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND
BALANCES (DEFICIT) - GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES
FISCAL YEAR ENDED JUNE 30, 2011

Net change in fund balances (deficit) - total governmental funds:		\$ (1,077,006)
Amounts reported for governmental activities in the statement of activities are different because:		
Governmental funds reports capital assets outlays as expenditures. However, in the Statement of Activities the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense:		
Expenditures for capital assets:	\$ 6,363,936	
Less: current year depreciation	<u>(1,915,755)</u>	4,448,181
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:		
		(98,791)
Revenues in the Statement of Activities that do not provide current financial resources are not reported as revenues in the funds:		
Property taxes-Debt Service Fund (current year)	114,460	
P.R. Department of Labor (Law No. 52 and 82)	77,975	
P.R. Electric Power Authority (PREPA) (current year)	371,028	
Christmas Bonus Reimbursement (current year)	184,333	
Federal Grant-Head Start	109,358	
Federal Grant-CDBG	48,997	
Federal Grant-Federal Transportation Act	49,000	
Federal Grant-Others	30,390	
Charges for services	33,767	
Donated capital assets	47,800	
Others	<u>279,507</u>	1,346,615
Revenues reported in funds which are not reported as revenues in the Statement of Activities:		
Property taxes-General Fund (current year)	88,066	
P.R. Department of Education (prior year)	82,000	
P.R. Electric Power Authority (PREPA) (prior year)	299,242	
Charges for services	151,997	
Federal Grant-Child Care	106,627	
Federal Grant-Head Start	171,590	
Christmas Bonus Reimbursement (prior year)	191,929	
Others	<u>100,100</u>	(1,191,551)
Proceeds from general obligation bonds are other financing sources in the governmental funds, but an increase of long-term liabilities in the Statement of Net Assets:		
		(1,350,000)
Proceeds from 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:		
		(4,312,000)
Proceeds from sale of machinery and equipment are other financing sources in the governmental funds, but a decrease of an account receivable in the Statement of Net Assets:		
		(73,667)
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	419,000	
Other long term liabilities	<u>5,791,194</u>	6,210,194
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:		
Bond issuance costs	6,467	
Amortization of bond issuance costs	<u>(3,250)</u>	3,217
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 (net change)	57,845	
Municipal solid waste land fill (net change)	(218,158)	
Christmas bonus	(396,869)	
P.R. Electric Power Authority (PREPA)	(556,542)	
Accrued interest (net change)	<u>1,199</u>	(1,152,525)
Change in net assets of governmental activities:		<u>\$ 2,752,667</u>

The accompanying notes are an integral part of this statement.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

NOTES TO FINANCIAL STATEMENTS

June 30, 2011

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

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

1. *Financial reporting entity*

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

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

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA

NOTES TO FINANCIAL STATEMENTS

June 30, 2011

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

Management's 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

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, 2011

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Government-wide statements

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

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

The types of transactions included as program revenues are: charges for services, fees, licenses and permits; operating grants which include operating-specific and discretionary (either operating or capital) grants; and capital grants which are capital-specific grants. Internally dedicated resources are reported as general revenues rather than as program revenues. Likewise, general revenues include all taxes. Property taxes (imposed nonexchange transactions) are recognized as revenues in the year for which they are levied and municipal license taxes 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, 2011

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, Debt Service and Commonwealth Legislature Resolutions Funds).

The Municipality reports the following major governmental funds:

General Fund: This is the operating fund of the Municipality and is used to account for and report all financial resources not accounted for and reported in another fund.

Community Development Block Grant Program Fund (CDBG): CDBG fund (including CDBG - ARRA) is used to account for and report revenue 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 (including Head Start - ARRA) is used to account for and report 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: This fund is used to account for and report financial resources that are restricted, committed, or assigned to expenditure for principal and interest.

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

The governmental funds reported in the fund financial 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.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

NOTES TO FINANCIAL STATEMENTS

June 30, 2011

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 balance sheet and the revenue is recognized.

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

Since the governmental fund statements are presented on a different measurement focus and basis of accounting than the government-wide statements, 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, 2011

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. *Deposits and investments*

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

The laws and regulations of the Commonwealth of Puerto Rico authorize the Municipality to invest only in obligations of the Commonwealth, obligations of the United States of America, certificates of deposits, commercial paper, bankers' acceptances, or in pools of obligations of the municipalities of Puerto Rico, which are managed by the Governmental Development Bank for Puerto Rico ("GDB"). Investment currently reported consist of a non-rated guaranteed investment contract ("GIC") managed by GDB. The GIC is valued at cost.

4. *Restricted assets*

Restricted assets are liquid assets which have third-party limitations on their use. Cash and cash equivalents related to Commonwealth and Federal grants (including Commonwealth Legislature Resolutions) 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.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

NOTES TO FINANCIAL STATEMENTS

June 30, 2011

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

5. *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 and sales tax revenues of current fiscal year collected by the CRIM (property tax) and the Puerto Rico Department of Treasury (sales tax) on the subsequent fiscal year.

6. *Interfund receivables and payables*

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

7. *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.

Inventory of medicines and medical supplies of the Municipality's Advanced Medical Center ("CIMA") is capitalized and valued at cost using the first-in, first-out method.

8. *Capital assets*

Capital assets reported in the governmental activities in the Statements of Net Assets include property, plant, equipment and infrastructure, (e.g., roads, bridges, sidewalks, and similar items). The Municipality defines capital assets (except for infrastructure assets) as assets that have an individual cost of \$500 or more and have a useful life of one or more years. Infrastructure assets are capitalized based on a percentage of the estimated useful life. The cost of normal maintenance and repairs that do not add to the value of the assets or materially extend assets lives are not capitalized. Major outlays for capital assets and improvements are capitalized as projects are constructed.

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.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA

NOTES TO FINANCIAL STATEMENTS

June 30, 2011

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

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.

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. *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, consist of general and special obligation bonds, liabilities for compensated absences, claims and judgments, and long-term liabilities to other governmental entities.

11. *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.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

NOTES TO FINANCIAL STATEMENTS

June 30, 2011

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

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.

12. Fund balances and Net Assets

During the year 2011 the Municipality implemented GASB Statement No. 54 Fund Balance Reporting and Governmental Fund Type Definitions ("GASB No. 54"). This statement establishes accounting and reporting standards for all governments that report governmental funds. It also establishes criteria for classifying fund balances into specifically defined classifications and clarifies definitions for governmental fund types. These classifications comprise a hierarchy based primarily on the extent to which the Municipality is bound to observe constraints upon the use of the resources reported. As a result of the implementation two special funds were reclassified from the general fund to other governmental funds. The classifications are as follows:

- | | |
|---------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Nonspendable: | Amounts that cannot be spent because are either (a) not in spendable form or (b) legally or contractually required to be maintained intact. |
| Restricted: | Amounts constrained by external parties (creditors, grantors, contributors, or laws and regulations of other governments), imposed by law through constitutional provisions or by enabling legislation. Enabling legislation authorizes the Municipality to assess, levy, charge or otherwise mandate payment or resources (from external resource providers) and includes a legally enforceable requirement that those resources be used only for the specific purposes stipulated in the legislation. Legally enforceability means that the Municipality can be compelled by an external party such as citizens, public interest groups, or the judiciary to use resources created by enabling legislation only for the purposes specified by the legislation. |
| Committed: | Amounts that can be used only for the specific purposes imposed through formal action (ordinance or resolution) by consent of both the Mayor and the Municipal Legislature, the highest level of decision-making authority for the Municipality. Those committed amounts cannot be used for any other purposes unless the highest level of decision-making authority for the Municipality removes or changes the specified use by taking the same type of action (ordinance or resolution) it employed to commit those amounts. Formal action to commits fund balance to a specific purpose should occur prior to the end of the fiscal year, but the amount, if any, which will be subject to the constraint, may be determined in the subsequent period. |

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA

NOTES TO FINANCIAL STATEMENTS

June 30, 2011

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

- Assigned: Amounts intended to be used by the Municipality for specific purposes but do not meet the criteria to be classified as restricted or committed. Intent can be expressed by the Mayor or the Finance Director, the official to which the Mayor has also delegated the authority to assign amounts. With the exception of the general fund, this is the residual fund balance of the classification of all governmental funds with positive fund balances. Action taken to assign fund balance may be made after year-end.
- Unassigned: Is the residual classification for the general fund and includes all spendable amounts not restricted, committed or assigned. The general fund is the only fund that reports a positive unassigned fund balance amount. For all other governmental funds the unassigned classification is used only to report a deficit balance resulting for the overspending for specific purposes for which amounts had been restricted, committed or assigned.

The Municipality applies restricted resources first when expenditures are incurred for purposes for which either restricted or unrestricted (committed, assigned and unassigned) amounts are available. Similarly, within unrestricted fund balance, committed amounts are reduced first followed by assigned and then unassigned amounts when expenditures are incurred for purposes for which amounts in any of the unrestricted fund balance classifications could be used.

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.
- 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.

13. *Interfund transactions*

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

NOTES TO FINANCIAL STATEMENTS

June 30, 2011

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

14. Risk financing

The Puerto Rico Treasury Department (PRDT) acts as an agent, obtaining and determining the coverage for the municipalities of Puerto Rico. The coverage for the Municipality of Isabela consists of professional, public responsibility, property and theft, auto and fidelity bond coverage. Insurance policies costs are allocated by PRDT among all the municipalities of Puerto Rico. Payment of the Municipality's insurance premiums is monthly deducted from advances of property tax and amounts of municipal equalization fund send to the Municipality by the Municipal Revenue Collection Center (CRIM). Workers compensation insurance is also deducted from the monthly advances by the CRIM. Settled cases have not exceeded insurance coverage for any of the past three years.

15. Use of estimates

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

16. Future adoption of accounting pronouncements

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

<u>Statement</u>	<u>To be adopted in fiscal year ended,</u>	
57	OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans	June 30, 2012
60	Accounting and Financial Reporting for Service Concession Arrangements	June 30, 2013
61	The Financial Reporting Entity: Omnibus—an amendment of GASB Statements No. 14 and No. 34	June 30, 2013
62	Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements	June 30, 2013
63	Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position	June 30, 2013
64	Derivative Instruments: Application of Hedge Accounting Termination Provisions—an amendment of GASB Statement No. 53	June 30, 2012

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA

NOTES TO FINANCIAL STATEMENTS

June 30, 2011

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

NOTE B – DEPOSITS AND INVESTMENT

1. 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 depository 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 of deposits in commercial banks amounting to \$34,052,136 was covered by federal depository insurance or by collateral held by the Secretary of Treasury of Puerto Rico in the Municipality's name. 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 \$4,414,602.

2. Investment

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 special obligation bond under custody of GDB, the Municipality's fiscal agent, pursuant to the bond purchase agreement. The GIC have an outstanding balance of \$193,335 as of June 30, 2011 earning interest at a variable rate (LIBOR minus .193%, .272% as of June 30, 2011), have an original maturity of 90 days and is due on August 3, 2010. The GIC outstanding balance is valued at cost.

NOTE C – RECEIVABLES - OTHER

Accounts receivable – Others as of June 30, 2011 follows:

	<u>Amount</u>
CIMA – third-party payors	\$ 231,504
Sale of machinery and equipment (sanitation trucks)	147,333
CIMA – capitation	39,506
Interest	26,252
Construction excise taxes	15,599
Miscellaneous	42,971
	<u>\$ 503,165</u>

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 G.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

NOTES TO FINANCIAL STATEMENTS

June 30, 2011

NOTE D – DUE FROM (TO) GOVERNMENTAL ENTITIES

1. *Amounts due from governmental entities as of June 30, 2011 follows:*

	<u>Commonwealth Government</u>	<u>Federal Government</u>
<u>Major fund - General fund:</u>		
P.R. Electric Power Authority (PREPA)	\$ 613,833	\$ -
Municipal Revenue Collection Center (CRIM) – property taxes	7,683	-
P.R. Department of Treasury – Christmas bonus reimbursement	184,333	-
P.R. Department of Education	222,000	-
P.R. Department of Health	27,917	-
Others	22,460	-
<u>Major fund – CDBG fund:</u>		
Office of Commissioner of Municipal Affairs – CDBG	-	4,200
U.S. Department of Housing and Urban Development – CDBG	-	166,449
U.S. Department of Housing and Urban Development – CDBG-AR	-	-
<u>Major fund – Head Start fund:</u>		
U.S. Department of Health and Human Services – Head Start	-	359,743
<u>Major fund – Debt service fund:</u>		
Municipal Revenue Collection Center (CRIM) – property taxes	140,885	-
<u>Major fund – Commonwealth Legislature Resolutions fund:</u>		
Commonwealth Legislative Resolutions	27,529	-
<u>Other governmental funds:</u>		
P.R. Infrastructure Financing Authority (PRIFA) – “PINI” Funds	81,535	-
Solid Waste Authority-Landfill improvements	170,176	-
P.R. Department of Labor – Law No. 52	159,488	-
P.R. Department of Family – Pres	122,699	-
Rural Development Corporation	105,097	-
P.R. Department of Family – Child Care	-	376,668
P.R. Traffic Safety Commission	-	30,128
P.R. Department of Transportation	66,097	49,000
Others	80,525	87,950
	<u>\$ 2,032,257</u>	<u>\$ 1,074,138</u>

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

NOTES TO FINANCIAL STATEMENTS

June 30, 2011

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

2. Amounts due to governmental entities as of June 30, 2011 follows:

	Commonwealth Government
Employees Retirement System of the Government of the Commonwealth of P.R. (current debt)	\$ 77,780
P.R. Aqueduct and Sewer Authority (PRASA)	17,943
P.R. Department of Labor – unemployment	21,428
	\$ 117,151

NOTE E - 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:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
General Fund	Major funds: CDBG Head Start Commonwealth Legislative Resolutions: Other governmental funds: Child Care TANF Traffic Safety Commission PRIFA – “PINI” Fund School Maintenance (OME) Rural Development Corporation Solid Waste Authority P.R. Dept. of Transportation P.R. Dept. of Family – Pres P.R. Dept. of Labor–Law No. 52 Others	\$ 56,252 306,497 31,972 710,508 175,712 246,080 311,496 154,368 131,240 153,782 297,243 122,700 267,670 418,270 <u>\$ 3,383,790</u>
Commonwealth Legislative Resolutions:	Major funds: General Fund Other governmental funds: PRIFA – “PINI” Fund Rural Development Corporation	\$ 1,545 23,576 15,258 <u>\$ 40,379</u>
Other governmental funds: WIA	Major funds: General Fund	 <u>\$ 9,068</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

NOTES TO FINANCIAL STATEMENTS

June 30, 2011

NOTE E - INTERFUND TRANSACTIONS - Continued

2. Advances to(from) other funds:

Advances to (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. The amount of \$5,954,767 was transferred from the debt service fund to a special fund.

NOTE F- FUND BALANCE

1. Fund balance classifications

The governmental fund balance classifications and amounts at June 30, 2011 are shown in the following table:

	General Fund	Community Development Block Grant	Head Start Program	Debt Service	Commonwealth Legislative Resolutions	Other Governmental Funds	Total
<u>Nonspendable:</u>							
Advances	\$ -	\$ -	\$ -	\$ -	\$ 1,307,497	\$ -	\$ 1,307,497
Inventories	195,236						195,236
	<u>195,236</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>1,307,497</u>	<u>-</u>	<u>1,502,733</u>
<u>Restricted:</u>							
General public works and sanitation	-					21,920	21,920
Public safety	216					2,533	2,749
Sports, culture and recreation	-					31,942	31,942
Health	5,089					-	5,089
Housing, welfare and community development	232,324				99,151	298,307	629,782
Debt Service	-			1,878,388		-	1,878,388
Capital outlays	-	827,091			2,380,042	4,348,948	7,556,081
General Government and other purposes	4,083					-	4,083
	<u>241,712</u>	<u>827,091</u>	<u>-</u>	<u>1,878,388</u>	<u>2,479,193</u>	<u>4,703,650</u>	<u>10,130,034</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

NOTES TO FINANCIAL STATEMENTS

June 30, 2011

NOTE F- FUND BALANCE - Continued

	General Fund	Community Development Block Grant	Head Start Program	Debt Service	Commonwealth Legislative Resolutions	Other Governmental Funds	Total
<i>Committed:</i>							
General public works and sanitation	863,792	-	-	-	-	-	863,792
Sports, culture and recreation	21,126	-	-	-	-	-	21,126
Health	50,000	-	-	-	-	-	50,000
Housing, welfare and community development	327,580	-	-	-	-	-	327,580
Capital outlays	1,505,346	-	-	-	-	-	1,505,346
General Government and other purposes	810,983	-	-	-	-	-	810,983
	<u>3,578,827</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>3,578,827</u>
<i>Assigned:</i>							
General public works and sanitation	171,436	-	-	-	-	-	171,436
Sports, culture and recreation	1,000	-	-	-	-	-	1,000
Health	1,741,032	-	-	-	-	-	1,741,032
Capital outlays	6,250,028	-	-	-	-	-	6,250,028
General government and other purposes	581,979	-	-	-	-	-	581,979
	<u>8,745,475</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>8,745,475</u>
<i>Unassigned</i>	11,611,036	(97,992)	(109,358)	-	-	(1,027,827)	10,375,859
	<u>\$ 24,372,286</u>	<u>\$ 729,099</u>	<u>\$ (109,358)</u>	<u>\$ 1,878,388</u>	<u>\$ 3,786,690</u>	<u>\$ 3,675,823</u>	<u>\$ 34,332,928</u>

2. Fund balance deficits

Certain special funds included in the fund statements disclosed fund balance deficits as follows:

Funds	Fund balance - unassigned amount
Major Funds:	
CDBG (Entitlement and State's Program)	\$ 97,992
Head Start	\$ 109,358
Other Governmental Funds:	
Child Care - (SENDEC and Summer Camp)	\$ 247,822
Law No. 52 and 82	169,590
Recycling 2000	149,669
P.R. Department of Family - "Pres"	122,699
P.R. Infrastructure Financing Authority - "PINI"	81,535

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

NOTES TO FINANCIAL STATEMENTS

June 30, 2011

NOTE F- FUND BALANCE - Continued

Funds	Fund balance - unassigned amount
P.R. Department of Transportation – Public	
Improvements	66,097
Federal Transit Grant - Trolleys	49,000
Public Order Code	29,750
Office of Elderly	29,660
ARRA – ECCBG (Air Conditioner)	28,084
Others	53,921
	\$ 1,027,827

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

NOTE G – CAPITAL ASSETS

1. Capital assets and depreciation activity:

	Balance July 1, 2010	Increases	Decreases	Balance June 30, 2011
<u>Governmental activities:</u>				
Capital assets, not being depreciated:				
Land	\$ 4,247,389	\$ 312,759	\$ -	\$ 4,560,148
Construction in progress	5,297,655	4,724,082	842,892	9,178,845
Total capital assets not being depreciated:	9,545,044	5,036,841	842,892	13,738,993
Capital assets, being depreciated:				
Land improvements	82,932	771,585	-	854,517
Buildings and building improvements	22,400,970	37,353	-	22,438,323
Leasehold improvements	522,833	44,354	-	567,187
Infrastructure	17,017,128	422,001	55,110	17,384,019
Vehicles, machinery and equipment	9,823,994	942,494	920,057	9,846,431
Total capital assets being depreciated	49,847,857	2,217,787	975,167	51,090,477

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

NOTES TO FINANCIAL STATEMENTS

June 30, 2011

NOTE G – CAPITAL ASSETS - Continued

	<u>Balance July 1, 2010</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance June 30, 2011</u>
Less accumulated depreciation for:				
Land improvements	1,753	7,483	-	9,236
Buildings and building improvements	3,929,113	747,832	-	4,676,945
Leasehold improvements	199,200	46,429	-	245,629
Infrastructure	2,258,033	316,986	13,283	2,561,736
Vehicles, machinery and equipment	4,978,112	797,025	642,093	5,133,044
Total accumulated depreciation	11,366,211	1,915,755	655,376	12,626,590
Total capital assets being depreciated, net	<u>38,481,646</u>	<u>302,032</u>	<u>319,791</u>	<u>38,463,887</u>
Governmental activities capital assets, net	<u>\$ 48,026,690</u>	<u>\$ 5,338,873</u>	<u>\$ 1,162,683</u>	<u>\$ 52,202,880</u>

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

Governmental activities:

General government	\$ 202,658
Public works and sanitation	710,851
Public safety	119,798
Culture and recreation	684,474
Health	42,374
Welfare and community development	68,038
Education	<u>87,562</u>
Total depreciation expense, governmental activities	<u>\$ 1,915,755</u>

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.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

NOTES TO FINANCIAL STATEMENTS

June 30, 2011

NOTE G – CAPITAL ASSETS - Continued

On June 29, 2009 the Municipality signed 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 the 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 was 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.

NOTE H – DEFERRED REVENUES – GOVERNMENTAL FUNDS

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

	<u>Commonwealth Government</u>	<u>Federal Grants</u>	<u>Other</u>
<u>Major fund - General fund:</u>			
P.R. Electric Power Authority (PREPA)	\$ 613,833	\$ -	\$ -
P.R. Department of Treasury – Christmas bonus reimbursement	184,333	-	-
P.R. Department of Education	140,000	-	-
P.R. Department of Health	27,917	-	-
Others	22,460	-	-
CIMA – third-party payors	-	-	33,766
<u>Major fund – CDBG fund:</u>			
Office of Commissioner of Municipal Affairs – CDBG	-	4,200	-
U.S. Department of Housing and Urban Development – CDBG	-	93,793	-
<u>Major fund – Head Start fund:</u>			
U.S. Department of Health and Human Services – Head Start	-	109,358	-
<u>Major fund – Debt Service fund:</u>			
Municipal Revenue Collection Center (CRIM) – property taxes	114,460		
<u>Major fund – Commonwealth Legislature Resolutions fund:</u>			
Commonwealth Legislative Resolutions	27,529	-	-
Interest	-	-	9,065

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

NOTES TO FINANCIAL STATEMENTS

June 30, 2011

NOTE H – DEFERRED REVENUES – GOVERNMENTAL FUNDS - Continued

	<u>Commonwealth Government</u>	<u>Federal Grants</u>	<u>Other</u>
<u>Other governmental funds:</u>			
P.R. Infrastructure Financing Authority (PRIFA) – “PINI” Funds	81,535	-	-
Solid Waste Authority-Landfill improvements	170,176	-	-
P.R. Department of Labor – Law No. 52	159,488		
P.R. Department of Family – Pres Rural Development Corporation	122,699	-	-
P.R. Department of Family – Child Care	-	247,822	-
P.R. Traffic Safety Commission	-	10,938	-
P.R. Department of Justice –Public Safety Partnership and Community Policing Grants – AR	-	220,005	-
U.S. Department of Housing and Urban Development – Homeless Prevention and Rapid Rehousing Program		39,641	
Others	146,622	121,950	830
	<u>\$ 1,916,149</u>	<u>\$ 847,707</u>	<u>\$ 43,661</u>

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, 2011:

	<u>Balance at July 1, 2010</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance at June 30, 2011</u>	<u>Due within one year</u>
General, Special Obligations Bonds and Notes	\$ 8,387,024	\$ 1,350,000	\$ 419,000	\$ 9,318,024	\$ 421,000
Note payable to CRIM-LIMS	98,530	-	64,719	33,811	33,811
Note payable to CRIM –Financing of delinquent accounts	63,368	-	2,880	60,488	2,880
Note payable to P.R. Solid Waste Authority	61,126	-	38,509	22,617	22,617
Note Payable to P.R. Treasury Department	160,617	-	160,617	-	-

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

NOTES TO FINANCIAL STATEMENTS

June 30, 2011

NOTE I – LONG-TERM DEBT - Continued

	<u>Balance at July 1, 2010</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance at June 30, 2011</u>	<u>Due within one year</u>
Note payable – Section 108 Loan Guarantee	4,581,000	4,312,000	4,581,000	4,312,000	269,000
Landfill Obligation	4,581,315	218,158	-	4,799,473	-
Compensated absences	2,934,663	390,306	448,151	2,876,818	345,612
Christmas bonus	413,223	396,869	413,223	396,869	396,869
Claims and judgments	-	40,000	-	40,000	40,000
Payable to CRIM- excess of property tax advances over actual collections	45,490	88,364	45,490	88,364	298
Payable to PREPA	542,047	556,542	484,756	613,833	428,319
	<u>\$ 21,868,403</u>	<u>\$ 7,352,239</u>	<u>\$ 6,658,345</u>	<u>\$ 22,562,297</u>	<u>\$ 1,960,406</u>

2. General and special obligation bonds and notes

The Municipality's outstanding general and special obligation bonds and notes at June 30, 2011 amount to \$9,318,024. All these bonds are serviced by the Governmental Development Bank for 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 funds 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.

	<u>Outstanding Amount</u>
1996 general obligation bonds of \$525,000 due in annual installments ranging from \$13,000 to \$36,000 through January 1, 2021; bearing interest at 4.50%	\$ 294,000

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

NOTES TO FINANCIAL STATEMENTS

June 30, 2011

NOTE I – LONG-TERM DEBT – Continued

4. Other long-term liabilities

**Outstanding
Amount**

Note payable to CRIM (Financing of delinquent accounts)– On April 2, 2002, the Municipality entered into a financing agreement with the CRIM in the amount of \$471,041, to finance delinquent property tax accounts sold to private investors, under the provision of Law No. 146 of October 11, 2001. The agreement is in the form of a non-revolving line of credit bearing interest of 6.5% for the first 5 years and variable for the next twenty-five 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 five 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 five years any collection from those delinquent accounts was credited to the loan principal. After the fifth year period the loan outstanding balance was restructured for a twenty-five 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:

\$ 60,488

<u>June 30,</u>	<u>Principal</u>	<u>Interest</u>
2012	\$ 2,880	\$ 3,762
2013	2,880	3,584
2014	2,880	3,404
2015	2,880	3,224
2016	2,880	3,046
2017-2021	14,402	12,542
2022-2026	14,402	8,062
2027-2031	14,402	3,582
2032	2,882	178
Totals	<u>\$ 60,488</u>	<u>\$ 41,384</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

NOTES TO FINANCIAL STATEMENTS

June 30, 2011

NOTE I – LONG-TERM DEBT – Continued

**Outstanding
Amount**

Note payable to Puerto Rico Solid Waste Authority – On September 17, 2004, the Municipality entered into a financing agreement with the P.R. 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 (including interest) and a final payment of \$22,944 in January 1, 2012. The note balance as of June 30, 2011 is being paid from unrestricted funds. Debt service requirements in future years are as follows:

\$ 22,617

June 30,	Principal	Interest
2012	\$ 22,617	\$ 327

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 and August 20, 2009 the Municipality received \$1,200,000 and \$3,650,000 respectively on advance funds under a \$4,850,000 variable/fixed rate note dated June 29, 2009. The VRF Note was designed to convert to a fixed rate note on its Conversion Date. On July 21, 2010 the variable/fixed rate note was converted to a \$4,312,000 4.21% note, payable in annual installments ranging from \$269,000 to \$270,000 and due on August 1, 2026. The face amount of the note was based on the outstanding balance of the cumulative amount of advances the Municipality received on or before the conversion date. Total payment of \$5,593,311 (including interest of \$1,281,311) will be financed through appropriation of funds from the Community Development Block Grants/ Entitlement Grants Program. Interest payments on fiscal year 2010-2011 amounts to \$72,450. Debt service requirements in future years are as follows:

\$ 4,312,000

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

NOTES TO FINANCIAL STATEMENTS

June 30, 2011

NOTE I – LONG-TERM DEBT – Continued

June 30,	Principal	Outstanding Amount
2012	\$ 269,000	
2013	269,000	
2014	269,000	
2015	269,000	
2016	269,000	
2017-2021	1,347,000	
2022-2026	1,350,000	
2027	270,000	
Totals	\$ 4,312,000	
Landfill obligation – represents the outstanding balance of the estimated liability for landfill closure and post-closure care costs		\$ 4,799,473
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. Amount is repaid with unrestricted funds.		\$ 2,876,818
Christmas Bonus – represents the accrued portion corresponding to fiscal year 2010-2011 of the Christmas bonus to be paid in December 2011.		\$ 396,869
Claims and judgments – represents amounts accrued arising from a final settlement of one case to be paid subsequently from unrestricted funds by the Municipality.		\$ 40,000
Payable to CRIM – represents the balance owed to CRIM at June 30, 2011 for excess of advances of property tax and other subsidies over preliminary amount of property tax collections for the fiscal year ended 2011. The 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).		\$ 88,364

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

NOTES TO FINANCIAL STATEMENTS

June 30, 2011

NOTE I – LONG-TERM DEBT – Continued

	<u>Outstanding Amount</u>
<p>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 2010 the Municipality’s annual energy charges amounted to \$1,906,151 but the CELI obligation amounted to \$1,349,609. The excess amount of \$556,542 was recorded as a payable and a receivable for the same amount and will be amortized over a three-year period. As of June 30, 2011 the outstanding amount of \$613,833 includes a balance of \$242,805 from fiscal year 2009 and is recognized by the Municipality as a receivable and a liability to PREPA. Debt service requirements in future years are as follows:</p>	<p>\$ 613,833</p>

June 30	Principal
2012	\$ 428,319
2013	185,514
Totals	\$ 613,833

NOTE J – LANDFILL CLOSURE AND POSTCLOSURE CARE COSTS OBLIGATIONS

For those municipalities that own and operate a solid waste landfill, the Commonwealth and Federal laws and regulations require to place a final cover on its landfill when it cease or discontinue accepting waste or close its landfill. Accordingly the Municipality is required to perform certain maintenance and monitoring activities 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.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

NOTES TO FINANCIAL STATEMENTS

June 30, 2011

**NOTE J – LANDFILL CLOSURE AND POSTCLOSURE CARE COSTS OBLIGATIONS –
Continued**

On June 2, 2011 the Municipality entered into a contract with a private company (“the Company”) for the transportation, disposal of solid waste and the operation of the municipal solid waste landfill for a 15 years term. As stated by contract terms and conditions, the Company will be responsible for the landfill’s closure and post closure care process but the Municipality and the Company will share the landfill closure and post-closure care costs. Costs will be shared based on the proportion of volume of solid waste deposited by each entity over total volume deposited during the landfill’s total operational periods. Total volume deposited was determined and will be revised annually by an independent engineering consulting company.

As part of the agreement in order to finance the future closure and post closure care activities, the Company will deposit on a monthly basis during the total contract period an amount equal to a 1/180 of the closure and post closure care prorated cost. The amount will be deposited in a separate bank account at the Municipality’s and Company’s name and will annually be revised based on the annual review of the calculation of the total volume of solid waste deposited.

The estimated liability for landfill closure and post-closure care costs outstanding balance of \$4,799,473 represents the Municipality’s share of cost as of June 30, 2011. As of June 30, 2011 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 general assessed on January 1 on all taxable property located within the Municipality and is based on the current value existing in the year 1957. For personal property the tax is due with the return filed on or before May 15. Taxes on real property may be paid on two equal installments, July 1st and January 1st. Total tax rates in force as of June 30, 2011 are 7.03% for personal property and 9.03% for real property. The distribution of these rates follows:

<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:	<u>2.00%</u>	<u>2.00%</u>
Total tax rate:	7.03%	9.03%
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>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

NOTES TO FINANCIAL STATEMENTS

June 30, 2011

NOTE K – PROPERTY TAXES - Continued

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. A net payable of \$88,364, resulting from the final settlement for fiscal year 2010 and preliminary settlement for fiscal year 2011, is recorded as other long-term debt in the government wide financial statements since it will not be paid with current available financial resources.

On July 2, 2010 the Commonwealth's Legislature approved Act No. 71 which established an incentive plan (amnesty) for the payment of property tax debts. The Act, applicable to tax years 2008-2009 and before, provided participants a 100% interest and penalties waived. Funds will be collected by the CRIM and remitted to the Municipalities. During the year 2010-2011 amnesty collections of \$433,326 and \$214,571 were recorded in the general fund and debt service fund respectively.

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, 2011 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 Areas which apply: up to \$100,000 - .30% of gross revenues, and from \$100,001 up to \$200,000 - .40%.

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 \$2,001,048 is recorded as deferred revenue.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

NOTES TO FINANCIAL STATEMENTS

June 30, 2011

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

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

- 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.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

NOTES TO FINANCIAL STATEMENTS

June 30, 2011

NOTE M – SALES AND USE TAXES - Continued

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 the 10th day of each month based on the tax collected in the preceding month. A total \$175,136 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; \$50,419 and \$32,882 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 \$24,494 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:

	Amount
Amount of municipal subsidies and equalization fund sent by CRIM	\$ 4,659,093
Compensation in lieu of tax from the Puerto Rico Electric Power Authority (PREPA)	2,487,232
Reimbursement from Commonwealth Government of Christmas Bonus expenditure	277,223
Reimbursement from Commonwealth Government of Law 52 program expenditures	19,399
Reimbursement from Commonwealth government – other programs expenditures	129,191
	\$ 7,572,138

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.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

NOTES TO FINANCIAL STATEMENTS

June 30, 2011

NOTE O – RETIREMENT PLAN - Continued

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

System 2000 is a hybrid defined contribution plan, also known as a cash balance plan. There will be a pool of pension assets, which will be invested by the System, together with those of the current defined benefit plan. Benefits at retirement age will not be guaranteed by the State government and will be subjected to the total accumulated balance of the savings account. The annuity will be based on a formula, which assumes that each year the employee's contribution (with a minimum of 8.275% of the employee's salary up to a maximum of 10%) will be invested in an account which will either: (1) earn a fixed rate based on the two-year Constant Maturity Treasury Note or, (2) earn a rate equal to 75% of the return of the System's investment portfolio (net of management fees), or (3) earn a combination of both alternatives. If 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.

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>
2011	<u>\$ 209,055</u>	<u>\$ 228,146</u>
2010	<u>\$ 236,930</u>	<u>\$ 234,155</u>
2009	<u>\$ 245,219</u>	<u>\$ 210,758</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

NOTES TO FINANCIAL STATEMENTS

June 30, 2011

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 2011, costs related to these post employment benefits amounted to \$121,650.

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 \$363,055. Management believes that the summary of the future minimum rental commitments under non-cancelable equipment leases with terms exceeding one year is not significant.

2. *Construction*

The Municipality has commitments at June 30, 2011 of approximately \$4,117,709 for construction, improvements or renovation of certain capital assets.

3. *Encumbrances*

As of June 30, 2011 the Municipality has outstanding encumbrances in the general fund of \$424,683 which are assigned for general operational purposes such as professional services, building repairs and maintenance, acquisition of fuel and lubricants, machinery, equipment and vehicles maintenance and other miscellaneous activities.

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 that the expenditures 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, certain cases whereby the legal counsel has not determined an outcome and other cases that will not be covered by insurance. However, it is the opinion of the Municipality and the legal counsels that, based on their experience, such actions and the potential liabilities will not impair the Municipality financial position.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

NOTES TO FINANCIAL STATEMENTS

June 30, 2011

NOTE S – NET ASSETS \ FUND BALANCE RESTATEMENTS

The following table disclosed the net change in net assets and fund balances at beginning of year as previously reported in the financial statements. The beginning balances have been restated as follows:

Description	Fund Balances		
	General Fund	Head Start Program Fund	Other Governmental Funds
Fund Balance / net assets, at beginning of year, as previously reported	\$ 17,030,844	\$ (171,590)	\$ 4,172,160
Reclassification of Law 52 and Law 82 Special Funds to Other Governmental Funds as a result of application of GASB Statement Number 54	91,736	-	(91,736)
Correction of an error, understatement of interfund loans balances	50,701	(50,701)	-
Fund Balance / net assets, at beginning of year, as restated	<u>\$ 17,173,281</u>	<u>\$ (222,291)</u>	<u>\$ 4,080,424</u>

NOTE T – SUBSEQUENT EVENTS

Subsequent to June 30, 2011 the Municipality issued the following long-term obligations:

1. On September 1, 2011 the Municipality issued a \$2,330,000 General Obligation Bond through the Governmental Development Bank of P.R. (GDB) for public improvements. The Bond will bear interest at 1.50% over prime rate (with a minimum of 6%) and will be due on July 1, 2028.
2. On September 22, 2011 the Municipality issued a \$3,625,000 General Obligation Note through the Governmental Development Bank of P.R. (GDB) for the acquisition of land and the construction of recreational facilities. The Note will bear interest at 1.50% over prime rate (with a minimum of 6%) and will be due on July 1, 2036.
3. On October 25, 2011 the Municipality issued a \$1,545,000 General Obligation Note through the Governmental Development Bank of P.R. (GDB) for the acquisition of properties and the construction of facilities for the Head Start program. The Note will bear interest at 1.50% over prime rate (with a minimum of 6%) and will be due on July 1, 2036.

REQUIRED SUPPLEMENTARY INFORMATION

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA

BUDGETARY COMPARISON SCHEDULE - GENERAL FUND
FISCAL YEAR ENDED JUNE 30, 2011

	Budgeted amounts		Actual Amounts (Budgetary Basis) (See Note A)	Variance with Final Budget Positive (Negative)
	Original	Final		
Revenues:				
Taxes:				
Property taxes	\$ 4,774,292	\$ 5,119,528	\$ 5,259,612	\$ 140,084
Municipal license taxes	2,481,830	2,683,813	2,813,225	129,412
Sales and use taxes	2,344,436	2,418,770	2,487,674	68,904
Intergovernmental	5,578,520	5,688,114	5,612,510	(75,604)
Fees, fines and charges for services	872,127	912,607	1,016,305	103,698
Interest	150,000	45,404	108,414	63,010
Other	75,000	644,877	572,311	(72,566)
Total revenues	16,276,205	17,513,113	17,870,051	356,938
Expenditures:				
Current:				
General government	8,720,338	8,771,840	8,485,836	286,004
Public works and sanitation	3,441,738	3,328,291	3,155,534	172,757
Public safety	1,058,599	1,038,193	1,010,803	27,390
Culture and recreation	583,822	593,017	575,401	17,616
Health	726,775	642,960	624,440	18,520
Housing, welfare and community development	1,490,679	1,443,835	1,365,654	78,181
Total expenditures	16,021,951	15,818,136	15,217,668	600,468
Excess of revenues over expenditures	254,254	1,694,977	2,652,383	957,406
Other financing uses:				
Transfers out	(254,254)	(1,694,977)	(1,684,419)	10,558
Total other financing uses	(254,254)	(1,694,977)	(1,684,419)	10,558
Excess of revenues over expenditures and other financing uses	\$ -	\$ -	\$ 967,964	\$ 967,964

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, 2011

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 assigned fund balance since they do not constitute expenditures or liabilities while on a budgetary basis encumbrances are recorded as expenditures of the 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, 2011

NOTE B - BUDGET TO GAAP RECONCILIATION - Continued

Excess of revenues and other financing sources over expenditures and other financing uses (budgetary basis):	\$	967,964
Budget to GAAP differences:		
Entity differences:		
Non budgeted funds recorded as revenues for financial reporting purposes:		2,931,945
Non budgeted funds recorded as expenditures for financial reporting:		(4,364,229)
Non budgeted transfers in:		7,509,301
Non budgeted transfers out:		(35,115)
Basis of accounting differences:		
Revenues recorded for financial reporting purposes but not in budgetary basis:		1,057,363
Expenditures recorded in budgetary basis but not for financial reporting purposes:		30,849
Expenditures recorded for financial reporting purposes but not in budgetary basis:		(657,517)
Revenues recorded in budgetary basis but not for financial reporting purposes:		(379,897)
Timing differences:		
Current year encumbrances recorded as expenditures for budgetary reporting purposes:		267,358
Prior year encumbrances recorded as expenditures for financial reporting purposes:		(129,017)
Net change in fund balance (GAAP basis):	\$	<u>7,199,005</u>

SUPPLEMENTARY INFORMATION

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

**SUPPLEMENTARY INFORMATION - FINANCIAL DATA SCHEDULE
BALANCE SHEET AND STATEMENT OF REVENUES AND EXPENSES INFORMATION
JUNE 30, 2011**

Line Item No.	Description	14,871
Balance Sheet		Housing Choice Vouchers
111	Cash - unrestricted	\$ 106,011
113	Cash - other restricted	\$ 61,109
100	Total cash	\$ 167,120
121	Accounts receivable - PHA projects	\$ 4,507
125	Accounts receivable - miscellaneous	\$ 592
126.2	Allowance for doubtful accounts - other	\$ (1,768)
120	Total receivables, net of allowance for doubtful accounts	\$ 3,331
150	Total Current Assets	\$ 170,451
164	Furniture, equipment and machinery - administration	\$ 26,450
166	Accumulated depreciation	\$ (13,917)
160	Total capital assets, net of accumulated depreciation	\$ 12,533
180	Total Non-current Assets	\$ 12,533
190	Total Assets	\$ 182,984
312	Accounts payable <= 90 days	\$ 474
322	Accrued compensated absences - current portion	\$ 3,196
332	Accounts Payable - PHA Projects	\$ 6,951
333	Accounts payable - other government	\$ 8,216
310	Total Current Liabilities	\$ 18,837
353	Non-current liabilities - other	\$ 1,979
350	Total Non-current Liabilities	\$ 1,979
300	Total Liabilities	\$ 20,816
508.1	Invested in Capital Assets, Net of Related Debt	\$ 12,533
511.1	Restricted Net Assets	\$ 60,759
512.1	Unrestricted Net Assets	\$ 88,876
513	Total Equity/Net Assets	\$ 162,168
600	Total Liabilities and Equity/Net Assets	\$ 182,984
Income Statement		
70600-010	Housing assistance payments	\$ 307,326
70600-020	Ongoing administrative fees earned	\$ 55,263
70600-070	Admin fee calculation description	
70600	HUD PHA operating grants	\$ 362,589
71500	Other revenue	\$ 9,656
700	Total Revenue	\$ 372,245
91100	Administrative salaries	\$ 34,524
91200	Auditing fees	\$ 5,000
91500	Employee benefit contributions- administrative	\$ 5,527
91600	Office expenses	\$ 2,121
91800	Travel	\$ 142

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

**SUPPLEMENTARY INFORMATION - FINANCIAL DATA SCHEDULE
BALANCE SHEET AND STATEMENT OF REVENUES AND EXPENSES INFORMATION
JUNE 30, 2011**

Line Item No.	Description	14,871
		Housing Choice Vouchers
91000	Total Operating - Administrative	\$ 47,314
96200	Other general expenses	\$ 913
96210	Compensated absences	\$ -
96600	Bad debt - other	\$ -
96000	Total Other General Expenses	\$ 913
96900	Total Operating Expenses	\$ 48,227
97000	Excess Revenue Over Operating Expenses	\$ 324,018
97300-050	All Other	\$ 315,479
97300	Housing assistance payments	\$ 315,479
97350	HAP Portability-in	\$ 8,290
97400	Depreciation expense	\$ 2,259
900	Total Expenses	\$ 374,255
10000	Excess (Deficiency) of Revenue Over (Under) Expenses	\$ (2,010)
11030	Beginning equity	\$ 164,178
11770-001	Administrative Fee Equity - Beginning Balance	\$ 95,268
11170-010	Administrative Fee Revenue	\$ 55,263
11170-020	Hard to House Fee Revenue	\$ -
11170-021	FSS Coordinator Grant	\$ -
11170-030	Audit Costs	\$ -
11170-040	Investment Income	\$ -
11170-045	Fraud Recovery Revenue	\$ -
11170-050	Other Revenue	\$ 9,654
11170-051	Comment For Other Revenue	\$ 64,917
11170-060	Total Admin Fee Revenues	\$ 48,227
11170-080	Total Operating Expenses	\$ 2,259
11170-090	Depreciation	\$ 8,290
11170-095	Housing Assistance Portability In	\$ -
11170-100	Other Expenses	\$ -
11170-101	Comment For Other Expense	\$ 58,776
11170-110	Total Expenses	\$ 6,141
11170-002	Net Administrative Fee	\$ 101,409
11170-003	Administrative Fee Equity - Ending Balance	\$ 101,409
11170	Administrative Fee Equity	\$ 101,409
11180-001	Housing Assistance Payments Equity - Beginning Balance	\$ 68,910
11180-010	Housing Assistance Payments Revenues	\$ 307,326

This amount corresponds to the administrative fees earned on the portability-in vouchers administered by the Municipality (\$1,364) plus the reimbursement received from the initial PHAs of the HAP rent payments made on behalf of the portability-in units during 10-11 (\$8,290).

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

**SUPPLEMENTARY INFORMATION - FINANCIAL DATA SCHEDULE
BALANCE SHEET AND STATEMENT OF REVENUES AND EXPENSES INFORMATION
JUNE 30, 2011**

		14.871
Line Item No.	Description	Housing Choice Vouchers
11180-015	Fraud Recovery Revenue	\$ -
11180-020	Other Revenue	\$ 2
11180-021	Comment For Other Revenue	This amount corresponds to the elimination of rent & utilities allowance checks that were outstanding for more than one year.
11180-025	Investment Income	\$ -
11180-030	Total HAP Revenues	\$ 307,328
11180-080	Housing Assistance Payments	\$ 315,479
11180-100	Total Housing Assistance Payments Expenses	\$ 315,479
11180-002	Net Housing Assistance Payments	\$ (8,151)
11180-003	Housing Assistance Payments Equity - Ending Balance	\$ 60,759
11180	Housing Assistance Payments Equity	\$ 60,759
11190-210	Total ACC HCV Units	1,032
11190	Unit Months Available	1,032
11210	Unit Months Leased	933

The accompanying notes are an integral part of this schedule.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

NOTE TO SUPPLEMENTARY INFORMATION - FINANCIAL DATA SCHEDULE

June 30, 2011

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.

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FISCAL YEAR ENDED JUNE 30, 2011

Federal Grantor/Pass Through Grantor/Program Title	Federal CFDA Number (note B)	Pass-Through Entity Identifying Number (note B)	Federal Expenditures (notes A and B)
U.S. Department of Agriculture			
Passed-through program from:			
<u>P.R. Department of Education</u> Child and Adult Care Food Program	10.558	CCC-27	\$ 111,684
U.S. Department of Housing and Urban Development			
Direct programs:			
Section 8 Housing Choice Vouchers Program	14.871	N/A	362,589
CDBG - Entitlement Grants Cluster:			
Community Development Block Grants / Entitlement Grants	14.218	N/A	1,407,977
Community Development Block Grant_ Section 108 Loan Guarantees	14.248	N/A	2,084,014
ARRA - Homeless Prevention and Rapid Re-Housing Program Technical Assistance	14.262	N/A	180,223
Passed-through programs from:			
<u>Office of Commissioner of Municipal Affairs</u> Community Development Block Grant / State's Program (State-Administered Small Cities Program)	14.228	FD-32, AF-32, AB-32, FC-32	1,143
<u>P.R. Department of Family</u> Emergency Shelter Grants Program	14.231	S10DC72001	14,476
<u>Municipality of San Juan</u> Housing Opportunities for Persons with AIDS (HOPWA)	14.241	L011-V00058	4,023
Subtotal U.S. Department of Housing and Urban Development			<u>4,054,445</u>
U.S. Department of Justice			
Passed-through program from:			
<u>P.R. Department of Justice</u> ARRA - Edward Byrne Memorial Justice Assistance Program - Grants to States and Territories (JAG)	16.803	2009-SU-B9-0053	29,995
U.S. Department of Transportation			
Direct program:			
Federal Transit Formula Grants	20.507	PR-80-0004	\$ 49,000
Passed-through program from:			
<u>P.R. Traffic Safety Commission</u> State and Community Highway Safety	20.600	11-03-78, 11-06-21	41,215
Subtotal U.S. Department of Transportation			<u>90,215</u>
U.S. Department of Energy			
Passed-through program from:			
<u>P.R. Energy Affairs Administration</u> ARRA - Energy Efficiency and Conservation Block Grant Program (EECBG)	81.128	EE0002296	113,084
U.S. Department of Health and Human Services			
Direct programs:			
Head Start Cluster:			
Head Start	93.600	N/A	803,750
ARRA - Head Start	93.708	N/A	1,432,780
Total Head Start Cluster:			<u>2,236,530</u>
Passed-through programs from:			
<u>P.R. Office of the Ombudsman for the Elderly:</u>			
Aging Cluster:			
Special Programs for the Aging_ Title III Part B_ Grants for Supportive Services and Senior Centers	93.044	100254R2	59,766
ARRA - Aging Congregate Nutrition Services for States	93.707	090248R2	8,686
Total Aging Cluster:			<u>68,452</u>
<u>P.R. Department of Family - Families and Children Administration:</u>			
CCDF Cluster:			
Child Care and Development Block Grant	93.575	2010-11-059	355,049
ARRA - Child Care and Development Block Grant	93.713	G-0901-PRCCD7, ARRA - 080	34,567
Total CCDF Cluster:			<u>389,616</u>
Subtotal U.S. Department of Health and Human Services:			<u>2,694,598</u>
U.S. Department of Homeland Security			
Passed-through programs from:			
<u>P.R. Governor Office - Office of Public Safety Affairs:</u> Citizens Corps	97.053	N/A	2,379
Total Expenditures of Federal Awards			<u>\$ 7,096,400</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, 2011

NOTE A – BASIS OF PRESENTATION

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of the Municipality under programs of the federal government for the year ended June 30, 2010. 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. Because the schedule presents only a selected portion of the operations of the Municipality, it is not intended to and does not present the financial position and changes in net assets of the Municipality.

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Expenditures reported on the Schedule are reported on the modified accrual basis of accounting. Such expenditures are recognized when the related liability is incurred following the cost principles contained in OMB Circular A-87 *Cost Principles for State, Local and Indian Tribal Governments*, wherein certain types of expenditures are not allowable or are limited as to reimbursement.

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.

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

CFDA No. / Description	Community Development Block Grant Program Fund	Head Start Program Fund	Other Governmental Funds
10.558	\$ -	\$ -	\$ 111,684
14.871	-	-	362,589
14.218	1,407,977	-	-
14.248	2,084,014	-	-
14.228	1,143	-	-
14.241	-	-	4,023
ARRA – 14.262	-	-	180,223
16.803	-	-	29,995
20.507	-	-	49,000
20.600	-	-	41,215
ARRA – 81.128	-	-	113,084
93.600	-	803,750	-
ARRA – 93.708	-	1,432,780	-

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

June 30, 2011

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

<u>CFDA No. / Description</u>	<u>Community Development Block Grant Program Fund</u>	<u>Head Start Program Fund</u>	<u>Other Governmental Funds</u>
93.044	-	-	59,766
ARRA – 93.707	-	-	8,686
93.575	-	-	355,049
ARRA – 93.713	-	-	34,567
Total federal awards expenditures:	3,493,134	2,236,530	1,349,881
Total non-federal awards expenditures:	-	-	2,183,572
Total expenditures, fund statements:	<u>\$ 3,493,134</u>	<u>\$ 2,236,530</u>	<u>\$ 3,533,453</u>

NOTE E – LOAN GUARANTEE LOAN OUTSTANDING

On October 1, 2007 and August 20, 2009 the Municipality received \$1,200,000 and \$3,650,000 respectively on advance funds under a \$4,850,000 variable/fixed rate note dated June 29, 2009. The VRF Note was designed to convert to a fixed rate note on its Conversion Date. On July 21, 2010 the variable/fixed rate note was converted to a \$4,312,000 4.21% note due on August 1, 2026. The face amount of the note was based on the outstanding balance of the cumulative amount of advances the Municipality received on or before the conversion date. The federal award will finance the construction of a Youth Sports and Education Center. The Municipality expended \$2,084,014 from these proceeds during fiscal year 2010-2011. The following represents the loan outstanding balance as of June 30, 2011:

<u>CFDA No.</u>	<u>Program Name</u>	<u>Loan Outstanding Balance</u>
14.248	Community Development Block Grants_ Section 108 Loan Guarantees	<u>\$ 4,312,000</u>

NOTE F – SUBRECIPIENTS

Of the federal expenditures presented in the schedule, the Municipality provided federal awards to subrecipients as follows:

<u>CFDA No.</u>	<u>Program Name</u>	<u>Amount Provided to Subrecipients</u>
14.262	ARRA – Homeless Prevention and Rapid-Re-Housing Program Technical Assistance	<u>\$ 180,223</u>

**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**

The Honorable Mayor, Members of
the Municipal Legislature of
the Municipality of Isabela
Isabela, PR, 00622

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the **Municipality of Isabela** of the Commonwealth of Puerto Rico (the "Municipality"), as of and for the year ended June 30, 2011, which collectively comprise the Municipality's basic financial statements and have issued our report thereon dated February 29, 2012. 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 opinions 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 *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, 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.

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS (CONTINUED)

Compliance and Other Matters

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

González Torres & Co., CPA, PSC
GONZALEZ TORRES & CO., CPA PSC

San Juan, Puerto Rico
February 29, 2012

Stamp No. 2632030 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.



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

The Honorable Mayor, Members of
the Municipal Legislature of
the Municipality of Isabela
Isabela, PR, 00622

Compliance

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

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

In our opinion, the Municipality complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2011. The results of our auditing procedures did not disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133

REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133 (CONTINUED)

Internal Control Over Compliance

Management of the Municipality is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the Municipality's internal control over compliance with the requirements that could have a direct and material effect on a major federal program to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Municipality's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be deficiencies, 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.

This report is intended for the information of the management 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.

San Juan, Puerto Rico
February 29, 2012

Stamp No. 2632030 of the Puerto Rico Society of Certified Public Accountants was affixed to the record copy of this report.

Gonzalez Torres Jno. CPA, PSC
GONZALEZ TORRES & CO., CPA PSC



COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
YEAR ENDED JUNE 30, 2011

Section I - Summary of Auditors' Results

Financial Statements

Type of auditors' report issued:

Unqualified

Internal control over financial reporting:

Material weakness identified?

Yes ___.

No X

Significant deficiencies identified not considered to be material weaknesses?

Yes ___

No X

Noncompliance material to financial statements noted?

Yes ___

No X

Federal awards

Internal Control over major programs:

Material weakness identified?

Yes ___

No X

Significant deficiencies identified not considered to be material weaknesses?

Yes ___

No X

Type of auditors' report issued on compliance for major programs:

Unqualified

Any audit findings disclosed that are required to be reported in accordance with Circular A-133, Section .510(a)?

Yes ___

No X

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
YEAR ENDED JUNE 30, 2011

Section I - Summary of Auditors' Results (Continued)

Identification of major program

<u>CFDA Number</u>	<u>Name of Federal Program or Cluster</u>
14.871	Section 8 Housing Choice Vouchers Program
14.218	Community Development Block Grants / Entitlement Grants
14.248	Community Development Block Grant_ Section 108 Loan Guarantees
93.600	Head Start
93.708	ARRA – Head Start
93.575	Child Care and Development Block Grant
93.713	ARRA - Child Care and Development Block Grant

Dollar threshold used to distinguish between Type A and Type B programs

\$300,000

Auditee qualified as low-risk auditee?

Yes ___ No X

Waive risk criteria under 520 (i) of Circular A-133?

Yes ___ No X

Section II – Financial Statements Findings

NONE

Section III – Federal Award Findings and Questioned Costs

NONE