

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

**MUNICIPIO DE ISABELA
AUDITORÍA 2012-2013
30 DE JUNIO DE 2013**

OCAM
DIV. SERVICIOS GENERALES
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**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, 2013***



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

***CPA Marisol Rosa Acevedo
Municipal Administrator***

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

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INDEPENDENT AUDITOR'S REPORT

Hon. Carlos Delgado Altieri and
Members of the Municipal Legislature of the
Commonwealth of Puerto Rico
Municipality of Isabela
Isabela, Puerto Rico

Report on the Financial Statements

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of Commonwealth of Puerto Rico, Municipality of Isabela, as of and for the year ended June 30, 2013, and the related notes to the financial statements, which collectively comprise the Municipality's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

INDEPENDENT AUDITOR'S REPORT (CONTINUED)

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

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 Commonwealth of Puerto Rico, Municipality of Isabela, as of June 30, 2013, and the respective changes in financial position thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and budgetary comparison information on pages 5-15 and 63-65 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.

Other Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Commonwealth of Puerto Rico, Municipality of Isabela's basic financial statements. The supplementary information shown in pages 66 through 70, are presented for purposes of additional analysis as required by the U.S. Department of Housing and Urban Development, Office of the Inspector General, and is not a required part of the financial statements. The 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 basic financial statements.

INDEPENDENT AUDITOR'S REPORT (CONTINUED)

The supplementary information 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 basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the supplementary and the schedule of expenditures of federal awards are fairly stated in all material respects in relation to the basic financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated March 14, 2014, on our consideration of the Commonwealth of Puerto Rico, Municipality of Isabela'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* in considering Commonwealth of Puerto Rico, Municipality of Isabela's internal control over financial reporting and compliance.

San Juan, Puerto Rico
March 14, 2014

The stamp number 02698441
was affixed to the original report


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MANAGEMENT'S DISCUSSION AND ANALYSIS

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA
MANAGEMENT'S DISCUSSION AND ANALYSIS
Fiscal year ended June 30, 2013**

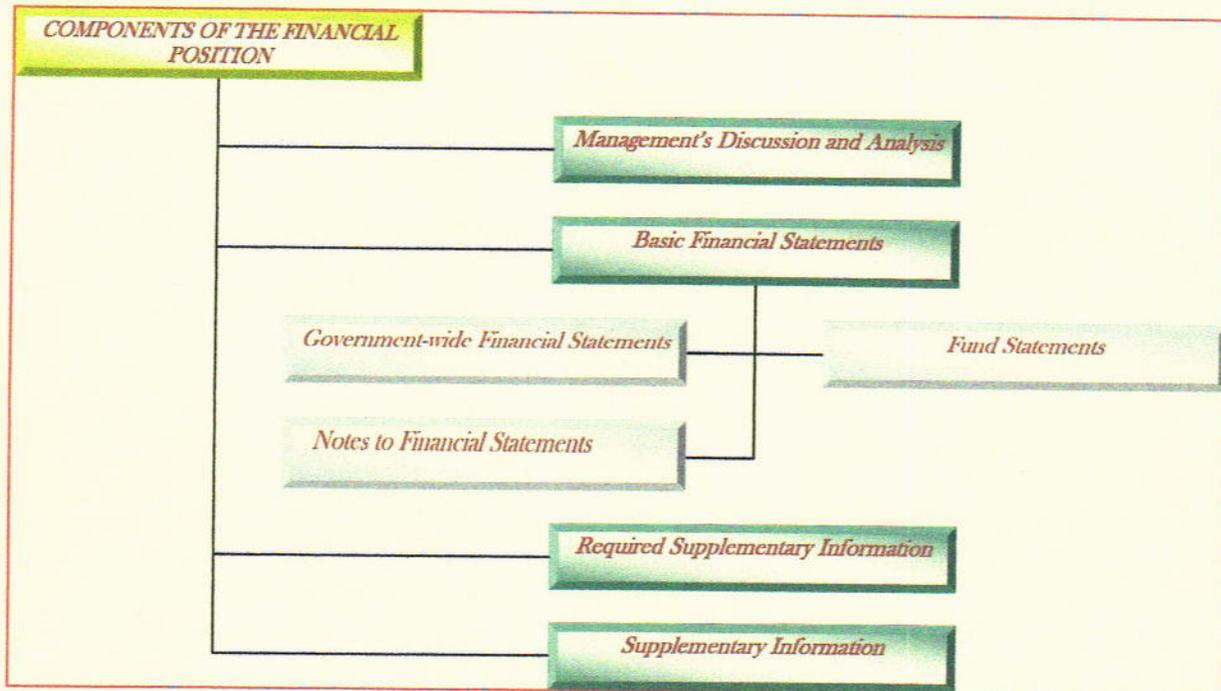
The discussion and analysis of the Municipality of Isabela's financial performance provides an overall view of the Municipality's financial activities for the year ended June 30, 2013. The purpose of this Management's Discussion and Analysis is to look at the Municipality's financial performance as a 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

- The assets of the Municipality, on a government-wide basis, exceeded its liabilities at the close of fiscal year 2013 by \$72,222,172 (net position). Of this amount, \$11,442,023 represents unrestricted net position, which may be used to meet the government's ongoing obligations to citizens and creditors.
- Revenues decreased 8% and expenses decreased 4% when compared with fiscal year 2012. As a result, the net position decreased \$1,284,338 or 40% with respect of prior year restated change in net position.
- A net change (decrease) in the fund balances of the Municipality's governmental funds of \$(2,804,528) in the fiscal year 2013 resulted in reported ending fund balances of \$34,033,613, decreasing 8% with respect to 2012 year. Approximately 63% of the total fund balances is unrestricted (committed, assigned or unassigned).
- For the fiscal year 2013, the General Fund reported a deficiency of revenues and other financing sources over expenditures and other financing uses of \$(1,068,625). The unassigned fund balance amounts to \$14,372,276 or an increase of 12% as compared to 2012.
- The investment in capital assets as of June 30, 2013 was \$64,817,416 (net of depreciation).
- Long-term debt decreased to \$30,976,204 or approximately 1% with respect to the prior year.
- On a budgetary basis, actual revenues exceeded actual expenditures by \$1,722,837.

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) other supplementary information.



COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA
MANAGEMENT'S DISCUSSION AND ANALYSIS
Fiscal year ended June 30, 2013

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 position* presents all of the reporting entity's non-fiduciary assets, deferred outflows, liabilities and deferred inflows, with the difference reported as net position. Over time, increases or decreases in the Municipality's net position 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 position changed during the year. All of the current year's revenues and expenses are taken into account in the statement of activities regardless of when cash is received or paid.

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

- ***Fund Financial Statements***

The fund financial statements provide more detailed information about the Municipality's most significant funds. Funds are accounting devices that the Municipality uses to keep track of specific sources of funding and spending for particular purposes. Some funds are required by Federal and Commonwealth regulations, as well 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 spendable 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 that is, a percentage of the assets and deferred outflows; liabilities and deferred inflows; revenues or expenditures or based on the Municipality's official's criteria if the fund is particularly important to financial statement users. Funds that do not comply with this criterion are grouped and presented in a single column as other governmental funds.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA
MANAGEMENT'S DISCUSSION AND ANALYSIS
Fiscal year ended June 30, 2013**

• *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 also includes a financial data schedule containing financial information of the Section 8 Housing Choice Voucher Program administered by the Municipality.

FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE

Net Position

The following table presents a summary of the Statements of Net Position as of June 30, 2013 and 2012:

TABLE 1

<i>Summary Statement of Net Position As of June 30,</i>		
	Governmental Activities	
	2013	2012
Assets		
Current and other assets	\$ 44,336,135	\$ 46,239,853
Capital assets	64,817,416	60,512,945
Total assets	<u>109,153,551</u>	<u>106,752,798</u>
Liabilities		
Current and other liabilities	8,271,485	5,062,812
Long-term liabilities	28,659,894	31,383,701
Total liabilities	<u>36,931,379</u>	<u>36,446,513</u>
Net Position		
Net investment in capital assets	51,452,920	49,178,253
Restricted	9,327,229	9,128,906
Unrestricted	11,442,023	11,999,126
Total net position	<u>\$ 72,222,172</u>	<u>\$ 70,306,285</u>

Net position (difference of non-fiduciary assets, deferred outflows versus liabilities and deferred inflows) serve as a useful indicator of a government's financial position. Over time, increases or decreases in the Municipality's net position is one indicator of whether its financial health is improving or deteriorating. At June 30, 2013, assets exceeded its liabilities by \$72,222,172. Of this amount, \$11,442,023 represents unrestricted net position, which may be used to meet the government's ongoing obligations to citizens and creditors. Restricted net position represents resources that are subject to external restrictions on how they may be used.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA
MANAGEMENT'S DISCUSSION AND ANALYSIS
Fiscal year ended June 30, 2013

The largest portion of the Municipality's net position (71 percent) reflects its investment in capital assets (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.

Net position reported an increase of 3% with respect to fiscal period 2012.

Changes in net position

The following table summarizes the changes in net position for the fiscal years ended 2013 and 2012:

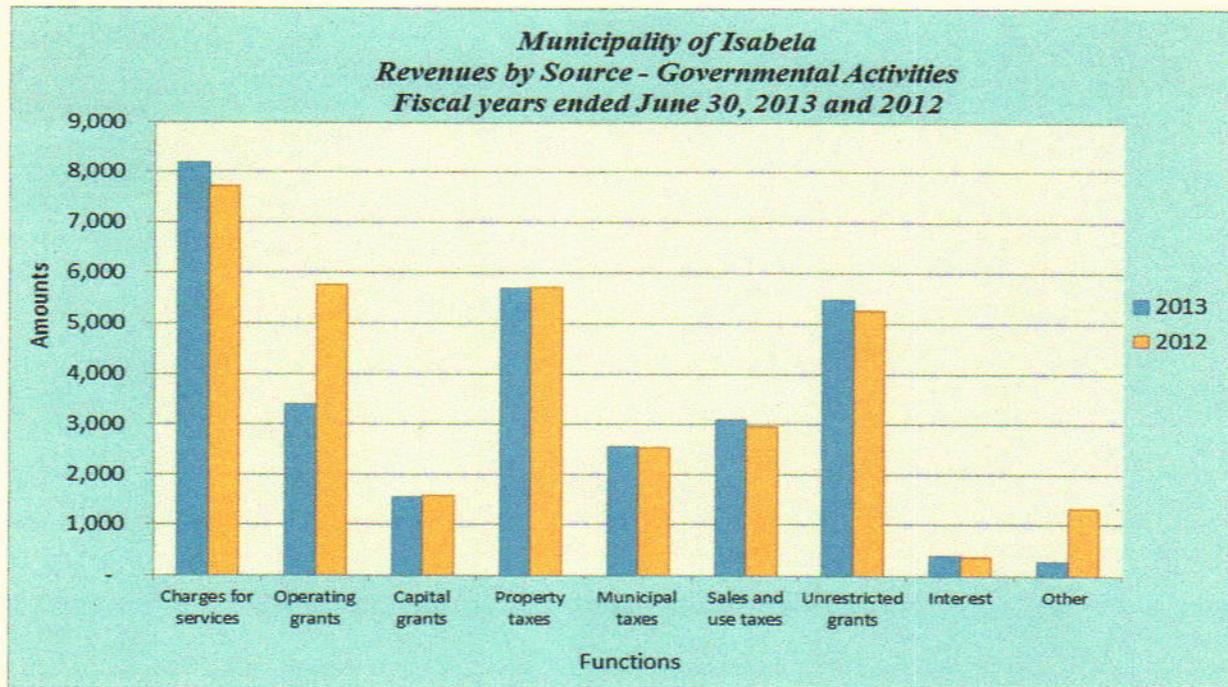
TABLE 2

<i>Summary of Changes in Net Position</i>		
<i>Fiscal Year ended June 30,</i>		
	Governmental Activities	
	2013	2012
Program revenues:		
Fees, fines and charges for services	\$ 8,186,817	\$ 7,699,021
Operating grants and contributions	3,419,030	5,755,048
Capital grants and contributions	1,559,456	1,588,668
General revenues:		
Property taxes	5,692,583	5,710,646
Municipal license taxes	2,565,969	2,531,481
Sales and use taxes	3,090,884	2,962,169
Grants and contributions not restricted to specific programs	5,475,240	5,259,170
Interest	402,525	366,437
Other	271,131	1,323,183
Total revenues	30,663,635	33,195,823
Expenses:		
General government	11,001,545	10,710,720
Public works and sanitation	4,710,798	6,100,900
Public safety	1,298,100	1,275,452
Culture and recreation	1,540,612	1,434,773
Health	4,219,028	3,647,984
Housing, welfare and community development	2,955,562	2,860,602
Education	2,277,394	3,347,507
Interest on long term debt	744,709	617,660
Total expenses	28,747,748	29,995,598
Change in net position	1,915,887	3,200,225
Net position-beginning of year	70,306,285	67,106,060
Net position-end of year	\$ 72,222,172	\$ 70,306,285

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA
MANAGEMENT'S DISCUSSION AND ANALYSIS
Fiscal year ended June 30, 2013**

The four major sources of revenues of the Municipality in fiscal year 2013 are: charges for services (27%), property taxes (19%), unrestricted grants and contributions (18%), and operating grants (11%). Revenues decreased 8%. This net decrease is due mainly to a 41% decrease in operating grants revenue due to (1) a significant reduction of ARRA funds for Early Head Start, Head Start-Expansion, Edward Byrne (JAG) and Homeless Prevention Program and, (2) a single-year grant from P.R. Infrastructure Financing Authority for capital improvements to the Municipal solid waste landfill received in 2012. Furthermore, other revenues decrease 80% due to donated machinery and equipment for a total amount of \$834,601 in 2012 and less miscellaneous income received in 2013. The following **Figure 1** illustrates the revenue comparison between 2013 and 2012:

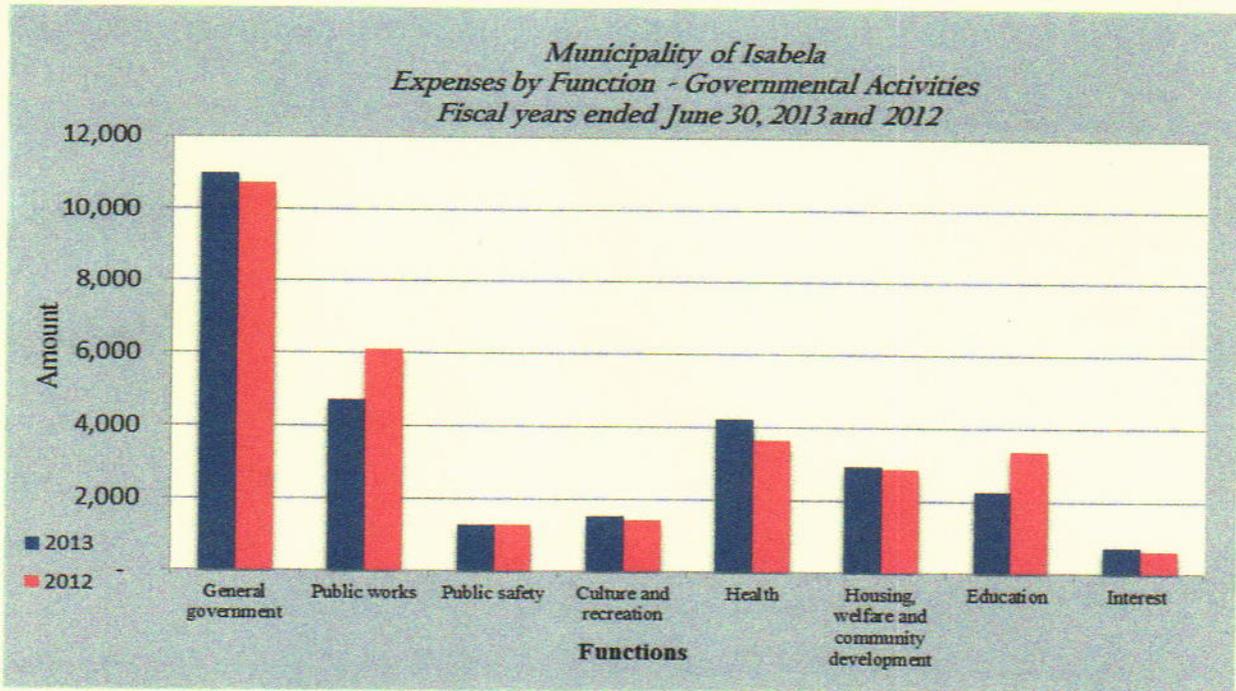
Figure 1



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA
MANAGEMENT'S DISCUSSION AND ANALYSIS
Fiscal year ended June 30, 2013**

The Municipality's expenses cover a range of services. The largest expenses are general government with 38%, public works and sanitation with 16% and health with 15%. The following **Figure 2** illustrates the expenses comparison between 2013 and 2012:

Figure 2



Total expenses reported a net decrease of 4% when compared with fiscal year 2012. The main reason is the net effect of (1) a decrease of 23% in public works expenses due to less costs related to solid waste landfill for payments to solid waste company and amortization of closure and post-closure care expense; (2) a decrease of 32% in education due to a significant reduction of ARRA funds for Early Head Start and Head Start-Expansion; (3) increase of 21% in interest expense due to payments of interest on new debt issued during 2012 year and (4) increase of 16% in health expense due to an increase in costs related to the operation of the Municipality's health center ("CIMA"). The decrease in revenues exceeds by 4% the decrease in expenses. As a result, the change in net position of \$1,915,887 decreased with respect of prior year change in net position of \$3,200,225.

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 direct expenses, including depreciation, by related program revenues, operating and capital grants, and contributions. The following table discloses 2013 and 2012 expenses net of program revenue and the general revenues available to finance remaining costs:

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA
MANAGEMENT'S DISCUSSION AND ANALYSIS
Fiscal year ended June 30, 2013**

TABLE 3

<i>Expenses Net of Program Revenues Fiscal Year ended June 30, 2013</i>		
Net expenses	2013	2012
General government	\$ (5,940,813)	\$ (5,465,432)
Public works and sanitation	(4,074,060)	(4,600,477)
Public safety	(1,248,837)	(952,820)
Culture and recreation	(1,519,880)	(1,288,747)
Health	(607,404)	(631,720)
Housing, welfare and community development	(1,171,281)	(1,054,601)
Education	(275,461)	(341,407)
Interest on long term debt	(744,709)	(617,660)
Total expenses, net of program revenues	(15,582,445)	(14,952,864)
General revenues		
Taxes	11,349,436	11,204,296
Grants and contributions not restricted to specific programs	5,475,240	5,259,170
Interest and other	673,656	1,689,620
Total general revenues	17,498,332	18,153,086
Change in net position	\$ 1,915,887	\$ 3,200,225

For the current and previous year the Municipality fully recovered its expenses with general revenues.

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 as they represent the portion of fund balance which has not yet been limited to use for a particular purpose by either an external party.

For the fiscal year ended June 30, 2013, the governmental funds reported ending fund balances of \$34,033,613, a net decrease of 8% in comparison with the prior year. Of the total fund balances, \$21,431,446 (or 63%) constitutes unrestricted fund balance, of which \$12,605,331 (or 37%) are unassigned funds. The remainder of the fund balances is restricted to indicate that it is not available for new spending. Following is a summary of the financial analysis of the Municipality's major funds:

- **General Fund**

The general fund is the operating fund of the Municipality. The fund balance of the general fund represents approximately 70% of total ending fund balances. Of the total fund balance 17% of the fund balance is committed and 20% is assigned for public works, health and capital projects. The remainder of the unrestricted fund balance of \$14,372,276 is unassigned fund balance, which represents 61% of the total fund balance of the general fund. Unassigned fund balance increased 12% with respect to the prior year.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA
MANAGEMENT'S DISCUSSION AND ANALYSIS
Fiscal year ended June 30, 2013

As more fully described in Note S of the basic financial statements, the total fund balance of the general fund is distributed between (1) Fund 01 of \$14,964,811 and, (2) other special funds of \$8,705,377. These special funds represent activities of the general fund which fund balance is restricted, committed or assigned for specific purposes.

During the fiscal year the fund balances of the general fund presented a negative net change of \$(1,068,625). The main sources of revenues of the general fund in fiscal year 2013 are: taxes (property taxes, sales and use taxes and municipal license taxes) with 39%, charges for services with 35%, and intergovernmental subsidies from the Commonwealth with 24%. Revenues increased 6% in comparison to 2012 due to increases in intergovernmental revenues and charges for services. The largest expenditures of the general fund are general government with 38%, health with 18% and capital outlays with 16%. Expenditures increased 12% as compared to 2012 year due to increases in general government, health and capital outlays. As disclosed above, the general fund is distributed between Fund 01 and other special funds. The decrease in general fund of \$(1,068,625) is the net effect of: (1) a positive change in fund balance of \$1,560,783 in Fund 01 and, (2) a negative change of \$(2,629,408) in the other special funds. The negative net change in fund balance of \$(2,629,408) was caused by capital outlays for the construction of a sports complex from a special fund whose resources were earned or provided in previous years but funds were expended in current year.

- ***USDHUD - Community Development Block Grant Program Fund("CDBG")***

The CDBG Fund is composed of the following individual funds: CDBG Entitlement and Section 108 Loan Guarantee. With respect to previous year, the CDBG fund operation presents a decrease in expenditures. In 2012 the Municipality expended resources in capital projects financed with CDBG or Section 108 Loan Guarantee funds that were finished in 2012 or early in 2013, including the Youth Sports and Education Center. Fund balance presents a deficit as liabilities and deferred inflows of resources exceed assets for unavailable revenues recorded.

- ***USDHHS-USDA Head Start Program Fund***

The fund reports the transactions of the following individual funds: USDHHS-Head Start Program Fund, USDHHS-ARRA Early Head Start Fund, USDHHS-ARRA Head Start Expansion and the USDA-PRDE-Head Start Food Program Fund. The fund presents a 30% decrease in expenditures with respect to 2012 due to a significant reduction of ARRA funds for Early Head Start and Head Start-Expansion. Fund balance presents a deficit as liabilities and deferred inflows of resources exceed assets for unavailable revenues recorded.

- ***Debt Service Fund***

The debt service fund accounts for the resources of three individual funds including the "Fondo 10 - CAE Fund" (sinking fund which accounts for the 2% of property taxes collected by the CRIM), "Fondo 11 - CRIM Fund (resources transferred from general fund to CRIM for debt service) and the "Municipal Redemption Fund" (.2% of the .5% from sales and use taxes will deposited in GDB to finance loans to Municipalities. The Fund presents an increase of 18% in total expenditures for interest on new debt issued in 2012. Notwithstanding, the Fund reported a positive net change of \$923,920 to bring the year-end fund balance to \$3,951,630 which represents 12% of total fund balances. Revenues decreased slightly 1% versus 2012.

- ***Commonwealth Legislature Fund***

This fund report revenue sources from grants provided by the Commonwealth's Legislature restricted for specific purposes. During the 2013 the fund balance decreased \$249,285. The fund received additional grants of \$20,000. Amounts were expended in public works, welfare projects and capital outlays. There were no significant expenditures with respect to previous year operation.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA
MANAGEMENT'S DISCUSSION AND ANALYSIS
Fiscal year ended June 30, 2013**

- **Bonds and Notes Issuance Fund**

The Municipality reports in this fund the bonds and notes issued through the Governmental Development Bank of Puerto Rico ("GDB") and during 2013 the transactions related to the issuance of bond anticipation notes issued by Rural Development. The fund expended \$1,823,524 in capital projects during 2013.

- **USDHHS-USDA Child Care Program Fund**

The fund reports the transactions of the following individual funds: USDHHS-Child Care Program Fund, Child Care Summer Camp Fund and the USDA-PRDE-Child and Adult Care Food Program Fund. There were no significant expenditures with respect to previous year operation. Fund balance presents a deficit as liabilities and deferred inflows of resources exceed assets for unavailable revenues recorded.

GENERAL FUND BUDGETARY HIGHLIGHTS

The general fund original budget for the fiscal year 2012-2013 presented only a .4% increase with respect to the prior year budget. Amendments of \$1,393,372 increasing the original budget to \$18,006,025 were approved by the Municipal Legislature. Actual revenues exceeded revised budgeted revenues by \$781,895 (net). The Municipality also reported a positive variance of \$940,942 between revised budgeted appropriations and actual expenditures. Actual revenues exceeded actual expenditures by \$1,722,837.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital assets

At the end of the fiscal year, the Municipality has invested \$64,817,416 (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 7% over the prior year. **Table 4** summarizes the Municipality's capital assets as of June 30, 2013:

<i>Capital Assets, net As of June 30,</i>		
	Governmental Activities	
	2013	2012
Non-depreciable assets:		
Land	\$ 5,475,030	\$ 5,355,029
Construction in progress	8,968,566	13,915,668
Depreciable assets:		
Land improvements	814,147	829,714
Leasehold improvements	-	275,129
Buildings and buildings improvements	27,540,414	17,715,965
Infrastructure	17,368,760	17,186,405
Vehicles, machinery and equipment	4,650,499	5,235,035
Total	\$ 64,817,416	\$ 60,512,945

The Municipality's major capital projects that were still in construction and the related construction in progress cost as of June 30, 2013 are as follows:

- Improvements to the downtown electrical infrastructure - \$5,081,662
- Expansion – Head Start Facilities - \$1,655,941
- Construction of Sports Center – Basketball Court - \$1,716,273

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA
MANAGEMENT'S DISCUSSION AND ANALYSIS
Fiscal year ended June 30, 2013

The following projects were finished during 2012-2013 and transferred from construction in progress to building and building improvements:

- Construction of Youth Sport and Educational Center - \$7,065,761
- Construction of Sports Center – Baseball park - \$2,076,222
- Recreational facilities in San Antonio de la Tuna Ward - \$525,355
- Improvements to basketball court – “Sector Capiro” - \$448,520

Other major capital assets additions include infrastructure projects for a total amount of \$640,290. More detailed information about the Municipality’s capital assets is presented in Note G to the financial statements.

Long term debt

At year-end, the Municipality had \$15,804,024 in general and special bonds and notes, a decrease of 4% with respect to prior year. The following is a summary of the Municipality’s outstanding debt as of June 30, 2013 and 2012:

TABLE 5
Outstanding Long-term Debt
As of June 30,

	Governmental Activities	
	2013	2012
General and special obligation bonds and notes	\$ 15,804,024	\$ 16,397,024
Bond Anticipation Note	102,918	-
Note Payable to CRIM – prior years delinquent		
Accounts	54,728	57,608
Note payable-Section 108 Loan Guarantee	3,774,000	4,043,000
Landfill obligation	6,975,627	6,688,381
Compensated absences	2,928,509	2,960,694
Christmas Bonus	312,676	337,975
Claims and judgments	97,000	-
Payable to CRIM – property tax advances	-	1,054
Payable to PREPA	926,722	897,965
Total	\$ 30,976,204	\$ 31,383,701

The Municipality has no significant change with respect to 2012 year. More detailed information about the Municipality’s long term liabilities is presented in Note H to the financial statements.

ECONOMIC FACTORS AND NEXT YEAR’S BUDGET

The Municipality’s officials considered certain factors when establishing the fiscal year’s 2013-2014 budget. One of these factors is the economy. Among economic areas considered are the estimates for the growth or decline in population, personal income, housing statistics and unemployment rates. The Municipality’s unemployment rate at June 2013 stands at 13%, and the Commonwealth rate stands at 13.8%.

For year 2013-2014 the Municipality applied a conservative approach in the development of budget estimates. Amounts available for appropriations in the General Fund are \$16,248,128 representing a decrease of approximately 2% with respect to prior year estimates. Budgeted expenditures are expected to rise according to the increase of budgeted revenues. If these estimates are realized, the Municipality’s budgetary general fund balance is expected to increase modestly by the close of the 2013-2014 fiscal year. In addition to the general fund estimated budget the Municipality plans to submit to the Federal and Commonwealth government fund proposals for welfare and community development as well as permanent capital improvements and public works.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA
MANAGEMENT'S DISCUSSION AND ANALYSIS
Fiscal year ended June 30, 2013

As more fully described in Note U the Commonwealth of Puerto Rico is facing a financial crisis due to limited liquidity, general fund deficit, a sizeable amount of debt, an underfunded government pension system and an economy recession since 2006. As a result of these matters, credit ratings agencies have been consistently downgrading the Commonwealth's and certain public corporation's general obligation bonds ratings. In order to address these matters the Commonwealth began to make legislation to reform its governmental pension system, provide liquidity to the Governmental Development Bank of Puerto Rico ("GDB"), its fiscal agent, and strength sinking funds to assess financial markets. The Commonwealth estimates that these corrective actions, along others to be implemented, will have a positive impact on the Commonwealth itself, GDB, the municipalities and its citizens. Among other actions on January 24, 2014 the Commonwealth approved Act No. 18 and 19. Those Act's provides for the restructuring and creation of financing structures from sales and use tax sources to guarantee and pay municipal long term debt issuances. As a result of this legislation the municipalities of Puerto Rico may improve its credit capacity along with maintaining sufficient resources for operations.

On February 4, 2014, February 7, 2014 and February 11, 2014 Standard & Poor's Ratings Services ("S&P"), Moody's Investors Service ("Moody's") and Fitch Ratings ("Fitch") respectively, lowered its ratings on the Commonwealth of Puerto Rico's general obligation (GO) debt and other of its instrumentalities such as GDB, ERS and COFINA. The downgrades follow S&P's, Moody's and Fitch's evaluation of liquidity and access to markets. It is the opinion of the Municipality's management that the corrective actions taken and to be taken in current and fiscal periods thereafter will lower the impact of this decision and cause a positive turnaround on the Commonwealth's and the Municipality's finances.

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 Budget and Finance at PO Box 507, Isabela, Puerto Rico 00602.

BASIC FINANCIAL STATEMENTS

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA
STATEMENT OF NET POSITION
June 30, 2013**

	Governmental Activities
<u>ASSETS</u>	
Cash and cash equivalents	\$ 25,271,079
Receivables, net:	
Municipal License Taxes	3,379
Sales and use taxes	310,780
Other	72,987
Due from:	
Commonwealth Government	2,602,819
Federal Government	1,369,035
Restricted assets:	
Cash and cash equivalents	4,641,216
Cash with fiscal agent	9,679,551
Investment held with fiscal agent	186,535
Inventories and Supplies	198,754
Capital Assets:	
Land and construction in progress	14,443,596
Other capital assets, net	50,373,820
	64,817,416
Total assets	109,153,551
<u>LIABILITIES</u>	
Accounts payable and accrued liabilities	3,356,911
Interest payable	309,658
Due to:	
Commonwealth Government	120,977
Unearned revenues:	
Municipal license taxes	2,167,629
Long-term liabilities:	
Due within one year	2,316,310
Due in more than one year	28,659,894
Total liabilities	36,931,379
<u>NET POSITION</u>	
Net investment in capital assets	51,452,920
Restricted for:	
Capital projects	3,621,563
Debt service	4,856,780
Other specified purposes	848,886
Unrestricted	11,442,023
Total net position	\$ 72,222,172

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, 2013

Functions	Program Revenues			Net (Expenses) Revenues and Change in Net Position
	Expenses	Fees, Fines and Charges for services	Operating Grants and Contributions	
Governmental Activities:				
General government	\$ 11,001,545	\$ 4,375,116	\$ 89,315	\$ (5,940,813)
Public works and sanitation	4,710,798	197,177	51,300	(4,074,060)
Public safety	1,298,100	-	49,263	(1,248,837)
Culture and recreation	1,540,612	2,900	8,926	(1,519,880)
Health	4,219,028	3,611,624	-	(607,404)
Housing, welfare and community development	2,955,562	-	1,218,293	(1,171,281)
Education	2,277,394	-	2,001,933	(275,461)
Interest on long-term debt	744,709	-	-	(744,709)
Total	\$ 28,747,748	\$ 8,186,817	\$ 3,419,030	\$ (15,582,445)

General revenues:	
Taxes:	
Property taxes	5,692,583
Municipal license taxes	2,565,969
Sales and use taxes	3,090,884
Grants and contributions not restricted to specific programs	5,475,240
Interest	402,525
Other	271,131
Total general revenues	17,498,332
Change in net position	1,915,887
Net position-beginning	70,306,285
Net position-ending	\$ 72,222,172

The accompanying notes are an integral part of this statement.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA
BALANCE SHEET – GOVERNMENTAL FUNDS
June 30, 2013**

Assets	Major Funds							Total Governmental Funds
	General	USDHUD - Community Development Block Grant Program	USDHHS- USDA Head Start	Debt Service	Commonwealth Legislature Resolutions	Bonds and Notes Issuance	USDHHS- USDA Child Care	
Cash and cash equivalents	\$ 25,271,079	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 25,271,079
Receivables, net	-	-	-	-	-	-	-	-
Municipal License Taxes	3,379	-	-	-	-	-	-	3,379
Sales and use taxes	257,929	-	-	52,851	-	-	-	310,780
Other	69,231	-	-	-	-	-	-	72,987
Due from:								
Commonwealth Government	1,631,715	-	-	347,218	27,529	-	-	2,602,819
Federal Government	-	178,822	316,943	-	-	-	791,030	1,369,035
Other funds	3,259,550	-	-	-	16,803	27,418	-	3,303,771
Advances to other funds	-	-	-	-	1,307,497	-	-	1,307,497
Inventories and Supplies	198,754	-	-	-	-	-	-	198,754
Restricted assets:								
Cash and cash equivalents	275,043	113,585	5,708	-	1,654,065	-	106,682	4,641,216
Cash with fiscal agent	-	-	-	4,777,598	-	4,811,675	-	9,679,551
Investment held with fiscal agent	-	-	-	-	-	186,535	-	186,535
Total assets	\$ 30,966,680	\$ 292,407	\$ 322,651	\$ 5,177,667	\$ 3,005,894	\$ 5,025,628	\$ 897,712	\$ 48,947,403
Liabilities, Deferred Inflows of Resources and Fund Balances (deficit)								
Liabilities:								
Accounts payable and accrued liabilities	\$ 2,053,585	\$ 203,004	\$ 108,677	\$ -	\$ 112	\$ 757,108	\$ 1,213	\$ 3,356,910
Matured bonds and interest payable	-	-	-	908,431	-	-	-	908,431
Due to:								
Commonwealth Government	120,977	-	-	-	-	-	-	120,977
Other funds	1,545	50,862	209,745	-	81,490	237,476	865,459	3,303,771
Advances from other funds	1,307,497	-	-	-	-	-	-	1,307,497
Unearned revenues:								
Municipal license taxes	2,167,629	-	-	-	-	-	-	2,167,629
Total liabilities	\$ 5,651,233	\$ 253,866	\$ 318,422	\$ 908,431	\$ 81,602	\$ 994,584	\$ 866,672	\$ 11,165,215
Deferred Inflow of Resources								
Unavailable revenues - Commonwealth Government Fur	1,585,981	-	-	317,606	27,529	-	-	2,498,190
Unavailable revenues - Federal grants	-	55,238	227,243	-	-	-	826,386	1,191,107
Unavailable revenues - Sales and use tax	35,664	-	-	-	-	-	-	35,664
Unavailable revenues - Other	23,614	-	-	-	-	-	-	23,614
Total deferred inflow of resources	\$ 1,645,259	\$ 55,238	\$ 227,243	\$ 317,606	\$ 27,529	\$ -	\$ 826,386	\$ 3,748,575
Fund balances (deficit):								
Nonspendable	198,754	-	-	-	1,307,497	-	-	1,506,251
Restricted	272,943	41,025	4,229	3,951,630	1,589,266	4,031,044	30,183	11,095,916
Committed	4,103,939	-	-	-	-	-	-	4,103,939
Assigned	4,722,276	-	-	-	-	-	-	4,722,276
Unassigned	14,372,276	(57,722)	(227,243)	-	-	-	(825,529)	12,605,231
Total fund balances (deficit)	\$ 23,670,188	\$ (16,697)	\$ (223,014)	\$ 3,951,630	\$ 2,896,763	\$ 4,031,044	\$ (795,346)	\$ 34,033,613
Total liabilities, deferred inflows of resources and fund balances (deficit)	\$ 30,966,680	\$ 292,407	\$ 322,651	\$ 5,177,667	\$ 3,005,894	\$ 5,025,628	\$ 897,712	\$ 48,947,403

The accompanying notes are an integral part of this statement.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA
RECONCILIATION OF THE BALANCE SHEET OF GOVERNMENTAL FUNDS
TO THE STATEMENT F NET POSITION
June 30, 2013**

Total fund balances - governmental funds

\$ 34,033,613

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

Capital assets used in governmental activities are not current financial resources and, therefore, are not reported in the governmental funds balance sheet

64,817,416

Other assets are not available to pay current-period expenditures and, therefore, are reported as deferred inflows of resources in the funds:

Receivables:

Christmas bonus reimbursement	\$ 3,379	
Charges for services	96,826	
Rent	1,500	
Sales and use tax - Municipal Development Fund	35,664	
Due from Commonwealth Government:		
Property taxes-General Fund (current year)	295,940	
Property taxes-Debt Service Fund (current year)	317,606	
P.R. Department of Labor (Law No. 52)	245,687	
P.R. Department of Education	140,000	
P.R. Electric Power Authority (PREPA)	926,723	
P.R. Office for Youth Affairs (OAJ)	115,873	
Christmas Bonus Reimbursement	145,228	
Grant from P.R. Department of Transportation	66,097	
Grant from P.R. Department of Family - "Pres"	80,180	
Other	86,765	
Due from Federal Government:		
Federal Grant-Child Care	826,385	
Federal Grant-Head Start	227,243	
Federal Grant-CDBG	55,238	
Federal Grant-US Department of Justice	48,750	
Federal Grant-Others	<u>33,490</u>	3,748,574

Interest liabilities are not due and payable in the current period and therefore, are not reported in the funds

(11,227)

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	(15,194,024)	
Bond anticipation note	(102,918)	
Note payable to CRIM-financing of delinquent accounts	(54,728)	
Note payable to HUD-Section 108 Loan Guarantee	(3,774,000)	
Payable to PREPA	(926,722)	
Compensated absences	(2,928,509)	
Judgments and legal claims	(97,000)	
Christmas Bonus	(312,676)	
Estimated solid waste landfill closure and post-closure costs	<u>(6,975,627)</u>	<u>(30,366,204)</u>

Net position of governmental activities:

\$ 72,222,172

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, 2013**

	Major Funds							Other Governmental Funds	Total Governmental Funds
	General	USDHUD - Community Development Block Grant Program	USDHHS- USDA Head Start	Debt Service	Commonwealth Legislature Resolutions	Bonds and Notes Issuance	USDHHS- USDA Child Care		
Revenues:									
Taxes:									
Property taxes	\$ 3,810,335	-	\$ -	\$ 1,767,661	\$ -	\$ -	\$ -	\$ -	\$ 5,577,996
Municipal license taxes	2,562,590	-	-	-	-	-	-	-	2,562,590
Sales and use taxes	2,653,269	-	-	432,332	-	-	-	-	3,085,601
Intergovernmental:									
Commonwealth government	5,602,923	-	-	-	20,000	-	-	367,771	5,990,694
Federal government	-	1,640,825	2,096,632	-	-	-	20,823	525,215	4,283,495
Fees, fines and charges for services	8,174,782	-	-	-	-	-	-	99,018	8,273,800
Interest	57,674	483.00	-	3,945	11,497	324,976	-	3,950	402,525
Other	239,305	-	-	-	-	7,026	-	24,800	271,131
Total revenues	23,100,878	1,641,308	2,096,632	2,203,938	31,497	332,002	20,823	1,020,754	30,447,832
Expenditures:									
Current:									
General government	9,013,795	205,812	-	-	-	17,714	-	163,814	9,401,135
Public works and sanitation	3,349,233	38,866	-	-	4,173	56,359	-	111,686	3,560,317
Public safety	1,112,769	-	-	-	-	-	-	14,679	1,127,448
Culture and recreation	688,504	1,885.00	-	-	-	-	-	10,454	700,843
Health	4,139,466	-	-	-	-	-	-	-	4,139,466
Housing, welfare and community development	1,444,169	555,988	108,342	-	15,849	-	28,112	672,066	2,824,526
Education	2,220	399,297	1,890,294	-	-	-	274,491	-	2,167,005
Capital outlays	3,882,428	-	111,605	-	97,647	1,823,524	-	624,989	6,939,490
Debt service:									
Principal	-	269,000	-	653,000	-	-	-	-	922,000
Interest	-	121,490	-	624,569	-	-	-	-	746,059
Bond issuance costs	-	-	-	-	-	-	-	-	-
Total expenditures	23,632,584	1,592,338	2,110,241	1,277,569	117,669	1,897,597	302,603	1,597,688	32,528,289
Excess (deficiency) of revenues over expenditures	(531,706)	48,970	(13,609)	926,369	(86,172)	(1,565,595)	(281,780)	(576,934)	(2,080,457)
Other financing sources (uses):									
Proceeds from general obligation bonds	-	-	-	-	-	-	-	-	-
Proceeds from bond anticipation note issuance	-	-	-	-	-	102,918	-	-	102,918
Proceeds from Section 108 Loan Guarantee note - Fixed Rate Note	-	-	-	-	-	-	-	-	-
Proceeds from debt settlement - P.R. Department of Treasury	-	-	-	-	-	-	-	-	-
Proceeds from sale of machinery and equipment	-	-	-	-	-	-	-	-	-
Payment of Section 108 Loan Guarantee - Variable/Fixed Rate Note	(826,989)	-	-	-	-	-	-	-	(826,989)
Transfers in	407,911	83,158	-	(2,449)	(163,113)	(324,270)	-	117,841	608,910
Transfers out	(117,841)	-	-	(2,449)	(163,113)	(221,352)	-	(1,237)	(608,910)
Total other financing sources (uses)	(536,919)	83,158	-	(2,449)	(163,113)	(221,352)	-	116,604	(724,071)
Net change in fund balances (deficit)	(1,068,625)	132,128	(13,609)	923,920	(249,285)	(1,786,947)	(281,780)	(460,330)	(2,804,528)
Fund balances at beginning of year,	24,738,813	(148,825)	(209,405)	3,027,710	3,146,048	5,817,991	(513,566)	979,375	36,838,141
Fund balances (deficit) at end of year	\$ 23,670,188	\$ (16,697)	\$ (223,014)	\$ 3,951,630	\$ 2,896,763	\$ 4,031,044	\$ (795,346)	\$ 519,045	\$ 34,033,613

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The accompanying notes are an integral part of this statement.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA
RECONCILIATION OF THE BALANCE SHEET OF GOVERNMENTAL FUNDS
TO THE STATEMENT F NET POSITION
June 30, 2013**

Net change in fund balances (deficit) - total governmental funds: **\$ (2,804,528)**

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:	\$ 6,939,490	
Less: current year depreciation	<u>(2,296,319)</u>	4,643,171

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 position differs from the change in fund balance by the cost of the disposed asset: (338,700)

Revenues in the Statement of Activities that do not provide current financial resources are not reported as revenues in the funds:

Property taxes-General Fund (current year)	295,940	
Property taxes-Debt Service Fund (current year)	317,606	
P.R. Department of Labor (Law No. 52)	56,042	
P.R. Electric Power Authority (PREPA) (current year)	570,497	
P.R. Office for Youth Affairs (OAJ)	8,888	
Christmas Bonus Reimbursement (current year)	145,228	
Federal Grant-Head Start	227,243	
Federal Grant-Child Care	274,192	
Federal Grant-CDBG	55,238	
Charges for services	96,019	
Others	<u>30,146</u>	2,077,039

Revenues reported in funds which are not reported as revenues in the Statement of Activities:

Property taxes-General Fund (current year)	371,973	
Property taxes-Debt Service Fund (prior year)	126,986	
P.R. Electric Power Authority (PREPA) (prior year)	541,739	
P.R. Infrastructure Financing Authority	81,535	
Charges for services	40,049	
Federal Grant-CDBG	60,814	
Federal Grant-Head Start	210,903	
Christmas Bonus Reimbursement (prior year)	156,979	
Others	<u>465,713</u>	(2,056,691)

Proceeds from bond anticipation notes are other financing sources in the governmental funds but an increase of long-term liabilities in the Statement Net Position: of Net Assets: (102,918)

Expenditures reported in funds which are not reported as expenses in the Statement of Activities:

Matured bonds principal payments-Debt Service Fund (net change)		60,000
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Repayment of long term debt is an expenditure in the governmental funds, but reduces long-term liabilities in the Statement of Net Position:

General obligation bonds and notes	593,000	
Other long term liabilities	<u>1,437,898</u>	2,030,898

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)	32,185	
Closure and post-closure care costs	(287,246)	
Judgment and legal claims (net change)	(97,000)	
Christmas bonus	(312,676)	
P.R. Electric Power Authority (PREPA)	(855,746)	
Accrued interest (net change)	1,350	
Others	<u>(73,251)</u>	(1,592,384)

Change in net assets of governmental activities:

\$ 1,915,887

The accompanying notes are an integral part of this statement.

NOTES TO FINANCIAL STATEMENTS

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2013

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) and organizations for which the primary government is financially accountable. In addition, the primary government may determine, through exercise of management's professional judgment, that the inclusion of an organization that does not meet the financial accountability criteria is necessary in order to prevent the reporting entity's financial statements from being misleading. Other entities should be evaluated as potential component units if they are closely related to, or financially integrated with, the primary government. It is a matter of professional judgment to determine whether the nature and the significance of a potential component unit's relationship with the primary government warrant inclusion in the reporting entity. An entity should be considered a component unit if meets any of the following three conditions:

- a. The primary government appoints a voting majority of the entity's governing body, and either:
 - 1) A financial benefit/ burden exist between the primary government and the entity or
 - 2) The primary government can impose its will on the entity.
- b. The entity is fiscally dependent on the primary government and there is a financial benefit/burden between the primary government and the entity.
- c. It would be necessary to include the entity as a component unit since the primary government's financial statements would be misleading without it.

In addition, "*Special criteria*" apply when evaluating a legally separate, tax-exempt organization as potential component unit. Specifically, such entities must be treated as component units if they meet all of the following criteria:

- 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.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2013

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

- 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.

Legally separate, tax-exempt organizations that do not meet the above *special criteria* should still be included as a component unit if the financial statements of the primary government would be misleading without them.

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 and (b) *discrete* presentation of the component unit's financial data. When a component unit functions as an integral part of the primary government, its data is *blended* with those of the primary government ("*blended component units*"). That is, the component unit's funds are treated just as though they were funds of the primary government with one exception: the general fund. Component units should be reported as *blended* if meets any of the following criteria:

- a. The component unit's governing body is substantively the same as the governing body of the primary government and there is either:
 - 1) A financial benefit/ burden exist between the primary government and the entity or
 - 2) Management of the primary government has operational responsibility for the primary government.
- b. The component unit provides services entirely, or almost entirely, to the primary government or otherwise exclusively, or almost exclusively, benefits the primary government.
- c. The component unit's debt is expected to be paid by the primary government.

Otherwise, the component unit should be presented as discrete. Those component units does not function as an integral part of the primary government and its data is presented discretely (separately) from the data of the primary government ("*discretely component units*"). Legally separate, tax-exempt organizations that meet the *special criteria* should be included as *discretely component units*.

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.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2013**

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

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.

Government-wide statements

The government-wide statements consist of a Statement of Net Position and a Statement of Activities. These statements are prepared using the economic resources measurement focus, which refers to the reporting of all of the net position available to the governmental unit for the purpose of providing goods and services to the public. 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 Position presents all of the reporting entity's non-fiduciary assets, deferred outflows, liabilities and deferred inflows, with the difference reported as net position. 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 direct expenses, including depreciation, by related program revenues, operating and capital grants, and contributions. Direct expenses are those that are clearly identifiable with a specific function. As a policy, indirect expenses are not allocated in the Statement of Activities. 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 and time requirements are met. Revenues on both operating and capital grants are recognized when all eligibility requirements (including time requirements) imposed by the provider have been met. For certain expenditure-driven grants, revenue is recognized after allowable expenditures are incurred.

The Municipality reports unearned revenues in the government-wide statements. Unearned revenues arise when resources are received before the Municipality has a legal claim to them (such as advances of derived tax revenues) 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 unearned revenues is removed from the statement of net position and the revenue is recognized.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2013**

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, deferred outflows, liabilities, deferred inflows, 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 and deferred outflows; liabilities and deferred inflows; revenues or expenditures; or based on the Municipality's official's criteria if the fund is particularly important to financial statement users (for USDHUD - Community Development Grant Program, USDHHS - USDA - Head Start 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.

USDHUD - Community Development Block Grant Program Fund (CDBG): the CDBG fund 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. The Fund reports the transactions of CDBG Entitlement Fund and Section 108 Loan Guarantee Fund.

USDHHS - USDA Head Start Fund: this fund 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. The fund reports the transactions of USDHHS-Head Start Program Fund, USDHHS-ARRA Early Head Start Fund, USDHHS-ARRA Head Start Expansion and the USDA-PRDE-Head Start Food Program Fund.

Debt Service Fund: this fund is used to account for and report financial resources that are restricted, committed, or assigned to expenditures for principal and interest. This fund accounts for the resources of three individual funds including the "Fondo 10 - CAE Fund" (sinking fund which accounts for the 2% of property taxes collected by the CRIM, "Fondo 11 - CRIM Fund (resources transferred from general fund to CRIM for debt service) and the "Municipal Redemption Fund" (.2% of the .5% from sales and use taxes will deposited in GDB to finance loans to Municipalities.

Commonwealth Legislature Resolutions Fund: this fund is used to account for and report revenue sources from grants provided by the Commonwealth's Legislature that are restricted, committed, or assigned for specific purposes which include, among others, acquisition, development and improvements of capital assets, public works, welfare and other community development projects.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2013

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Bonds and Notes Issuance Fund: the Bonds and Notes Issuance Fund is used to account for and report financial resources from bond proceeds and notes issuance which are restricted for acquisition or construction of capital assets. This fund reports transactions of individual funds of Bonds and Notes issued through GDB and the transactions of Rural Development (RD) Bond Anticipation Notes Fund.

USDHHS – USDA Child Care Fund: Head Start fund is used to account for and report revenues sources for child care assistance for low-income families, including provision of nutritious and healthy food. The Fund reports the transactions of USDHHS-Child Care Program Fund, Child Care Summer Camp Fund and the USDA-PRDE-Child and Adult Care Food Program Fund.

The governmental 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.

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 unearned revenues in the governmental funds statements. Unearned revenues arise when resources are received before the Municipality has a legal claim to them (such as advances of derived tax revenues) 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 unearned revenues is removed from the balance sheet and the revenue is recognized.

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2013

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

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

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 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 Bonds and Notes Issuance Fund represent the undisbursed proceeds of certain bonds or loans which are maintained in a cash custodian account by the GDB. Restricted cash with fiscal agent of the Other Governmental Funds represent the undisbursed proceeds of 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, 2013**

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 (CAE - property tax) and GDB – (Municipal Redemption Fund - 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 Position, 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 Position 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.

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2013

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

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 outflows/inflows of resources*

In addition to assets, the statement of net position will sometimes report a separate section for deferred outflows of resources. This separate financial statement element, deferred outflows of resources, represents a consumption of net position that applies to a future period(s) and so will not be recognized as an outflow of resources (expense/expenditure) until then.

In addition to liabilities, the statement of financial position will sometimes report a separate section for deferred inflows of resources. This separate financial statement element, deferred inflows of resources, represents an acquisition of net position that applies to a future period(s) and so will not be recognized as an inflow of resources (revenue) until that time. The government has only one item, which arises only under a modified accrual basis of accounting that qualifies for reporting in this category. Accordingly, the item, *unavailable revenue*, is reported only in the governmental funds balance sheet. The governmental funds report *unavailable revenue* from three sources: unavailable intergovernmental revenues, unavailable sales and use taxes and unavailable other charges for services. These amounts are deferred and recognized as an inflow of resources in the period that the amounts become available.

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 Position, consist of general and special obligation bonds, liabilities for compensated absences, claims and judgments, and long-term liabilities to other governmental entities. Related bond issuance costs, whenever rise, are reported as current outflows of resources in the Statement of Activities, 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.

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, 2013

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. Claims and judgments

The estimated amount of the liability for claims and judgments, which is due on demand, such as from adjudicated or settled claims, is recorded in the general fund when they mature (generally, when payment is due). The accompanying government-wide statements include an amount estimated as a contingent liability or liabilities as incurred.

13. Net position

In the government-wide statements, assets plus deferred outflows of resources less liabilities and deferred inflows of resources equal net position, and should be displayed in three components: net investment in capital assets, restricted, and unrestricted, as follows:

Net investment in capital assets: Consists of capital assets, net of accumulated depreciation, reduced by the outstanding balances of bonds, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets. Deferred outflows of resources and deferred inflows of resources that are attributable to the acquisition, construction, or improvement of those assets or related debt also should be included in this component of net position. The portion of the debt or deferred inflows of resources attributable to the unspent debt proceeds is not included in the calculation of net investment in capital assets. Instead, the portion of the debt or deferred inflows of resources is included in the same net position component (restricted or unrestricted) as the unspent amount.

Restricted net position: The restricted component of net position consists of restricted assets (subject to restrictions beyond the Municipality's control) reduced by liabilities and deferred inflows of resources related to those assets. Generally, a liability relates to restricted assets if the asset results from a resource flow that also results in the recognition of a liability or if the liability will be liquidated with the restricted assets reported. Restrictions are externally imposed (by creditors, grantors, contributors, or laws and regulations of other governments) or imposed by the law through constitutional provisions or enabling legislation.

Unrestricted net position: Unrestricted net position is the net amount of the assets, deferred outflows of resources, liabilities, and deferred inflows of resources that are not included in the determination of net investment in capital assets or the restricted component of net position. Unrestricted net position is 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.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2013

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

14. *Net position flow assumption*

Sometimes the government will fund outlays for a particular purpose from both restricted (restricted bond or grant proceeds) and unrestricted resources. In order to calculate the amounts to report as restricted – net position and unrestricted – net position in the government-wide financial statements, a flow assumption must be made about the order in which the resources are considered to be applied. It is the government's policy to consider restricted – net position to have been depleted before unrestricted – net position is applied.

15. *Fund balances*

The GASB Statement No. 54 Fund Balance Reporting and Governmental Fund Type Definitions ("GASB No. 54") establish 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. 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 pursuant to constraints imposed through formal action (ordinance or resolution) by consent of the government's highest level of decision-making authority, which in the case of the Municipality is the Mayor and the Municipal Legislature. Those committed amounts cannot be used for any other purposes unless the Mayor and the Municipal Legislature 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.

Assigned: Amounts that are constrained by the Municipality's intent to be used for specific purposes, but are neither restricted nor committed. In distinction to committed balances, the authority for making an assignment is not required to be the government's highest level of decision-making authority, (both the Mayor and the Municipal Legislature). It is the Municipality's policy that intent can be expressed by the Mayor, the Finance Director (the official to which the Mayor has also delegated the authority to assign amounts) or by any other official or body to which the Mayor delegates. Furthermore, the nature of the actions necessary to remove or modify an assignment is not as prescriptive as it is with committed fund balances. 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.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2013

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

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 from the overspending for specific purposes for which amounts had been restricted, committed or assigned.

16. 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.

17. Risk financing

The Puerto Rico Treasury Department (PRDT) determines the insurance 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 policy costs are paid directly to private insurance companies. Workers compensation insurance is monthly deducted from advances of property tax and amounts of municipal equalization fund sent to the Municipality by the Municipal Revenue Collection Center (CRIM). Settled cases have not exceeded insurance coverage for any of the past years.

18. 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.

19. Reclassifications

Various reclassifications have been made in the accompanying basic financial statements which affect the comparability with the basic financial statements issued for previous fiscal years.

20. Future adoption of accounting pronouncements

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

- a. **GASB Statement No. 66** "Technical Corrections—2012—an amendment of GASB Statements No. 10 and No. 62". The provisions of this Statement are effective for financial statements for periods beginning after December 15, 2012 (fiscal year ended June 30, 2014).
- b. **GASB Statement No. 67** "Financial Reporting for Pension Plans—an amendment of GASB Statement No. 25". The provisions of this Statement are effective for financial statements for fiscal years beginning after June 15, 2013 (fiscal year ended June 30, 2014).
- c. **GASB Statement No. 68** "Accounting and Financial Reporting for Pensions—an amendment of GASB Statement No. 27". The provisions of this Statement are effective for fiscal years beginning after June 15, 2014 (fiscal year ended June 30, 2015).

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2013

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

- d. **GASB Statement No. 69** "*Government Combinations and Disposals of Government Operations*". The provisions of this Statement are effective for government combinations and disposals of government operations occurring in financial reporting periods beginning after December 15, 2013, and should be applied on a prospective basis (fiscal year ended June 30, 2015).
- e. **GASB Statement No. 70** "*Accounting and Financial Reporting for Nonexchange Financial Guarantees*". The provisions of Statement 70 are effective for financial statements for reporting beginning after June 15, 2013 (fiscal year ended June 30, 2015).
- f. **GASB Statement No. 71** "*Pension Transition for Contributions Made Subsequent to the Measurement Date*". The provisions of this Statement should be applied simultaneously with the provisions of Statement 68 (fiscal year ended June 30, 2015).

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

NOTE B - DEPOSITS AND INVESTMENT

1. ***Deposits***

Custodial credit risk on Deposits. This 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 \$30,290,591 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 \$9,679,550.

2. ***Investment***

The investment held with fiscal agent consists of a non-participating 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 \$186,535 as of June 30, 2013. The GIC outstanding balance is valued at cost. This investment is exposed to credit risk, concentration of credit risk and interest rate risk. A description of these risks as of June 30, 2013 follows:

Credit Risk. The Municipality should provide information about the credit risk on investments by disclosing the credit quality ratings of investments as described by nationally recognized statistical rating organizations. As of June 30, 2013 the ratings are Baa3 for Moody's and BBB- for Standard & Poor's and Fitch. On February 2014 those ratings were downgraded to Ba2 by Moody's, BB+ by Standard and Poor's and BB by Fitch. See related Note T.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2013**

NOTE B – DEPOSITS AND INVESTMENT - Continued

Interest Rate Risk. Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The GIC earns interest at a variable rate (LIBOR minus .193%, .280% as of June 30, 2013); have an original maturity of 90 days and is due on July 1, 2013. This short term maturity limits the decline in fair value. The Municipality does not have a formal policy for managing the interest rate risk besides investing its funds in barely non-risky instruments as required by the Office of Commissioner of Municipal Affairs (“OCAM”) rulings (Chapter V of “Reglamento de Normas Basicas de los Municipios de P.R.”).

Concentration of Credit Risk. The investment in GIC represents the 100% of the Municipality’s total investments.

NOTE C – RECEIVABLES - OTHER

Accounts receivable – Others as of June 30, 2013 follows:

	Amount
CIMA – third-party payors	\$ 38,434
CIMA – capitation	22,065
Interest	5,266
Miscellaneous	7,222
	\$ 72,987

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

NOTE D – DUE FROM (TO) GOVERNMENTAL ENTITIES

1. *Amounts due from governmental entities as of June 30, 2013 follows:*

	Commonwealth Government	Federal Government
<u>Major fund - General fund:</u>		
P.R. Electric Power Authority (PREPA)	\$ 926,722	\$ -
Municipal Revenue Collection Center (CRIM) – property taxes	295,940	-
P.R. Department of Treasury – Christmas bonus reimbursement	145,228	-
P.R. Department of Education	140,000	-
P.R. Department of Health	121,910	-
Others	1,915	-
<u>Major fund – USDHUD - CDBG fund:</u>		
U.S. Department of Housing and Urban Development – CDBG	-	178,822
<u>Major fund – USDHHS – USDA - Head Start fund:</u>		
U.S. Department of Health and Human Services – Head Start	-	290,837

**COMMONWEALTH OF PUERTO RICO
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NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2013**

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

2. Amounts due from governmental entities as of June 30, 2013 follows:

	Commonwealth Government	Federal Government
<u>Major fund – Debt service fund:</u>		
Municipal Revenue Collection Center (CRIM) – property taxes	347,218	-
<u>Major fund – Commonwealth Legislature Resolutions fund:</u>		
Commonwealth Legislative Resolutions	27,529	-
<u>Major fund – USDHHS – USDA – Child Care fund:</u>		
P.R. Department of Family – Child Care	-	791,030
<u>Other governmental funds:</u>		
P.R. Department of Labor – Law No. 52	245,688	-
P.R. Department of Family – Pres	80,180	-
P.R. Department of Transportation	66,097	-
P.R. Office of Youth Affairs	115,873	-
P.R. Public Security Affairs Office	-	48,750
P.R. Department of Education	-	26,106
Others	88,519	33,490
	\$ 2,602,819	\$ 1,369,035

See note I for detail of amounts due from governmental entities recorded as deferred inflow of resources.

3. Amounts due to governmental entities as of June 30, 2013 follows:

	Commonwealth Government
Employees Retirement System of the Government of the Commonwealth of P.R. (current debt)	\$ 70,983
P.R. Aqueduct and Sewer Authority (PRASA)	41,736
P.R. Department of Labor – unemployment	8,258
	\$ 120,977

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:

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2013**

NOTE E - INTERFUND TRANSACTIONS - Continued

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
General Fund	Major funds:	
	CDBG	\$ 50,862
	Head Start	209,745
	Commonwealth Legislative Resolutions	81,490
	Bonds and Notes Issuance Fund	237,746
	Child Care and Child Care Summer Camp	865,459
	Other governmental funds:	
	TANF	175,712
	Traffic Safety Commission	166,997
	School Maintenance (OME)	196,881
	Rural Development Corporation	89,840
	P.R. Dept. of Transportation	297,243
	P.R. Dept. of Family – Pres	122,700
	P.R. Dept. of Labor–Law No. 52	340,824
	P.R. Office of Youth Affairs	129,250
	OAP (Elderly) Fund	89,079
	Others	205,722
		<u>\$ 3,259,550</u>
Commonwealth Legislative Resolutions:	Major funds:	
	General Fund	\$ 1,545
	Other governmental funds:	
	Rural Development Corporation	15,258
		<u>\$ 16,803</u>
Bonds and Notes Issuance Fund:	Other governmental funds:	
	PREPA Electric Infrastructure	\$ 27,418
TOTAL		<u><u>\$ 3,303,771</u></u>

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 and cash with fiscal agent in the Debt Service, Commonwealth Legislative Resolutions and Bonds and Notes Issuance Funds which are transferred to the general fund and, (2) a transfer from the general fund to other governmental funds to provide resources for certain governmental fund's activities.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2013**

NOTE F- FUND BALANCE

1. Fund balance classifications

The governmental fund balance classifications and amounts at June 30, 2013 are shown in the following table:

	General Fund	Community Development Block Grant Program	USDHHS- USDA Head Start	Debt Service	Commonwealth Legislative Resolutions	Bonds and Notes Issuance	USDHHS- USDA Child Care	Other Governmental Funds	Total
Nonspendable:									
Advances to other funds	\$ -	\$ -	\$ -	\$ -	\$ 1,307,497	\$ -	\$ -	\$ -	\$ 1,307,497
Inventories	198,754	-	-	-	-	-	-	-	198,754
	198,754	-	-	-	1,307,497	-	-	-	1,506,251
Restricted:									
General public works and sanitation	-	-	-	-	-	-	-	119,414	119,414
Public safety	34	-	-	-	-	-	-	65,105	65,139
Health	2,083	-	-	-	-	-	-	-	2,083
Housing, welfare and community development	269,217	-	4,229	-	83,696	-	30,183	186,692	574,017
Debt service	-	-	-	3,951,630	-	-	-	-	3,951,630
Capital outlays	-	41,025	-	-	1,505,570	4,031,044	-	804,385	6,382,024
General government and other purposes	1,609	-	-	-	-	-	-	-	1,609
	272,943	41,025	4,229	3,951,630	1,589,266	4,031,044	30,183	1,175,596	11,095,916
Committed:									
General public works and sanitation	2,413,221	-	-	-	-	-	-	-	2,413,221
Sports, culture and recreation	21,125	-	-	-	-	-	-	-	21,125
Health	10,115	-	-	-	-	-	-	-	10,115
Housing, welfare and community development	585,734	-	-	-	-	-	-	-	585,734
Capital outlays	614,770	-	-	-	-	-	-	-	614,770
General government and other purposes	458,974	-	-	-	-	-	-	-	458,974
	4,103,939	-	-	-	-	-	-	-	4,103,939
Assigned:									
General public works and sanitation	201,861	-	-	-	-	-	-	-	201,861
Public safety	8,405	-	-	-	-	-	-	-	8,405
Sports, culture and recreation	12,497	-	-	-	-	-	-	-	12,497
Health	1,909,919	-	-	-	-	-	-	-	1,909,919
Housing, welfare and community development	1,434	-	-	-	-	-	-	-	1,434
Capital outlays	2,124,100	-	-	-	-	-	-	-	2,124,100
General government and other purposes	464,060	-	-	-	-	-	-	-	464,060
	4,722,276	-	-	-	-	-	-	-	4,722,276
Unassigned									
	14,372,276	(57,722)	(227,243)	3,951,630	2,896,763	4,031,044	(825,529)	(656,551)	12,605,231
	\$ 23,670,188	\$ (16,697)	\$ (223,014)	\$ 3,951,630	\$ 2,896,763	\$ 4,031,044	\$ (795,346)	\$ 519,045	\$ 34,033,613

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2013**

NOTE F – FUND BALANCE - Continued

2. Fund balance deficits

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

<u>Funds</u>	<u>Amount</u>
Major Funds:	
USDHUD – Community Development Block Grant	\$ 16,697
USDHHS-USDA - Head Start	223,014
USDHHS-USDA-Child Care	795,346
Other Governmental Funds:	
Law No. 52	236,924
Office for Youth Affairs	115,873
P.R. Department of Family - "Pres"	80,180
P.R. Department of Transportation – Public Improvements	63,945
Public Security Affairs	48,750
OAP (Elderly) Fund	26,721
Others	49,002

The deficits result from the recognition of deferred inflows of resources for unavailable revenues. As required by current standards, the Municipality recorded intergovernmental revenues for 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:

<u>Governmental activities:</u>	<u>Balance July 1, 2012 (as restated)</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance June 30, 2013</u>
Capital assets, not being depreciated:				
Land	\$ 5,355,029	\$ 120,001	\$ -	\$ 5,475,030
Construction in progress	13,915,668	5,171,755	10,118,857	8,968,566
Total capital assets not being depreciated:	19,270,697	5,291,756	10,118,857	14,443,596
Capital assets, being depreciated:				
Land improvements	854,517	-	-	854,517
Buildings and building improvements	23,144,193	10,747,707	-	33,891,900
Leaschold improvements	567,187	-	567,187	-
Infrastructure	20,063,150	640,290	105,246	20,598,194
Vehicles, machinery and equipment	11,147,802	378,594	39,344	11,487,052
Total capital assets being depreciated	55,776,849	11,766,591	711,777	66,831,663

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2013**

NOTE G – CAPITAL ASSETS - Continued

	Balance July 1, 2012 (as restated)	Increases	Decreases	Balance June 30, 2013
Less accumulated depreciation for:				
Land improvements	24,803	15,567	-	40,370
Buildings and building improvements	5,428,228	923,258	-	6,351,486
Leasehold improvements	292,058	23,214	315,272	-
Infrastructure	2,876,745	383,619	30,930	3,229,434
Vehicles, machinery and equipment	5,912,767	950,661	26,875	6,836,553
Total accumulated depreciation	14,534,601	2,296,319	373,077	16,457,843
Total capital assets being depreciated, net	41,242,248	9,470,272	338,700	50,373,820
Governmental activities capital assets, net	\$ 60,512,945	\$ 14,762,028	\$ 10,457,557	\$ 64,817,416

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

Governmental activities:

General government	\$ 226,555
Public works and sanitation	783,616
Public safety	167,114
Culture and recreation	839,770
Health	51,646
Welfare and community development	117,258
Education	110,360
Total depreciation expense, governmental activities	\$ 2,296,319

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 financed 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.

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 to change 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.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2013**

NOTE H – 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, 2013:

	Balance at July 1, 2012 (as restated)	Increases	Decreases	Balance at June 30, 2013	Due within one year
General, Special Obligations Bonds and Notes	\$ 16,397,024	\$ -	\$ 593,000	\$ 15,804,024	\$ 654,000
General Obligation Bond Anticipation Note	-	102,918	-	102,918	-
Note payable to CRIM -Financing of delinquent accounts	57,608	-	2,880	54,728	2,880
Note payable – Section 108 Loan Guarantee	4,043,000	-	269,000	3,774,000	269,000
Landfill Obligation	6,688,381	287,246	-	6,975,627	-
Compensated absences	2,960,694	259,902	292,087	2,928,509	339,279
Christmas bonus	337,975	312,676	337,975	312,676	312,676
Claims and judgments	-	97,000	-	97,000	97,000
Payable to CRIM- excess of property tax advances over actual collections	1,054	-	1,054	-	-
Payable to PREPA	897,965	855,746	826,989	926,722	641,475
	<u>\$ 31,383,701</u>	<u>\$ 1,915,488</u>	<u>\$ 2,322,985</u>	<u>\$ 30,976,204</u>	<u>\$ 2,316,310</u>

2. General and special obligation bonds and notes

The Municipality's outstanding general and special obligation bonds and notes at June 30, 2013 amount to \$15,804,024. 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 a percent of property taxes to be deposited in a sinking fund ("CAE Sinking Fund") 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. Principal and interest payments of outstanding general and special obligation bonds and notes are paid through the CAE Sinking Fund except for principal and interest payments of 2011 special obligation bonds of \$3,625,000 which are paid through the Municipal Redemption Fund.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2013**

NOTE H – LONG-TERM DEBT - Continued

A detail of the general and special obligation bonds and notes as of June 30, 2013 follows:

	<u>Outstanding Amount</u>
1996 general obligation bonds of \$525,000 due in annual installments ranging from \$13,000 to \$36,000 through January 1, 2021; bearing interest at 4.50%	\$ 245,000
1999 general obligation bonds of \$410,000 due in annual installments ranging from \$11,000 to \$29,000 through January 1, 2024; bearing interest at 4.50%	254,024
2001 general obligation bonds of \$3,455,000 due in annual installments ranging from \$45,000 to \$290,000 through July 1, 2026; bearing interest rates ranging from 1.28% to 7.50% (1.28% at June 30, 2013)	2,630,000
2006 general obligation bonds of \$255,000 due in annual installments ranging from \$5,000 to \$25,000 through July 1, 2029; bearing interest rates ranging from 4.17% to 5.31% (4.36% at June 30, 2013)	215,000
2006 general obligation bonds of \$600,000 due in annual installments ranging from \$25,000 to \$60,000 through July 1, 2021; bearing interest rates ranging from 1.53% to 7.00% (1.53% at June 30, 2013)	430,000
2006 general obligation bonds of \$3,010,000 due in annual installments ranging from \$40,000 to \$260,000 through July 1, 2031; bearing interest rates ranging from .55% to 6.75% (.53% at June 30, 2013)	2,695,000
2008 general obligation note of \$1,325,000 due in annual installments ranging from \$150,000 to \$240,000 through July 1, 2015; bearing interest rates ranging from 1.53% to 7.50% (1.53% at June 30, 2013)	655,000
2010 general obligation bonds of \$1,350,000 due in annual installments ranging from \$15,000 to \$115,000 through July 1, 2035; bearing interest rates ranging from 6.00% to 7.50% (6.00% at June 30, 2013)	1,320,000
2011 general obligation bonds of \$2,330,000 due in annual installments ranging from \$65,000 to \$230,000 through July 1, 2028; bearing interest rates ranging from 6.00% to 7.50% (6.00% at June 30, 2013)	2,265,000

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2013**

NOTE H – LONG-TERM DEBT – Continued

	Outstanding Amount
2011 special obligation bonds of \$3,625,000 due in annual installments ranging from \$55,000 to \$310,000 through July 1, 2036; bearing interest rates ranging from 6.00% to 7.50% (6.00% at June 30, 2013)	3,570,000
2011 general obligation bonds of \$1,545,000 due in annual installments ranging from \$20,000 to \$130,000 through July 1, 2036; bearing interest rates ranging from 6.00% to 7.50% (6.00% at June 30, 2013)	1,525,000
	\$ 15,804,024

The annual requirement to amortize general and special obligation bonds and notes as of June 30, 2013 follows:

June 30,	Principal	Interest
2014	\$ 654,000	\$ 906,882
2015	701,000	972,517
2016	758,000	932,337
2017	556,000	900,010
2018	593,000	861,766
2019-2023	3,528,000	3,733,337
2024-2028	4,139,024	2,368,474
2029-2033	2,990,000	1,088,344
2034-2036	1,885,000	213,000
Totals	\$ 15,804,024	\$ 11,976,667

3. Other long-term liabilities

	Outstanding Amount
General obligation bond anticipation note – The Municipality has issued a general obligation bond anticipation note \$102,918 to Rural Development (“RD”). This is the first note of a total note of \$2,078,000 to be issued to finance the construction of an Emergency Operation Center financed by RD. The note bears interest at 3.75% and is due the date of the final payment issued by RD to the Municipality, but not exceeding 25 years from the date of the note. The Municipality intends to refinance the note on a long term basis through a \$2,078,000 general obligation bond (GOB) issuance approved by the Municipal Legislature and the Governmental Development Bank of Puerto Rico, payable from the CAE Sinking Fund. The GOB issuance will take place after the construction project is finished.	\$ 102,918

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA
NOTES TO FINANCIAL STATEMENTS
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NOTE H – LONG-TERM DEBT – Continued

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:

\$ 54,728

<u>June 30,</u>	<u>Principal</u>	<u>Interest</u>
2014	\$ 2,880	\$ 1,370
2015	2,880	1,298
2016	2,880	1,226
2017	2,880	1,154
2018	2,880	1,082
2019-2023	14,402	4,327
2024-2028	14,402	2,524
2029-2032	11,524	721
Totals	\$ 54,728	\$ 13,702

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2013**

NOTE H – LONG-TERM DEBT – Continued

**Outstanding
Amount**

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 financed 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 2012-2013 amounts to \$121,490. Debt service requirements in future years are as follows:

\$ 3,774,000

June 30,	Principal
2014	\$ 269,000
2015	269,000
2016	269,000
2017	269,000
2018	269,000
2019-2023	1,348,000
2024-2027	1,081,000
Totals	\$ 3,774,000

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2013**

NOTE H – LONG-TERM DEBT – Continued

	Outstanding Amount
Landfill obligation – represents the outstanding balance of the estimated liability for landfill closure and post-closure care costs.	\$ 6,975,627
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.	\$ 2,928,509
Christmas Bonus – represents the accrued portion corresponding to fiscal year 2012-2013 of the Christmas bonus to be paid in December 2013.	\$ 312,676
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 2012 the Municipality’s annual energy charges amounted to \$2,209,498 but the CELI obligation amounted to \$1,353,752. The excess amount of \$855,746 was recorded as a payable and a receivable for the same amount and to be amortized over a three-year period. As of June 30, 2013 the outstanding amount of \$926,722 includes the unamortized balances of \$570,496 and \$356,226 from fiscal years 2012 and 2011 respectively and is recognized by the Municipality as a receivable and a liability to PREPA. Debt service requirements in future years are as follows:	\$ 926,722

June 30	Principal
2014	\$ 641,475
2015	285,247
Totals	\$ 926,722

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2013**

NOTE I – DEFERRED INFLOW OF RESOURCES – GOVERNMENTAL FUNDS

As required by current standards, revenues and other governmental fund financial resources should be recognized in the accounting period in which they become both measurable and available. When an asset is recorded in governmental fund's financial statements but the revenue is not available, the Municipality should report a deferred inflow of resources until such time as the revenue becomes available. A detail of these balances follows:

	<u>Commonwealth Government Funds</u>	<u>Federal Grants</u>	<u>Sales and use Tax and Other</u>
<u>Major fund - General fund:</u>			
P.R. Electric Power Authority (PREPA)	\$ 926,722	\$ -	\$ -
Municipal Revenue Collection Center (CRIM) – property taxes	295,940	-	-
P.R. Department of Treasury – Christmas bonus reimbursement	145,228	-	-
P.R. Department of Education	140,000	-	-
P.R. Department of Health	78,091	-	-
Sales and Use Taxes	-	-	35,664
Others	-	-	5,686
CIMA – third-party payors	-	-	17,928
<u>Major fund – USDHUD - CDBG fund:</u>			
U.S. Department of Housing and Urban Development – CDBG	-	55,238	-
<u>Major fund – USDHHS – USDA - Head Start fund:</u>			
U.S. Department of Health and Human Services – Head Start	-	227,243	-
<u>Major fund – Debt Service fund:</u>			
Municipal Revenue Collection Center (CRIM) – property taxes	317,606	-	-
<u>Major fund – Commonwealth Legislature Resolutions fund:</u>			
Commonwealth Legislative Resolutions	27,529	-	-
<u>Major fund – USDHHS – USDA - Child Care fund:</u>			
P.R. Department of Family – Child Care	-	785,803	-
<u>Other governmental funds:</u>			
P.R. Department of Labor – Law No. 52	245,688	-	-
P.R. Office of Youth Affairs	115,873	-	-
P.R. Department of Family – Pres	80,180	-	-
P.R. Department of Transportation	66,097	-	-
Alzheimer Mobile Center	27,848	-	-
P.R. Public Security Affairs Office	-	48,750	-
Others	31,388	74,073	-
	<u>\$ 2,498,190</u>	<u>\$ 1,191,107</u>	<u>\$ 59,278</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2013

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.

Effective on June 6, 2011 the Municipality entered into a contract with a private company ("the Company") for the collection, transportation, disposal of domestic solid waste and for the independently operation of the municipal solid waste landfill for a period of 15 years. 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 total landfill closure and post-closure care costs liability. 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 life existence period. Total volume of waste deposited was determined (quantified) at contract date and will be revised annually by an independent engineering consulting company. The engineering consulting company estimated that a total expected volume of 1,101,356m³ of solid waste will be deposited in the landfill upon April, 2014 (date of landfill end of waste deposit capacity) of which 977,121 was deposited as of June 6, 2011. Based on this proportion the Municipality's share was determined as 88.72% and the Company share of 11.28%. As of June 30, 2013 the outstanding balance of the landfill closure and post-closure care costs liability amounts to \$6,975,627 of a total projected liability of \$7,215,000.

As part of the agreement, in order to finance the future closure and post closure care activities, the Company is legally required to deposit an amount equal to \$8,061 on a monthly basis during the total contract period for its share of the closure prorated cost. The amount is required to be deposited in a separate bank account at the Municipality's and Company's name. On October 10, 2013 the contract agreement was cancelled due to non-compliance of certain contract clauses including the required deposit to finance the future closure and post-closure care costs. As part of the settlement resulting from the contract agreement cancellation the Municipality retained the corresponding amount of Company's share of deposits as of September 30, 2013. The Municipality will assume the 100% share of the financing of the closure and post-closure care liability and the operation of the municipal solid waste landfill. Subsequent to October 10, 2013 the Municipality entered into agreements with private companies for the collection, transportation and disposal of domestic solid waste.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2013

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, 2013 are 7.53% for personal property and 9.53% 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>2.50%</u>	<u>2.50%</u>
Total tax rate:	7.53%	9.53%
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>7.33%</u></u>	<u><u>9.33%</u></u>

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

The CRIM advances funds to the Municipality based on an estimate of special governmental subsidies and the property taxes to be levied and which are collected in subsequent periods. This distribution includes advances of property tax and amounts of municipal equalization fund from the Commonwealth government. The CRIM is required by law to prepare a settlement statement on a fiscal year basis, whereby a comparison is made between the amounts advanced to the Municipality and amounts actually collected from taxpayers. The CRIM prepares a preliminary settlement not later than three months after fiscal year-end and a final settlement not later than six months after fiscal year-end. If actual collections exceed the advances a receivable from CRIM is recorded. However, if advances exceed actual collections, a payable to CRIM is recorded. A receivable of \$295,940 from the final settlement of fiscal 2012-2013 was recorded as deferred inflows of resources since is not available are required by current standards.

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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 the fifth working day after April 15 each year. During the fiscal year ended June 30, 2013 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 \$2,167,629 is recorded as unearned revenue.

NOTE M – SALES AND USE TAXES

1. As of June 30, 2013

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 amended 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:

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NOTE M – SALES AND USE TAXES - Continued

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

The Municipal Legislature approved the Municipal Ordinance No. 15 Series 2007-2008 to conform to dispositions of Act 80. Individuals, organizations and entities subject to collect the municipal sales and use tax must file a tax return to the Municipality. The tax is due the 10th day of each month based on the tax collected in the preceding month. The Municipality recorded as revenue \$2,653,269 in the general fund (of which \$2,155,042 corresponds to the 1% imposition) and \$487,603 corresponds to the Municipal Development Fund) and \$432,332 in the debt service fund corresponding to the Municipal Redemption Fund.

A total \$183,152 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; \$74,777 and \$52,851 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 \$35,664 related to Municipal Development Fund is recorded as deferred inflows of resources in the governmental fund statements since is not available as required by current standards.

On June 30, 2013 the Commonwealth approved Act No. 40 which among other things, reduces the municipal sales and use tax from 1.5% to 1% and increasing the Commonwealth sales and use tax from 5.5% to 6% effective December 1, 2013. This Act was subsequently amended to change this effective date from December 1, 2013 to February 1, 2014. In addition, subsequent to June 30, 2013 the Commonwealth approved Act No. 18 and 19 of January 24, 2014 for the restructuring and creation of financing structures from sales and use tax sources to guarantee and pay municipal long term debt issuances. See related Note U.

**NOTE N – INTERGOVERNMENTAL REVENUES AND FEES, FINES AND CHARGES FOR SERVICES
- GENERAL FUND**

- 1. Intergovernmental revenues in the General Fund are comprised of the following:

	Amount
Amount of municipal subsidies and equalization fund sent by CRIM	\$ 5,168,686
Reimbursement from Commonwealth Government of Christmas Bonus expenditure	264,685
Reimbursement from Commonwealth government – other programs expenditures	169,552
	\$ 5,602,923

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**NOTE N – INTERGOVERNMENTAL REVENUES AND FEES, FINES AND CHARGES FOR SERVICES
- GENERAL FUND**

2. Fees, fines and charges for services revenues reported in the general fund are comprised of the following:

	Amount
CIMA – Capitation and third party payors	\$ 3,555,654
Compensation in lieu of tax from the Puerto Rico Electric Power Authority (PREPA)	2,976,660
Construction excise tax	700,619
P.R. Department of Education – transportation services to students	554,611
Cemetery – special fund	195,947
Licenses and permits	24,690
Others	166,601
	\$ 8,174,782

NOTE O – RETIREMENT PLAN

1. Plan description

As of June 30, 2013 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 of Puerto Rico 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 non-occupational disabilities. Benefits vest after ten years of plan participation.

The system operate under *Act 447, approved on May 15, 1951* effective on January 1, 1952 and *Act 1 of February 16, 1990* for employees that entered as participants of the Plan starting April 1, 1990 and ending December 31, 1999. 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.

Act No. 305 of September 24, 1999 amended *Act. No. 447 of 1951* and *Act 1 of February 16, 1990* to establish 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.

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NOTE O – RETIREMENT PLAN - Continued

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 have not been granted under the new program. The employer contributions (11.275% 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.

As of June 30, 2012, the ERS has an unfunded actuarial accrued liability of approximately \$26.4 billion. In the opinion of management if measures are not implemented to deal with this situation, the ERS's net assets will be exhausted by the fiscal year 2015. In order to address this issue, among other measures, on July 6, 2011 (effective July 1, 2011) the Commonwealth Legislature approved Act No. 116 increasing the employers' contributions rate from 9.275% to 10.275% of employee compensation for fiscal year 2012, an additional 1% annually for each of the next four years, and 1.25% annually for each of the five years thereafter, reaching an aggregate contribution rate of 20.525% effective July 1, 2020. The purpose of this Act is to provide cash flow and strength the System to adequately cover administrative expenses and payment of benefits.

The Municipality is required to contribute 11.275% of gross salary for fiscal year 2013. As stated in the Act, percent increases applicable to municipalities for fiscal years 2011-2012, 2012-2013 y 2013-2014 would be financed through the Commonwealth's budget approved by the Commonwealth's Legislature. The Municipality's actual contribution for Law 447 and System 2000, which is equal to the required contribution, are \$373,304, \$431,311, and \$437,201 for the years ended on June 30, 2013, 2012, and 2011, respectively.

In order to address its unfunded liability and rescue the System from insolvency, on April 4, 2013 the Commonwealth of Puerto Rico enacted Act No. 3 of 2013, representing a comprehensive reform of the ERS. See related Note U.

**COMMONWEALTH OF PUERTO RICO
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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 2013, costs related to these post employment benefits amounted to \$158,339.

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 \$97,968. 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, 2013 of approximately \$1,945,301 for construction, improvements or renovation of certain capital assets.

3. Encumbrances

The Municipality has encumbrances outstanding which represent the estimated amount of expenditures required to complete contracts, purchase orders and other commitments in process of completion at fiscal year end. Outstanding encumbrances as of June 30, 2013 in the general fund represent unassigned amounts that are encumbered and are classified by management as assigned fund balance. Purpose classification follows:

Purpose	General Fund- assigned fund balance
General public works and sanitation	\$ 61,246
Public safety	8,405
Culture and recreation	8,497
Housing, welfare and community development	1,434
General government and other purposes	281,008
	\$ 360,590

Fund balance of major and other governmental funds (special revenue, capital project and debt service funds) is classified as restricted, some or all of which may be encumbered. Encumbrances of restricted fund balance are not reported separately from this classification because the encumbrance does not further restrict the purpose for which the resources may be used.

**COMMONWEALTH OF PUERTO RICO
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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.

NOTE S- GENERAL FUND - FUND BALANCE COMPOSITION

The general fund is composed of Fund 01, which is the Municipality's operational fund, and other special funds, which represent fund balance of the general fund restricted, committed or assigned for specific purposes. The following discloses the distribution of the net change in fund balance of the general fund as reported in the governmental funds statement of revenues, expenditures and changes in fund balances:

	<u>Fund 01</u>	<u>Special Funds in General Fund</u>	<u>Total General Fund</u>
Fund balance at beginning of year	\$ 13,404,028	\$ 11,334,785	\$ 24,738,813
Net change in fund balance	<u>1,560,783</u>	<u>(2,629,408)</u>	<u>(1,068,625)</u>
Fund balance at end of year	<u>\$ 14,964,811</u>	<u>\$ 8,705,377</u>	<u>\$ 23,670,188</u>

The negative net change in fund balance of \$(2,629,408) was caused by capital outlays for the construction of a sports complex from a special fund whose resources were earned or provided in previous years but funds were expended in current year.

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NOTE T – RESTATEMENT OF NET POSITION

The following table disclosed the net change in net position to the balance at beginning of year as previously reported in the financial statements. The beginning balance has been restated as follows:

<u>Description</u>	<u>Net position, government- wide statements</u>
Net position, at beginning of year, as previously reported	\$ 69,587,217
Balance of construction in progress of a building not recorded in previous year	1,006,314
Liability for solid waste landfill closure and post-closure care costs erroneously not accrued	(287,246)
Net assets, at beginning of year, as restated	<u>\$ 70,306,285</u>

NOTE U – SUBSEQUENT EVENTS

The Commonwealth of Puerto Rico is facing a financial crisis due to limited liquidity, general fund deficit, a sizeable amount of debt, an underfunded government pension system and an economy recession since 2006. As a result of these matters, credit ratings agencies have been consistently downgrading the Commonwealth's and certain public corporation's general obligation bonds ratings. In order to address these matters the Commonwealth began to make legislation to reform its governmental pension system, provide liquidity to the Governmental Development Bank of Puerto Rico ("GDB"), its fiscal agent, and strength sinking funds to assess financial markets. The Commonwealth estimates that these corrective actions, along others to be implemented, will have a positive impact on the Commonwealth itself, GDB, the municipalities and its citizens:

1. Pension System Reform

In order to address its unfunded liability and rescue the System from insolvency, on April 4, 2013 the Commonwealth of Puerto Rico enacted Act No. 3 of 2013, representing a comprehensive reform of the ERS. Act No. 3 became effective on July 1, 2013 and amends the provisions of the different benefits structures under the ERS, including, but not limited to, the following:

- a. Moves all participants (employees) under the defined benefit pension plans (Act 447 and Act 1) and the defined contribution plan (System 2000) to a new hybrid plan ("New Plan").
- b. For active participants of the contributory defined benefit programs under Act No. 447 of 1951 and Act No. 1 of 1990, all retirement benefits accrued through June 30, 2013 will be frozen, and thereafter, all future benefits will accrue under the New Plan. Participants will receive a pension at retirement age equivalent to what they have accrued under Act 447 and Act 1 up to June 30, 2013, and a supplemental annuity corresponding to contributions made after July 1, 2013.
- c. Participants under System 2000 will no longer receive a lump-sum payment upon retirement, but rather a lifetime annuity calculated at retirement based on a factor that will incorporate the individual's life expectancy and a rate of return.
- d. New participants under the New Plan will receive a lifetime annuity based on the accumulated balance of their individual accounts (employees' contributions plus a return on investment)

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NOTE U – SUBSEQUENT EVENTS - Continued

- e. Eliminates the possibility of accruing a merit pension (payable once the participant has achieved 30 years of creditable service) after June 30, 2013.
- f. Increases employee contributions from 8.275% to a minimum of 10.000%.
- g. After July 1, 2013 all employers must contribute 12.275% of employee contribution with an additional 1% annually up to June 30, 2016; after July 1, 2016 an additional 1.25% annually for each of the five years thereafter, reaching an aggregate contribution rate of 20.525% effective July 1, 2020. These contributions will be used to increase the System's assets, reduce the actuarial deficit and enable the System to comply with future obligations.
- h. Retirement age will be modified as follows:
 - 1) Act 447 regular employees: age 58 to 61,
 - 2) Act 447 high risk employees (state and municipal police, firefighters and custody officials): from age 50 to 55 years,
 - 3) Act 305 (System 2000) regular employees: age 60 to 65; high risk employees remains the same (55 years).Act 1 employees will remain the same (65 years for regular employees and 55 for high risk employees. For new employees under the New Plan will retire after 67 years (retirement age will be 67 for regular employees and 58 for high risk employees).
- i. Modifies Special Law benefits as follows:
 - 1) Reduction in Christmas bonus from \$600 to \$200 (current retirees),
 - 2) Elimination of summer bonus of \$100 (current retirees),
 - 3) No change in medical plan contribution of up to \$1,200 and medicine bonus of \$100 (current retirees)
 - 4) Eliminates Special Law benefits to future retirees.Employers will contribute \$2,000 per retiree and future retiree (originally under Act 447 and Act 1); the System will benefit from the savings generated between this employer contribution and the Special Law benefits paid out to retirees.
- j. Given these changes to Special Laws, the minimum monthly pension for current retirees was increased from \$400 to \$500.
- k. Disability benefits will be eliminated and substituted for a mandatory disability insurance policy.
- l. Survivor benefits will be modified.

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NOTE U – SUBSEQUENT EVENTS - Continued

In addition to the previously scheduled measures, the ERS reform plan also assumes an estimated \$140 million incremental contribution from the general fund (1.4% of general fund expenses for fiscal year 2014) to be included in the Commonwealth's proposed budget for the fiscal year 2014 and thereafter. The Commonwealth projects that the combined impact of these measures will allow the retirement system to increase the liquidity and solvency and meet the revised future obligations.

2. Sales and use taxes – Act No. 18 and 19 of 2014

In order to address the fiscal and credit crisis of the Commonwealth of Puerto Rico, the GDB liquidity and the difficult fiscal situation of the municipalities of Puerto Rico, on January 24, 2014 the Commonwealth approved Act No. 18 and 19. Those Act's provides for the restructuring and creation of financing structures from sales and use tax sources to guarantee and pay municipal long term debt issuances. As a result of this legislation the municipalities of Puerto Rico may improve its credit capacity along with maintaining sufficient resources for operations.

a. Act No. 18 of January 24, 2014

The purpose of this Act is to create a special fund called "Municipal Administration Fund" ("FAM") under custody of the Governmental Development Bank of Puerto Rico ("GDB") that permits the Municipalities to guarantee and pay long term debt and provide funds for its general operations. In addition, this Act improves the financing capacity of the Puerto Rico Sales Tax Financing Corporation ("COFINA"), a Commonwealth fund administered by GDB and the P.R. Secretary of Treasury. The Act includes provisions for municipalities that do not want to be covered by the Act. Special rules apply for those municipalities. The Act is effective on February 1, 2014.

The 6% corresponding to the Commonwealth's sales and use tax will be deposited in COFINA. From these funds during a transitory period from February 1, 2014 to June 30, 2014 the Commonwealth will deposit \$43,440,184 in the FAM to be distributed to the Municipalities as follows:

- .2% will be deposited in a Municipal Development Fund to be distributed to the municipalities,
- .2% will be deposited in a Municipal Redemption Fund to guarantee and repay the municipalities long term debt and,
- .1% 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.

After July 1, 2014 the 6% corresponding to the Commonwealth's sales and use tax will be deposited in COFINA. From these funds the Commonwealth will deposit .5% in the FAM. Distribution to municipalities will depend on whether the municipalities signed an agreement to be covered or not covered by the Act's provisions. The Municipality of Isabela signed the agreement to be covered.

For municipalities covered by the agreement the .5% will be distributed as follows:

- .2% will be deposited in the Municipal Development Fund to be distributed to the municipalities,

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NOTE U- SUBSEQUENT EVENTS - Continued

- .2% will be deposited in a Municipal Redemption Fund to then be deposited in the municipalities general fund (the municipalities has the option to maintain funds in the Municipal Redemption Fund or to transfer funds from the Municipal Development Fund to increase its debt margin and issue loans to be obtained from financial institutions)
- .1% 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.

For municipalities not covered by the agreement the .5% will be distributed as follows:

- .2% will be deposited in the "Municipal Development Fund". Section 4 of the Act requires amounts deposited in the Municipal Development Fund of municipalities not covered by the Act to be redistributed to the municipalities covered by the Act,
- .2% will be deposited in a "Municipal Redemption Fund" to guarantee and repay long term debt through any financial institution (each semester the municipalities may transfer to their general fund the funds in excess of debt service requirements),
- .1% 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.

b. Act No. 19 of January 24, 2014

The purpose of this Act is to create the "Municipal Finance Corporation" ("COFIN") a public corporation and a component unit of the Governmental Development Bank of Puerto Rico ("GDB") which may issue, pay or refinance long-term debt of municipalities. Principal and interest of these bonds and loans will be guaranteed with the municipal sales and use tax (1%). The Act includes provisions for municipalities that do not want to be covered by the Act. Special rules apply for those municipalities. The Act is effective on February 1, 2014.

After July 1, 2014 the 1% corresponding to the municipalities' sales and use tax will be deposited in COFIN. From these funds COFIN will deposit to the COFIN's sinking fund the greater of: .3% of the 1% municipal sales and use tax or an Annual Rental Fee ("RFA"). The RFA for fiscal year 2014-2015 will be \$65,541,281 and thereafter will be 1.5% of the RFA of the preceding fiscal period. The excess of the required deposit to the COFIN's sinking fund (.7% of the 1% of the municipal sales and use tax) will be transferred to the general fund of municipalities covered by the agreement or to the Municipal Redemption Fund as decided by the municipality. Before the transfer of the .7% to the municipalities covered by the Act, COFIN will transfer the 1% municipal sales and use tax to the municipalities not covered by the Act. These municipalities cannot obtain loans guaranteed by COFIN's sinking fund.

If at any moment the required deposits to the COFIN's sinking fund were not sufficient to pay the principal and interest of any outstanding obligation, the deficiency will be covered by appropriations of the Commonwealth's general fund budget.

As stated above the purpose of Act 18 and 19 of 2014 is to provide a financial structure to guarantee and pay long term debt to the municipalities while maintaining adequate cash flows for its operations, as well as provide liquidity to the GDB.

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NOTE U – SUBSEQUENT EVENTS - Continued

Notwithstanding the above corrective actions, on February 4, 2014 Standard & Poor's Ratings Services ("S&P") lowered its rating on the Commonwealth of Puerto Rico's general obligation (GO) debt to 'BB+' from 'BBB-' and the Commonwealth's appropriation secured debt and Employee Retirement System (ERS) debt to 'BB'. In addition, S&P downgraded the GDB to 'BB', and the rating remains on CreditWatch with negative implications. S&P have not taken a rating action on sales tax-secured debt of COFINA, but have retained their negative outlook on their COFINA ratings reflecting S&P's view of the economic outlook and that COFINA sales tax is not subject to the prior diversion of revenue for general obligation debt service payments. The downgrades follow S&P's evaluation of liquidity for the Commonwealth, including what they believe is a reduced capacity to access liquidity from GDB. S&P also believe that the Commonwealth's access to liquidity and to the market either through GDB or other means will remain constrained in the medium term. As S&P, the rating is not lower due to the progress the current administration has made in reducing operating deficits and recent success with reform of the public employee and teacher pension systems. They view those reforms as significant which could contribute to a sustainable path to fiscal stability.

In addition, on February 7, 2014 Moody's Investors Service ("Moody's") has downgraded the general obligation (GO) rating of the Commonwealth of Puerto Rico, the Pension funding bonds and GDB senior notes to Ba2 from Baa3. Other ratings that are capped by or linked to the Commonwealth's GO rating were also downgraded two notches, with the exception of the Puerto Rico Aqueduct and Sewer Authority (PRASA) Revenue Bonds, which were downgraded to Ba2 from Ba1. At the same time, Moody's downgraded the Puerto Rico Sales Tax Financing Corporation's (COFINA's) senior-lien bonds to Baa1 from A2 and its junior-lien bonds to Baa2 from A3. The outlooks for ratings on the GO and the related bonds, as well as the COFINA bonds, are negative. Downgrade is based among other Commonwealth's problems in years of deficit financing, pension underfunding, budgetary imbalance and seven years of economic recession. As a result, Commonwealth's debt load and fixed costs are high, its liquidity is narrow, and its market access has become constrained. Moody's recognizes major actions taken to stabilize Commonwealth finances, including significant reform to main pension system, and tax increases to reduce budget deficit.

Furthermore, on February 11, 2014 Fitch Ratings has downgraded the ratings, among other instrumentalities, for the Commonwealth general obligation (GO) bonds and ERS pension funding bonds from BB from BBB-. The current action does not affect the ratings that Fitch assigns to bonds issued by COFINA, since those bonds are secured by the Commonwealth's sales and use tax and insulated from the Commonwealth's general credit strain. Fitch reported that recent downgrades have triggered new liquidity requirements and lowered expectations for the market available for the Commonwealth's debt going forward, though there have been no significant negative developments regarding the Commonwealth's finances or economy since November 2013. In addition, the report recognizes that the Commonwealth's management has responded quickly and decisively to challenges that have arisen in recent years and the current administration has made significant progress in addressing longstanding credit issues.

These downgrades may have a significant impact in the economic environment of Puerto Rico and the Commonwealth Government, its instrumentalities and the municipalities in critical areas such as access to markets and liquidity for the current fiscal year and thereafter. It is the opinion of the Commonwealth's and Municipality of Isabela's management that the corrective actions taken and to be taken in current and fiscal periods thereafter will lower the impact of this decision and cause a positive turnaround on the Commonwealth's and the Municipality's finances.

REQUIRED SUPPLEMENTARY INFORMATION

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA
BUDGETARY COMPARISON SCHEDULE - GENERAL FUND
FISCAL YEAR ENDED JUNE 30, 2013**

	Budgeted amounts		Actual Amounts (Budgetary Basis) (See Note A.)	Variance with Final Budget Positive (Negative)
	Original	Final		
Revenues:				
Taxes:				
Property taxes	\$ 4,892,760	\$ 5,284,435	\$ 5,438,100	\$ 153,665
Municipal license taxes	2,337,758	2,555,495	2,567,671	12,176
Sales and use taxes	2,344,436	2,437,750	2,688,790	251,040
Intergovernmental	6,043,929	3,805,606	3,805,606	-
Fees, fines and charges for services	768,770	3,430,981	3,582,947	151,966
Interest	125,000	315,000	378,627	63,627
Other	100,000	176,758	326,179	149,421
Total revenues	16,612,653	18,006,025	18,787,920	781,895
Expenditures:				
Current:				
General government	9,100,219	8,795,891	8,359,795	436,096
Public works and sanitation	3,105,730	3,011,687	2,599,525	412,162
Public safety	1,216,194	1,167,781	1,147,159	20,622
Culture and recreation	749,402	703,315	682,129	21,186
Health	964,275	731,872	711,290	20,582
Housing, welfare and community development	1,387,579	1,287,196	1,256,902	30,294
Total expenditures	16,523,399	15,697,742	14,756,800	940,942
Excess of revenues over expenditures	89,254	2,308,283	4,031,120	1,722,837
Other financing uses:				
Transfers out	(89,254)	(2,308,283)	(2,308,283)	-
Total other financing uses	(89,254)	(2,308,283)	(2,308,283)	-
Excess of revenues over expenditures and other financing uses	\$ -	\$ -	\$ 1,722,837	\$ 1,722,837

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA
NOTES TO REQUIRED SUPPLEMENTAL INFORMATION
BUDGETARY COMPARISON SCHEDULE – GENERAL FUND
JUNE 30, 2013

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 SUPPLEMENTAL INFORMATION
BUDGETARY COMPARISON SCHEDULE – GENERAL FUND
JUNE 30, 2013**

NOTE B - BUDGET TO GAAP RECONCILIATION – Continued

Excess of revenues and other financing sources over expenditures and other financing uses (budgetary basis):	\$ 1,722,837
Budget to GAAP differences:	
Entity differences:	
Non budgeted funds recorded as revenues for financial reporting purposes:	4,004,020
Non budgeted funds recorded as expenditures for financial reporting:	(8,825,161)
Non budgeted transfers in:	2,350,024
Non budgeted transfers out:	(158,291)
Basis of accounting differences:	
Revenues recorded for financial reporting purposes but not in budgetary basis:	1,197,182
Expenditures recorded in budgetary basis but not for financial reporting purposes:	8,059
Expenditures recorded for financial reporting purposes but not in budgetary basis:	(1,048,871)
Revenues recorded in budgetary basis but not for financial reporting purposes:	(363,783)
Timing differences:	
Current year encumbrances recorded as expenditures for budgetary reporting purposes:	107,136
Prior year encumbrances recorded as expenditures for financial reporting purposes:	(61,777)
Net change in fund balance (GAAP basis):	<u>\$ (1,068,625)</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, 2013

Line Item No.	Description	14.871	
		Housing Choice Vouchers	
Balance Sheet			
111	Cash - unrestricted	\$	114,293
113	Cash - other restricted	\$	10,819
100	Total cash	\$	125,112
121	Accounts receivable - PHA projects	\$	7,799
125	Accounts receivable - miscellaneous	\$	592
126.2	Allowance for doubtful accounts - other	\$	(5,419)
120	Total receivables, net of allowance for doubtful accounts	\$	2,972
150	Total Current Assets	\$	128,084
164	Furniture, equipment and machinery - administration	\$	33,817
166	Accumulated depreciation	\$	(20,651)
160	Total capital assets, net of accumulated depreciation	\$	13,166
180	Total Non-current Assets	\$	13,166
190	Total Assets	\$	141,250
200	Deferred Outflows of Resources	\$	-
290	Total Assets and Deferred Outflows of Resources	\$	141,250
312	Accounts payable <= 90 days	\$	4,129
322	Accrued compensated absences - current portion	\$	5,216
332	Accounts Payable - PHA Projects	\$	6,951
333	Accounts payable - other government	\$	18,659
310	Total Current Liabilities	\$	34,955
353	Non-current liabilities - other	\$	1,979
350	Total Non-current Liabilities	\$	1,979
300	Total Liabilities	\$	36,934
300	Deferred Inflows of Resources	\$	-
508.1	Net Investment in Capital Assets	\$	13,166
511.1	Restricted Net Position	\$	6,691
512.1	Unrestricted Net Position	\$	84,459
513	Total Equity/Net Position	\$	104,316
600	Total Liabilities, Deferred Inflows of Resources and Equity/Net Position	\$	141,250

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA
SUPPLEMENTARY INFORMATION – FINANCIAL DATA SCHEDULE
BALANCE SHEET AND STATEMENT OF REVENUES AND EXPENSES INFORMATION
JUNE 30, 2013

Line Item No.	Description	14.871	
		Housing Choice Vouchers	
		Income Statement	
70600-010	Housing assistance payments	\$	342,008
70600-020	Ongoing administrative fees earned	\$	53,578
70600-070	Admin fee calculation description		
70600	HUD PHA operating grants	\$	395,586
71500	Other revenue	\$	16,726
700	Total Revenue	\$	412,312
91100	Administrative salaries	\$	38,373
91200	Auditing fees	\$	5,000
91500	Employee benefit contributions- administrative	\$	6,624
91600	Office expenses	\$	2,574
91800	Travel	\$	5,242
91000	Total Operating - Administrative	\$	57,813
96210	Compensated absences	\$	756
96600	Bad debt - other	\$	2,631
96000	Total Other General Expenses	\$	3,387
96900	Total Operating Expenses	\$	61,200
97000	Excess Revenue Over Operating Expenses	\$	351,112
977300-020	Home-Ownership	\$	-
97300-050	All Other	\$	348,815
97300	Housing assistance payments	\$	348,815
97350	HAP Portability-in	\$	13,834
97400	Depreciation expense	\$	3,455
97500	Fraud losses	\$	-
900	Total Expenses	\$	427,304
10000	Excess (Deficiency) of Revenue Over (Under) Expenses	\$	(14,992)

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA
SUPPLEMENTARY INFORMATION – FINANCIAL DATA SCHEDULE
BALANCE SHEET AND STATEMENT OF REVENUES AND EXPENSES INFORMATION
JUNE 30, 2013

Line Item No.	Description	14.871
Income Statement		Housing Choice Vouchers
10000	Excess (Deficiency) of Revenue Over (Under) Expenses	\$ (14,992)
11030	Beginning equity	\$ 119,308
11770-001	Administrative Fee Equity - Beginning Balance	\$ 105,810
11170-010	Administrative Fee Revenue	\$ 53,578
11170-050	Other Revenue	\$ 16,726
11170-051	Comment For Other Revenue	This amount corresponds to the administrative fees earned on the portability-in vouchers administered by the Municipality (\$2,892) plus the reimbursement received from the initial PHAs from the HAP rent payments made on behalf of the portability-in units during 12-13 (\$13,834).
11170-060	Total Admin Fee Revenues	\$ 70,304
11170-080	Total Operating Expenses	\$ 61,200
11170-090	Depreciation	\$ 3,455
11170-095	Housing Assistance Portability In	\$ 13,834
11170-110	Total Expenses	\$ 78,489
11170-002	Net Administrative Fee	\$ (8,185)
11170-003	Administrative Fee Equity - Ending Balance	\$ 97,625
11170	Administrative Fee Equity	\$ 97,625
11180-001	Housing Assistance Payments Equity - Beginning Balance	\$ 13,498
11180-010	Housing Assistance Payments Revenues	\$ 342,008
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.
11180-030	Total HAP Revenues	\$ 342,008
11180-080	Housing Assistance Payments	\$ 348,815
11180-091	Comment For Other Expense	
11180-100	Total Housing Assistance Payments Expenses	\$ 348,815
11180-002	Net Housing Assistance Payments	\$ (6,807)
11180-003	Housing Assistance Payments Equity - Ending Balance	\$ 6,691
11180	Housing Assistance Payments Equity	\$ 6,691
11190-210	Total ACC HCV Units	1,032
11190	Unit Months Available	1,032
11210	Unit Months Leased	959

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA
NOTES TO SUPPLEMENTARY INFORMATION – FINANCIAL DATA SCHEDULE
JUNE 30, 2013

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.

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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, 2013**

Federal Grantor/Pass Through Grantor/Program Title	Federal CFDA Number	Pass-Through Entity Identifying Number	Federal Expenditures
<u>U.S. Department of Agriculture</u>			
Direct programs:			
Community Development Loans and Grants	10.766	N/A	\$ 102,918
Passed-through program from:			
P.R. Department of Education Child and Adult Care Food Program	10.558	CCC-27	136,454
Subtotal U.S. Department of Agriculture			<u>239,372</u>
<u>U.S. Department of Housing and Urban Development</u>			
Direct programs:			
Section 8 Housing Choice Vouchers Program	14.871	N/A	395,586
Community Development Block Grants / Entitlement Grants	14.218	N/A	1,590,452
Municipality of San Juan Housing Opportunities for Persons with AIDS (HOPWA)	14.241	NAV	8,260
Subtotal U.S. Department of Housing and Urban Development			<u>1,994,298</u>
<u>U.S. Department of Transportation</u>			
Passed-through program from:			
P.R. Traffic Safety Commission State and Community Highway Safety	20.600	11-03-78,11-06-21	14,170
<u>U.S. Department of Energy</u>			
Direct program:			
P.R. Energy Affairs Administration ARRA - Energy Efficiency and Conservation Block Grant Program (EECBG)	81.128	EE0002296	16,415
<u>U.S. Department of Health and Human Services</u>			
Direct programs:			
Head Start Cluster:			
Head Start	93.600	N/A	1,094,344
ARRA - Head Start	93.708	N/A	907,555
Total Head Start Cluster:			<u>2,001,899</u>
Passed-through programs from:			
P.R. Office of Ombudsman Administration (OAP): Special Programs for the Aging Title III, Part C Nutrition Services	93.045	120202R2; 130145R2	93,760
P.R. Department of Family - Families and Children Administration: Child Care and Development Block Grant	93.575	2012-2013-059; 2013-2014-059	274,491
Subtotal U.S. Department of Health and Human Services:			<u>368,251</u>
<u>U.S. Department of Homeland Security</u>			
Passed-through programs from:			
P.R. Governor Office - Office of Public Safety Affairs: Homeland Security Grant Program	97.067	2010 SS-T0-0093	48,750
Total Expenditures of Federal Awards			<u>\$ 4,683,155</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA
NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FISCAL YEAR ENDED JUNE 30, 2013**

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, 2013. 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, except for Section 8 Housing Choice Voucher Program (HCV). 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. Expenditures for HCV Program are reported on a statutory basis as required by the U.S. Department of Housing and Urban Development. Such expenditures should equal the net ACC subsidy for the PHA's fiscal period.

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	USDHUD - Community Development Block Grant Program Fund	USDHHS - USDA - Head Start Fund	Bonds and Notes Issuance Fund	USDHHS - USDA - Child Care Fund	Other Governmental Funds
10.766	\$ -	\$ -	\$ 102,918	\$ -	\$ -
10.558	-	108,342	-	28,112	-
14.871	-	-	-	-	395,586
14.218	1,590,452	-	-	-	-
14.241	-	-	-	-	8,260
20.600	-	-	-	-	14,170
ARRA - 81.128	-	-	-	-	16,415
93.600	-	1,094,344	-	-	-
ARRA - 93.708	-	907,555	-	-	-
93.045	-	-	-	-	93,760
93.575	-	-	-	274,491	-
93.067	-	-	-	-	48,750
Total federal awards expenditures:	<u>1,590,452</u>	<u>2,110,241</u>	<u>102,918</u>	<u>302,603</u>	<u>576,941</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA
NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FISCAL YEAR ENDED JUNE 30, 2013**

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>USDHUD - Community Development Block Grant Program Fund</u>	<u>USDHHS – USDA – Head Start Fund</u>	<u>Bonds and Notes Issuance Fund</u>	<u>USDHHS – USDA – Child Care Fund</u>	<u>Other Governmental Funds</u>
Carry forward amount, total federal awards expenditures:					
Additional amount recorded as expenditures under modified accrual basis for Section 8 HCV Program:	1,590,452	2,110,241	102,918	302,603	576,941
Total non-federal awards expenditures:	-	-	-	-	27,228
Total expenditures, governmental fund statements:	<u>1,886</u>	<u>-</u>	<u>1,794,679</u>	<u>-</u>	<u>993,519</u>
	<u>\$ 1,592,338</u>	<u>\$ 2,110,241</u>	<u>\$ 1,897,597</u>	<u>\$ 302,603</u>	<u>\$ 1,597,688</u>

NOTE E – LOAN GUARANTEE

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 financed the construction of a Youth Sports and Education Center. During fiscal year 2013 the Municipality paid the final costs of the Project and transferred the final project cost from construction in progress to building and building improvements function. The following represents the loan outstanding balance as of June 30, 2013:

<u>CFDA No.</u>	<u>Program Name</u>	<u>Loan Outstanding Balance</u>
14.248	Community Development Block Grants_ Section 108 Loan Guarantees	<u>\$ 3,774,000</u>

**INDEPENDENT AUDITOR'S 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**

Hon. Carlos Delgado Altieri and
Members of the Municipal Legislature of the
Commonwealth of Puerto Rico
Municipality of Isabela
Isabela, Puerto Rico

We have audited, in accordance with the 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, the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of Commonwealth of Puerto Rico, Municipality of Isabela, as of and for the year ended June 30, 2013, and the related notes to the financial statements, which collectively comprise Commonwealth of Puerto Rico, Municipality of Isabela's basic financial statements, and have issued our report thereon dated March 14, 2014.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered Commonwealth of Puerto Rico, Municipality of Isabela's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Commonwealth of Puerto Rico, Municipality of Isabela's internal control. Accordingly, we do not express an opinion on the effectiveness of Commonwealth of Puerto Rico, Municipality of Isabela's internal control.

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. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

**INDEPENDENT AUDITOR'S 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)**

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or, significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Commonwealth of Puerto Rico, Municipality of Isabela's financial statements are free from 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*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

San Juan, Puerto Rico
March 14, 2014

The stamp number 02698442
was affixed to the original report


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**INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE FOR EACH MAJOR
PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE REQUIRED BY
OMB CIRCULAR A-133**

Hon. Carlos Delgado Altieri and
Members of the Municipal Legislature of the
Commonwealth of Puerto Rico
Municipality of Isabela
Isabela, Puerto Rico

Report on Compliance for Each Major Federal Program

We have audited Commonwealth of Puerto Rico, Municipality of Isabela'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 Commonwealth of Puerto Rico, Municipality of Isabela's major federal programs for the year ended June 30, 2013. Commonwealth of Puerto Rico, Municipality of Isabela's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to its federal programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of Commonwealth of Puerto Rico, Municipality of Isabela's major federal programs based on our audit of the types of compliance requirements referred to above. 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 Commonwealth of Puerto Rico, Municipality of Isabela's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of Commonwealth of Puerto Rico, Municipality of Isabela's compliance.

**INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE FOR EACH MAJOR
PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE REQUIRED BY
OMB CIRCULAR A-133 (CONTINUED)**

Opinion on Each Major Federal Program

In our opinion, Commonwealth of Puerto Rico, Municipality of Isabela complied, in all material respects, with the types of 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, 2013.

Report on Internal Control over Compliance

Management of Commonwealth of Puerto Rico, Municipality of Isabela is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered Commonwealth of Puerto Rico, Municipality of Isabela's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program 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 Commonwealth of Puerto Rico, Municipality of Isabela'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. A *significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

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 material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE FOR EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE REQUIRED BY OMB CIRCULAR A-133 (CONTINUED)

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.

San Juan, Puerto Rico
March 14, 2014

González Torres
GONZALEZ TORRES & CO., CPA, PSC

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
JUNE 30, 2013

Section I. Summary of Auditors' Results:

Part I Financial Statements

1. Type of audit report:
 Unqualified opinion Qualified opinion
 Adverse opinion Disclaimer of opinion

2. "Going concern" emphasis-of-matter paragraph included
 Yes No

3. Significant deficiency disclosed:
 Yes No

4. Material weakness disclosed:
 Yes No

5. Material noncompliance disclosed:
 Yes No

Part II Federal Awards

1. Type of report: on compliance for major programs:
 Unqualified opinion Qualified opinion
 Adverse opinion Disclaimer of opinion

2. Reportable condition reported as a major weakness and/or significant deficiency:
 Yes No

3. Material noncompliance disclosed:
 Yes No

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
JUNE 30, 2013**

Section I. Summary of Auditors' Results (continued):

Part II Federal Awards (continued):

4. Audit findings required to be reported under Section 510 (a) of Circular A-133:

Yes No

5. Major Programs:

CFDA Number (s)	Federal Program Grantor and Program Name
14.871	Section 8 Housing Choice Vouchers Program
14.218	Community Development Block Grants / Entitlement Grants
93.600	Head Start
93.575	ARRA – Head Start

6. Dollar threshold used to distinguish Type A and Type B programs: \$300,000

7. Low-risk auditee

Yes No

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

Yes No

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
JUNE 30, 2013**

Section II. Financial Statements Findings

NONE.

Section III. Federal Awards Findings and Questioned Costs

NONE.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF ISABELA**

**SCHEDULE OF PRIOR YEAR FINDINGS AND QUESTIONED COSTS
JUNE 30, 2013**

NONE