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AREA DE ASESORAMIENTO, REGLAMENTACION E INTERVENCION FISCAL
AREA DE ARCHIVO DIGITAL

MUNICIPIO DE SANTA ISABEL
AUDITORIA 2002-2003
30 DE JUNIO DE 2003

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MUNICIPALITY OF SANTA ISABEL, PUERTO RICO
GENERAL PURPOSE FINANCIAL STATEMENTS AND
SINGLE AUDIT REPORT
FOR THE YEAR ENDED JUNE 30, 2003
(WITH INDEPENDENT AUDITOR'S REPORT THEREON)

GONZÁLEZ TORRES & CO., PSC
Certified Public Accountant & Consultants

**MUNICIPALITY OF SANTA ISABEL, PUERTO RICO
SINGLE AUDIT REPORT
JUNE 30, 2003**

TABLE OF CONTENTS

	<u>PAGE</u>
INDEPENDENT AUDITOR'S REPORT ON GENERAL PURPOSE FINANCIAL STATEMENTS AND SCHEDULE OF FEDERAL FINANCIAL ASSISTANCE	1-3
GENERAL PURPOSE FINANCIAL STATEMENTS:	
COMBINED BALANCE SHEET-ALL FUND TYPES AND ACCOUNT GROUPS	4
COMBINED STATEMENT OF REVENUES AND EXPENDITURES AND CHANGES IN FUND BALANCES ALL FUND TYPES	5
COMBINED STATEMENT OF REVENUES AND EXPENDITURES BUDGET AND ACTUAL	6
NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS	7-23
SUPPLEMENTAL INFORMATION:	
SCHEDULE OF FEDERAL FINANCIAL ASSISTANCE	24-25
AUDITOR'S REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING REQUIRED BY GOVERNMENTAL AUDITING STANDARDS	26-28
AUDITOR'S REPORTS ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH MAYOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE REQUIRED BY OMB CIRCULAR A-133	29-32
SUMMARY OF AUDIT RESULT	33-34
SCHEDULE OF CURRENT FINDINGS AND QUESTIONED COST	35-39
SCHEDULE OF PRIOR FINDINGS	40-42

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Certified Public Accountants and Consultants



Member of:
Puerto Rico Society of Certified Public Accountants
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INDEPENDENT AUDITOR'S REPORT ON GENERAL PURPOSE FINANCIAL STATEMENTS

**To the Mayor and Municipal Assembly
Municipality of Santa Isabel, Puerto Rico
Santa Isabel, Puerto Rico**

We have audited the accompanying general purpose financial statements of the Municipality of Santa Isabel, Puerto Rico as of and for the year ended June 30, 2003, as listed in the accompanying table of contents. These general purpose financial statements are the responsibility of the Municipality of Santa Isabel's management. Our responsibility is to express an opinion on these general-purpose financial statement based on our audit.

Except as discussed in the following paragraphs, we conducted our audit in accordance with generally accepted auditing standards 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, and the provisions of the Office of Management and Budget Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations". Those standards and OMB Circular A-133 standards require that we plan and perform the audit to obtain reasonable assurance about whether the general-purpose financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the general-purpose financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall general-purpose financial statements presentation. We believe that our audit provides a reasonable basis for our opinion.

The Municipality's accounting system and subsidiary record of property, plant and equipment did not provide competent evidence with respect to the amounts presented in the accompanying general-purpose financial statements. We were unable to satisfy ourselves about such amount. Therefore, we do not express an opinion on such amounts included in the general fixed assets account group.

The Municipality did not provide us sufficient evidence of inter-fund transactions, including inter-fund receivables and payables, with respect to the amounts presented in the accompanying general-purpose financial statements. Therefore, we were unable to satisfy ourselves about such transactions and amounts. We do not express an opinion on such transactions and amounts included in the general-purpose financial statements.

The Municipality did not provide for our review the details of certain accounts payable in the amount of \$269,173. Thus, we were unable to perform auditing procedures over these balances, which are included as part of the accounts payable for general fund.

**INDEPENDENT AUDITOR'S REPORT
ON GENERAL PURPOSE FINANCIAL STATEMENTS
(CONTINUED)**

The Municipality adjusted its beginning general, special revenue and capital project fund balances in the amount of \$840,700, (\$599,143) and \$161,430, respectively; for corrections of transactions and other adjustments to assets and liabilities. The adjustments were made against prior year fund balances without considering any effect, if any on the current year operations. As subscribed in paragraph four of this report, the Municipality maintain unreconciled differences in their inter fund cash transactions and because of the uncertainty of corrections of general, special and capital project funds balances were unable to determine the effect if any in 2003 operations. The Municipality recognized an account receivable in the amount of 389,987 in which we were unable to obtain evidential matters regarding the net realizable value of such account receivable.

In our opinion, except for the facts described in the third, four, fifth and sixth paragraphs of this report and the applicable adjustments, if any, the general purpose financial statements referred to above present fairly, in all material respects, the financial position of the Municipality of Santa Isabel as of June 30, 2003, and the result of its operations for the year then ended, in conformity with generally accepted accounting principles in the United States of America.

In accordance with Government Auditing Standards, we have also issued our report dated March 26,2004 on our consideration of the Municipality's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grants.

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

**INDEPENDENT AUDITOR'S REPORT
ON GENERAL PURPOSE FINANCIAL STATEMENTS
(CONTINUED)**

As described in the Note 11, the Municipality is a defendant in a lawsuit alleging political discrimination by ex-employees and other damages. The Municipality's management, after consultation with the Legal Counsel, have established a provision for a contingency liability in the amount of \$3,571,548 in the general long term debt account group and \$520,200 in the accounts payable in the general fund. However, such amount are not final. Other contingencies for claims against the Municipality are described in the Note 11, but no provision has been established by Management because the outcome of these cases are not presently determinable.

San Juan, Puerto Rico
March 26, 2004

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**MUNICIPALITY OF SANTA ISABEL, PUERTO RICO
COMBINED BALANCE SHEET
ALL FUND TYPES AND ACCOUNT GROUPS
JUNE 30, 2003**

	Government Fund Types				Accounts Group		Memorandum Only 2003
	GENERAL	SPECIAL REVENUE	DEBT SERVICE	CAPITAL PROJECT	GEN. FIXED ASSETS	GEN. LONG TERM DEBT	
ASSETS AND OTHER DEBITS							
Cash (Note 2) including CD'S of 301,553	\$	\$785,902	\$	\$ 287,329	\$	\$	1,073,231
Cash with Fiscal Agent (Note 2)	681,916	10,476	689,809	776,066			2,158,267
Accounts Receivable:							
Due from Other Fund	99,859	684,116					783,975
Due from Federal Agencies		369,278		36,392			405,670
Gen. Fixed Assets (Notes 1-E, G and 7)					3,378,811		3,378,811
Due from Other Governmental Units	537,164	99,864					637,028
Other receivables	389,987	217					390,204
Amount To Be Provided for payment of long term debt:							
From Debt Service						689,809	689,809
Long Term Debt						13,494,865	13,494,865
TOTAL ASSETS	\$ 1,708,926	\$1,949,853	\$689,809	\$1,099,787	\$3,378,811	\$14,184,674	23,011,860
LIABILITIES AND FUND EQUITY (DEFICIT)							
Liabilities:							
Accts. Payable & Acc. Liab.	\$ 1,647,481	\$ 274,258	\$	\$ 301,394	\$	\$ 540,000	2,763,133
Due to Other Fund	684,116	99,859					783,975
Bank overdraft	99,140						99,140
Mature Bonds and Notes Payable (Note 8)			245,000			5,802,242	6,047,242
Due to Other Government Units (Note 12)	1,534,324					3,022,018	4,556,342
Accrued Vacation and Sick Leave (Note 1-M)						1,248,866	1,248,866
Contingencies (Note 11)	520,200					3,571,548	4,091,748
Interest payable			114,765				114,765
Deferred Revenues	1,081,131	1,327,224		46,025			2,454,380
TOTAL LIABILITIES	5,566,392	1,701,341	359,765	347,419	3,378,811	14,184,674	22,159,591
Invest. In Gen. Fixed Assets (Note 7)					3,378,811		3,378,811
FUND BALANCES (DEFICIT):							
Designated funds (Note 1)		248,512	330,044	752,368			1,330,924
Deficit	(3,857,466)						(3,857,466)
TOTAL FUND EQUITY (DEFICIT)	(3,857,466)	248,512	330,044	752,368	3,378,811		852,269
TOTAL LIABILITIES AND FUND EQUITY	\$ 1,708,926	\$1,949,853	\$689,809	\$1,099,787	\$ 3,378,811	\$14,184,674	23,011,860

SEE NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS

**MUNICIPALITY OF SANTA ISABEL, PUERTO RICO
COMBINED STATEMENTS OF REVENUES, EXPENDITURES
AND CHANGES IN FUND BALANCES
ALL GOVERNMENT FUND TYPES
FOR THE FISCAL YEAR ENDED JUNE 30, 2003**

	GOVERNMENTAL FUND TYPES				MEMORANDUM ONLY
	GENERAL	SPECIAL REVENUE	DEBT SERVICE	CAPITAL PROJECT	2003
REVENUES:					
Property Taxes (Note 4)	\$1,326,116		\$344,767		\$1,670,883
Volume of Business Tax	655,801				655,801
Intergovernmental Revenues (Note 6)	3,621,851	972,581		73,317	4,667,749
Fees, fines and charges	25,790				25,790
Other Revenues	1,729,686		15,165		1,744,851
Licenses and Permits	432,668				432,668
Interest	35,920	1,729	6,470	90	44,209
Federal Financial Assistance	-	2,375,352		1,391,816	3,767,168
TOTAL REVENUES	7,827,832	3,349,662	366,402	1,465,223	13,009,119
EXPENDITURES:					
General Government	3,527,530	763,465		260,607	4,551,802
Public Safety	456,293				456,293
Health & Welfare	876,549				876,549
Public Works & Transportation and Sanitation	2,501,553	143,423			2,644,976
Sports & Recreation	430,688				430,688
Education		1,514,469			1,514,469
Capital Outlays				2,143,582	2,143,582
Housing and Federal Welfare Programs		1,078,468			1,078,468
Debt Service:					
Principal			2,040,000		2,040,000
Interest			318,067		318,067
TOTAL EXPENDITURES	7,792,613	3,499,825	2,358,067	2,404,189	16,054,694
EXCESS (DEFICIENCY) OF EXPENDITURES OVER REVENUES	35,219	(150,163)	(1,991,665)	(938,966)	(3,045,575)
Operation transfer in	6,400	153,899	1,514,125		1,674,424
Operation transfer out	(1,668,023)		(6,401)		(1,674,424)
LOAN PROCEEDS (Note 8)	1,850,000			816,378	2,666,378
TOTAL OTHER FINANCING SOURCES (USES)	188,377	153,899	1,507,724	816,378	2,666,378
EXCESS (DEFICIENCY) OF REVENUES AND OTHER FINANCING SOURCES (USES) OVER/ (UNDER) EXPENDITURES	223,596	3,736	(483,941)	(122,588)	(379,197)
FUND BALANCE (DEFICIT) JUNE 30, 2002	(4,921,762)	843,919	813,985	713,526	(2,550,332)
PRIOR PERIOD ADJUSTMENT (Note 17)	\$840,700	(\$599,143)		\$161,430	\$402,987
FUND BALANCE (DEFICIT) JUNE 30, 2003 RESTATED	(\$4,081,062)	\$244,776	\$813,985	\$874,956	(\$2,147,345)
ENDING FUND BALANCE (DEFICIT)	(\$3,857,466)	\$248,512	\$330,044	\$752,368	(\$2,526,542)

SEE NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS

**MUNICIPALITY OF SANTA ISABEL, PUERTO RICO
 COMBINED STATEMENTS OF REVENUES, EXPENDITURES
 BUDGET-GAAP BASIS AND ACTUAL
 GENERAL AND DEBT SERVICE FUNDS
 FOR THE FISCAL YEAR ENDED JUNE 30, 2003**

	GENERAL FUND			DEBT SERVICE FUND		
	BUDGET	ACTUAL	VARIANCE FAVORABLE (UNFAV)	BUDGET	ACTUAL	VARIANCE FAVORABLE (UNFAV)
REVENUES:						
Property taxes	1,423,919	1,326,116	(97,803)	\$389,610	\$366,402	(\$23,208)
Volume of business taxes	750,500	655,801	(94,699)			
Municipal license taxes	580,000	432,668	(147,332)			
Intergovernmental	4,857,591	3,366,977	(1,490,614)			
Fees, fines and charges for services	13,000	25,790	12,790			
Interest	30,000	42,320	12,320			
Other	382,998	246,623	(136,375)			
TOTAL REVENUES	8,038,008	6,096,295	(1,941,713)	389,610	366,402	(23,208)
EXPENDITURES:						
CURRENT:						
General government	3,386,362	2,664,309	722,053			
Health	622,045	606,118	15,927			
Public works and sanitation	2,807,489	2,536,591	270,898			
Public safety	481,128	449,156	31,972			
Culture and recreation	463,062	408,135	54,927			
Welfare	277,922	272,671	5,251			
Debt Service:						
Principal				270,239	305,000	(34,761)
Interest				119,371	185,578	(66,207)
TOTAL EXPENDITURES	8,038,008	6,936,980	1,101,028	389,610	490,578	(100,968)
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES	\$ -	(\$840,865)	(\$840,865)	\$ -	(\$124,176)	(124,176)

SEE NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS

MUNICIPALITY OF SANTA ISABEL, PUERTO RICO
NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS
JUNE 30, 2003

(1) ORGANIZATION, OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Municipality of Santa Isabel (the Municipality) was founded in 1841. The governmental system is composed of the executive and legislative body. The Mayor is the main Executive and is elected each four (4) years in the Puerto Rico's general elections. The legislative body is composed of twelve (12) Assemblymen each of whom is elected every four (4) years.

The Municipality provides services such as public safety, recreation and culture, housing and community development, public health, sanitation, construction and/or improvements of streets and other general and administrative services.

The Municipality's accounting policies conform to generally accepted accounting principles as applicable to governmental units. The following is a summary of significant policies:

(A) REPORTING ENTITY

The financial statements of the Municipality consist only of the governmental funds and account groups of the Municipality. The Municipality has no oversight responsibility for any other governmental entity since no other entities are considered to be controlled by or dependent on the Municipality. Control or dependence is determined on the basis of budget adoption, taxing authority, and funding.

(B) USE OF ESTIMATES

The preparation of financial statements in conformity with generally accepted accounting principles 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 financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(C) BASIS OF PRESENTATION- FUND ACCOUNTING

The Municipality accounts are organized on the basis of funds and account groups, each of which is considered a separate accounting entity. Each fund operation is accounted by its own group of self-balancing accounts that comprised its assets, liabilities, fund balances, revenues and expenditures. The Municipality funds are allocated to, and accounted for individual funds based upon the purposes for which they are spent and the means by which spending activities are controlled.

MUNICIPALITY OF SANTA ISABEL, PUERTO RICO
NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS
JUNE 30, 2003

**(1) ORGANIZATION, OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(CONTINUED)**

(D) GOVERNMENTAL FUND TYPES

Governmental funds are those through which most governmental functions are financed. The acquisition, use and balances of the Municipality's expendable financial resources and the related current liabilities are accounted for through governmental funds. The measurement focus is upon determination of changes in financial position, rather than upon net income determination. The following are the Municipality's governmental funds.

General Fund- is the general operating fund of the Municipality. It is used to record all the financial resources and the majority of current operations except for those required to be accounted in other funds.

Special Revenue Fund- are funds legally restricted for specific purposes. The Municipality maintains a separate Special Revenue Fund for each Federal or State grant program. The financial statements have been prepared for reporting purposes by combining those funds which are similar in nature or are funded by the same grantor agency.

Debt Service Fund- is used to account for the accumulation of resources assigned for the payment of principal, interest and related costs of general long-term debt. The main source of this fund is property taxes and interests.

Capital Project Fund- The capital project fund is used to record the financial resources for the acquisition or construction of permanent major improvements, except projects financed by special revenue funds. The principal sources of revenues are federal funds, municipal long-term debt proceeds, and legislative appropriations.

Long Term Liabilities expected to be financed from governmental funds are accounted for in the general long-term debt account group, not in the governmental fund.

Capital expenditures and permanent improvements financed through governmental funds are accounted for under the general Fixed Assets account group.

The two account groups are not "Funds". They are concerned only with the measurement of financial position. They are not involved with measurement of results of operations.

**MUNICIPALITY OF SANTA ISABEL, PUERTO RICO
NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS
JUNE 30, 2003**

**(1) ORGANIZATION, OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(CONTINUED)**

(E) GOVERNMENTAL FUND TYPES (CONTINUED)

Because of their spending measurement focus, expenditure recognition for governmental fund types is limited to excluded amounts represented by non - current liabilities. Since they do not affect net current assets, these long - term amounts are not recognized as governmental fund type expenditures of fund liabilities. They are instead reported as liabilities in the general long - term debt account group.

(F) ACCOUNT GROUPS

Account groups are not funds and are used to establish accounting control and to account for general fixed assets and general long-term debt of the Municipality. They are not involved with measurement of results of operations.

(G) GENERAL FIXED ASSETS AND GENERAL LONG-TERM LIABILITIES

The accounting and reporting treatment applied to the Fixed Assets and Long-Term liabilities associated with a fund are determined by its measurement focus. All governmental funds are accounted for on a spending or "Financial Flow" measurement focus. This means that only current assets and current liabilities are generally included on their balance sheets. Their reported fund balance (Net Current Assets) is considered a measure of "Available Spendable Resources". Governmental fund operating statements present increases (Revenues and Other Financing Sources) and decreases (Expenditures and Other Financing Uses) in net current assets. Accordingly, they are said to present a summary of sources and uses of " Available Spendable Resources" during a period.

Fixed assets used in governmental fund type operations (General Fixed Assets) are accounted for in the general fixed assets account group, rather than in governmental funds. Public domain (Infrastructure) general fixed assets consisting of certain improvements other than Building, Including Roads, Bridges, Curbs and Gutters, Streets and Sidewalks, Drainage Systems and Lighting Systems, have been capitalized. Such assets are normally immovable and of value only to the city. Depreciation has not been provided on general fixed assets.

**MUNICIPALITY OF SANTA ISABEL, PUERTO RICO
NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS
JUNE 30, 2003**

**(1) ORGANIZATION, OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICES
(CONTINUED)**

(H) GENERAL FIXED ASSETS AND GENERAL LONG-TERM LIABILITIES (CONTINUED)

The general fixed assets acquired are recorded as expenditures in the government fund and will be capitalized at cost in the general fixed assets account group. Donated general fixed assets will be recorded at their estimated fair market value at the time they were received by the Municipality. The general long-term debt account group recognized the debt for long-term basis.

(I) BASIS OF ACCOUNTING

The Municipality uses the modified accrual basis of accounting. Under this method, revenues are recorded when they are measurable and available for disposition. Available for disposition means the immediate collection of revenues is within the current accounting period or immediately after it, in a way that the amount may be used to pay short term debts.

Expenditures are generally recognized under the modified accrual basis of accounting when the related fund liability is incurred. Exceptions to this general rule include the principal and interest on general long-term debt which is recognized when due.

To account for inter-governmental revenues some legal contractual requirements of the diverse individual programs are used. Essentially there are two kinds of revenues. Some revenues are budgeted for restricted use and, therefore, are recorded using the expenditures for which they were budgeted as their base. Therefore, revenues are recognized based upon the disbursements made. For other types of revenue, the resources are without restrictions as to the expenditures.

(J) ENCUMBRANCES

The accounting of segregation of funds for encumbrances is used in the Municipal funds. By these encumbrances, the purchase orders, contracts and engagements for the disbursement of funds, are properly recorded in a way that the correct amount for the future obligations are reserved. The encumbrances amounts related to future obligations are presented as a reserve of the fund balance because they do not represent disbursements or liabilities. However, the Municipality does not maintain the encumbrance systems since the information is not available.

**MUNICIPALITY OF SANTA ISABEL, PUERTO RICO
NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS
JUNE 30, 2003**

**(1) ORGANIZATION, OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(CONTINUED)**

(K) BUDGETARY DATA

The Municipality follows these procedures, which are in accordance with the Municipal Law, in establishing the budgetary data presented in the general purpose financial statements.

- (1) Prior to May 31, the Mayor submits to the Municipal Assembly a proposed budget for the fiscal year commencing the following July 1. The proposed budget includes estimated expenditures and the means of financing them.
- (2) The budget document is available for public inspection prior to its approval by the Municipal Assembly.
- (3) Prior to July 1, the annual budget is legally enacted through passage of the annual appropriation ordinance.
- (4) Subsequent to the enactment of the annual appropriation ordinance, the Municipal Assembly has the authority to make the necessary adjustments to the budget. Adjustments made during the year are reflected in the budget information included in the general purpose financial statements.

The budget is prepared following the modified accrual basis of accounting except for encumbrances as described below.

The actual results of operations, presented in the Statement of Revenue and Expenditures-Budget and Actual General Fund, is in conformity with the budgetary accounting of the Municipality for a better comparison with the budget information.

The most significant difference between the budgetary and accounting bases is that encumbrances are recorded as expenditures under the accounting basis. The budget prepared for each of the special revenue funds is based in a program period which is not necessarily a year. Accordingly, it is not practical to present an annual comparison of budget and actual for the special revenue fund.

**MUNICIPALITY OF SANTA ISABEL, PUERTO RICO
NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS
JUNE 30, 2003**

**(1) ORGANIZATION, OPERATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(CONTINUED)**

(K) BUDGETARY DATA (CONTINUED)

The necessary adjustments to convert the results of operations of the general fund from the accounting basis to the budgetary basis are as follows:

	General Fund	Debt Service
Excess of revenues over expenditures as reported on the Statement of Revenues, Expenditures and Changes in Fund Balances	\$ 223,596	(\$ 483,941)
Differences - Budget to GAAP:		
Non budgeted items recorded as current year revenues for financial reporting purposes	(3,587,938)	(1,514,125)
Non budgeted items recorded as current year expenditures for financial reporting purposes	1,813,426	359,765
Prior year encumbrances recorded as expenditures for financial reporting purposes	<u>710,231</u>	<u>1,514,125</u>
Excess of revenues over expenditures as reported on the Budgetary Basis	<u>(\$ 840,685)</u>	<u>(\$ 124,176)</u>

(L) PROPERTY, PLANT AND EQUIPMENT

The general fixed assets acquired are recorded as expenses in the governmental funds and are capitalized at cost in the general fixed assets accounts group. The general fixed assets donated to the Municipality are recorded at estimated market value at donation date. Interest incurred for construction period are not capitalized and no depreciation is provided on general fixed assets.

(M) COMPENSATED ABSENCES

The vacation policy of the Municipality provides for the accumulation of 2.5 days per month. Unpaid vacation time accumulated is fully vested to the employees from the first day of work. Sick-leave accumulates to all employees at a rate of 1.5 days per month up to a maximum of 90 days. Law number 156 of August 20, 1996, amendment section of Law 5 of October 14, 1975, as amendments. The referred law requires from the Governmental Agencies the liquidation of any excess of sick leave and vacations accrued in excess of the maximum amount authorized by the Law. For regular vacation the maximum number of days allowed to be accrued is 60 days and the excess must be paid after the month of June of every fiscal year. For sick leave the maximum number of days allowed to be accrued are 90 days and such excess must be paid after December of every year. The disposition of this law was effective after June 30, 1997. Separation from employment prior to use of all or part of the sick leave terminates all rights for compensation, except for employees with ten years of service who are entitled to sick leave to the maximum allowed.

**MUNICIPALITY OF SANTA ISABEL, PUERTO RICO
NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS
JUNE 30, 2003**

**(1) ORGANIZATION, OPERATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(CONTINUED)**

Employees maximum allowed accumulated vacations and sick leave together with the employers share of payroll taxes are accounted for in the General Long-Term Debt Account Group.

(N) INSURANCE

The Municipality has insurance coverage for its public facilities, mainly to provide protection from fortuitous losses. Also, the Municipality's principal officials are covered with fidelity bonds. The Secretary of the Department of Treasury of Puerto Rico is the agent in charge to obtain and pay the insurance coverage of the Municipality. Corresponding premiums payable by the Municipality are withheld by the Municipality Revenue Collection (CRIM for its Spanish acronyms) and paid to the Treasury from the advances of annual property taxes.

(O) FEDERAL AND STATE GRANT REVENUE

Grant revenue is recognized when program expenditures are incurred in accordance with program guidelines. Such revenue is subject to review by the funding agency and may result in disallowance in subsequent periods.

(P) TOTAL COLUMNS

The data presented under this column represents the aggregate amount of the different types of funds and account groups. The total amounts under this column do not result from a consolidation and, therefore, do not present a consolidated information. The accounts between funds have not been eliminated.

(Q) INTER-FUND TRANSACTIONS

The general fund provides services at cost to the special revenue funds. The amounts charged to these funds for these services are treated as a reduction of expenditures in the general fund and as current expenditures in the other federal and state funds.

MUNICIPALITY OF SANTA ISABEL, PUERTO RICO
NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS
JUNE 30, 2003

(2) CASH

The Director of Finance of the Municipality is responsible for investing the available resources in certificates of deposit and other short-term investments. The cash balances presented in the balance sheets are mainly bank accounts with a financial institution and the Governmental Development Bank.

The Municipality's deposits with commercial financial institutions at June 30, 2003 were entirely covered by Federal Depository Insurance or collateral held by the Treasury Department of the Commonwealth of Puerto Rico.

Cash with fiscal agent is composed of cash held by the Governmental Development Bank restricted by the Municipal Bonds Trust Indenture and also by the Puerto Rico Treasury Department for the payment of principal and interest on bonds and notes payable for long-term debt, and those funds are not available to be used for other purposes.

(3) CONCENTRATION OF CREDIT RISK

The Municipality maintains its cash accounts in local commercial banks, whose accounts are warranty be Federal Deposits Insurance Corporation (FDIC) up to \$100,000. Deposits in excess of \$100,000 are colaterized by bank to property safeguard such funds.

Management believes that concentration of credit risk is limited because balances are deposit with high standing institutions.

(4) PROPERTY TAXES

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

The property tax is levied each year on the assessed value of the property at the beginning of the calendar year. Assessed values of real property were established at estimated current values in 1957 and for personal property are based at the current value at the date of the assessment.

Real property taxes are billed by "CRIM" and due in the two equal installments in July and January following the assessment date. Personal property taxes are self assessed and are due on May 15th, when the related property tax return is required to be filed.

MUNICIPALITY OF SANTA ISABEL, PUERTO RICO
NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS
JUNE 30, 2003

(4) PROPERTY TAXES (CONTINUED)

The tax rate per annum is 8.33% for real property and 6.33% for personal property of which 1.03% of both belong to the Commonwealth of Puerto Rico and 7.3% and 5.3%, respectively belong to the Municipality. From the portion belonging to the Municipality, 6.0% and 4.0%, respectively, represents the Municipality's basic tax rate which is appropriated for general purposes, and, therefore, accounted for through the general fund. The remaining portion belonging to the Municipality of 1.2% represents the "ad valorem" tax withheld by "CRIM" and restricted for debt service which is accounted for through the debt service fund. The Municipality has reached the maximum statutory tax rate limit for the basic tax while there is no limitation for the "ad valorem" tax rate.

Complete real property tax exoneration is granted by the Commonwealth of Puerto Rico for the first \$15,000 of the assessed valuation of owner occupied residential units. However, the Municipality receives the full amount levied, except for residential units assessed at less than \$3,500, on which a complete exemption is granted. Veterans have additional exemption from taxes of \$5,000 of the assessed value of real property. The Department of the Treasury, instead of the property taxpayer, becomes the source of payment in these cases.

Complete exemption from personal property taxes up to an assessment of \$50,000 is granted to retailers with an annual volume of net sales under \$150,000. However, the Municipality receives the full amount levied.

(5) MUNICIPAL BUSINESS TAXES

The volume of business tax is levied each year based on the prior year's gross revenues for all commercial and industrial organizations doing business in the Municipality and which are not totally or partially exempt from this tax under the Industrial Incentives Act of Puerto Rico. All taxpayers are required to file their annual declarations by April 15th.

The tax rates are as follows:

- 1.5% for financial institutions, thrift and loan associations.
- From .3% to .5% for all other non-financial organizations.

Taxes are payable in two equal semiannual installments on or before July 1 and January 1 following the levy date. A 5% of discount is granted only if the total amount is paid on or before the filing date of April 15th. Collections of taxes applicable to the next fiscal year are recorded as deferred revenues.

**MUNICIPALITY OF SANTA ISABEL, PUERTO RICO
 NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS
 JUNE 30, 2003**

(6) INTERGOVERNMENTAL REVENUES

Sources of intergovernmental revenues consist primarily of governmental payments from the Commonwealth of Puerto Rico and "in lieu of tax" payments from certain quasi-public corporations, such as the Puerto Rico Electric Authority and the Puerto Rico Aqueduct and Sewer Authority.

Grants and subsidies received from the Commonwealth of Puerto Rico include, among others, a general subsidy for capital improvements.

All of these intergovernmental revenues are accounted for through the general fund except for those directly related to the special revenue fund.

(7) GENERAL FIXED ASSETS

The following is a summary of the general fixed assets as of June 30, 2003:

A summary of changes in general fixed assets follows:

	Beginning Balance	Additions	Retirements	Ending Balance
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Equipment, real estate and other	<u>\$3,378,811</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$3,378,811</u>

MUNICIPALITY OF SANTA ISABEL, PUERTO RICO
NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS
JUNE 30, 2003

(8) GENERAL AND SPECIAL OBLIGATIONS

The general long-term debt of the Municipality is recorded in a separate self-balancing accounts group. Loans and bonds payable with Ad Valorem property taxes are paid through the debt service fund. During the year, the Municipality obtained two loans in the amount of \$2,580,000 (\$1,850,000 and \$730,000) which were used for payment of accounts payable to suppliers and capital expenditures.

The following is the long-term debt, payable to Government Development Bank for Puerto Rico at June 30, 2003:

\$1,850,000 note payable Series of 2003 payable in annual installments ranging from \$30,000 to \$140,000 through July 2027, interest from 5% to 6.50%	\$1,850,000
\$730,000 note payable Series of 2003 payable in annual installment ranging from \$10,000 to \$55,000 through July 2027, interest at 6.5%	\$ 730,000
\$155,000 Series of 2002 in annual installments ranging from \$20,000 to \$25,000 through July, 2008, interest ranging from 5.00% to 7.30%	135,000
\$182,500 Series of 1980 payable in annual installments of \$10,000 through January, 2004, interest at 5.00%.	10,031
\$390,000 Series of 1984 payable in annual installments ranging from \$15,000 to \$26,000 through January, 2009, interest at 5.00%.	141,000
\$324,000 Series of 1987 payable in annual installments ranging from \$11,000 to \$23,000 through January, 2011, interest at 5.00%.	153,000
\$361,000 Series of 1992 payable in annual installments ranging from \$10,000 to \$25,000 through January 2016, interest at 5.00%.	250,000
\$33,000 Series of 1994 payable in annual installments ranging from \$1,000 to \$2,000 through January 2018, interest at 4.5%.	24,000

**MUNICIPALITY OF SANTA ISABEL, PUERTO RICO
NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS
JUNE 30, 2003**

(8) GENERAL AND SPECIAL OBLIGATIONS (CONTINUED)

\$215,000 Series of 1994 payable in annual installments ranging from \$5,000 to \$15,000 through January 2018, interest at 4.5%.	162,000
\$630,000 Series of 1997 payable in annual installments ranging of \$10,000 to \$60,000, through July 2020, interest accrued at prevailing rates.	560,000
\$205,000 note payable Series of 1997 payable in quarterly installments ranging from \$5,000 to \$20,000 through July 2023, interest accrued at prevailing rates.	180,000
\$235,000 Series of 2000 payable in annual installments ranging of \$10,000 to \$30,000, through July 2011, interest accrued at prevailing rates.	195,000
\$580,000 Series of 2001 payable in semi annual installments ranging of \$35,000 to \$80,000, through July 2010, interest ranging from 5% to 8%	500,000
\$755,000 Series of 2001 payable in semi annual installments ranging of \$5,000 to \$65,000, through July 2025, interest ranging from 5% to 7.50%	740,000
\$229,000 note payable Series of 1999 payable in annual installments ranging from \$41,000 to \$50,000 through January 2004, interest accrued at prevailing rates.	50,000
\$300,000 USDA Rural Development note obligation. Bond anticipation note.	182,211
\$410,000 note payable Series of 2000 payable in annual installments ranging from \$70,000 to \$95,000 through January 2004, interest accrued at prevailing rates.	<u>185,000</u>
	<u>\$6,047,242</u>

**MUNICIPALITY OF SANTA ISABEL, PUERTO RICO
NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS
JUNE 30, 2003**

The annual requirements to amortize the general long-term debt outstanding as of June 30, 2003, including interest payments of \$4,373,334 are as follows:

<u>Year Ending June 30</u>	<u>Interest</u>	<u>Principal</u>
2004	\$ 275,365	\$ 364,031
2005	341,121	328,000
2006	325,895	246,000
2007	310,885	268,000
2008	294,832	281,000
2009 thru 2013	1,329,688	1,219,000
2014 thru 2018	772,319	1,014,000
2019 thru 2023	565,825	990,000
2024 thru 2028	<u>1,578,251</u>	<u>1,337,211</u>
Total	<u>\$ 5,794,181</u>	<u>\$ 6,047,242</u>

(9) DEBT SERVICE FUND

Revenues of the debt service fund consist of accretion of discounts on investments which are recorded as interest income on investments and the ad valorem property taxes which are recognized as revenue when they are collected and reported by the Municipal Revenue Collection Center (CRIM). CRIM retains these collections for the payment of principal and interest of bonds and notes issued by the Municipality. CRIM pays to the Municipality interests over the average balance maintained for debt service.

Principal and interest on these obligations were paid to the Governmental Development Bank from funds obtained from the following:

Property taxes	\$ 484,177
Ordinary Funds (Municipal)	<u>1,514,125</u>
	<u>\$ 1,998,302</u>

Payment as of June 30, 2003 were as follows:

Principal	\$ 1,795,000
Interests	<u>203,302</u>
	<u>\$ 1,998,302</u>

MUNICIPALITY OF SANTA ISABEL, PUERTO RICO
NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS
JUNE 30, 2003

(10) EMPLOYEE'S RETIREMENT PLAN

The Municipality's regular employees participate in the retirement system of the Commonwealth of Puerto Rico (RSCPR), an agent multiple-employer public employee retirement system. Retirement and related benefits provided by the RSCPR and required contributions to the RSCPR by employees are determined by Law No. 447, approved May 15, 1951, as amended. Required contributions by the Municipality are determined by the Administrator of the RSCPR. Through March 1990, member's contribution were 4.5% on 7% and Municipality's contribution 7% or 8% of gross salary. Effective April 1990 member's contributions were increased to 5.777% or 8.275% and the Municipality's contribution to 9.275% of gross salary.

The present value of the accrued benefits and the assets of the RSCPR pertaining to the Municipality employees was not available as of June 30, 2002.

(11) CONTINGENCIES

The Municipality is defendant or co-defendant in various pending lawsuits amounting more than \$6,567,202. Those legal claims are expected to be judged. The Legal Counsel has issued an opinion about the results of these claims against the Municipality, and the Municipality's Management, after consultation, established a provision for a contingency liability, considering the best defense from the Municipality, in the amount of \$3,571,548 to respond for these claims. The financial statements include the amount of \$3,250,000 in the general long term debt account group and \$520,200 for the general fund for current period.

The Municipality participates in a number of federal financial assistance programs. These programs may still be subject to financial and compliance audits and resolutions of previously identified questioned costs. The amount, if any, of expenditures which may be disallowed by the granting agencies cannot be determined at this time. However, the Municipality's Management understands that claim, if any, as a result of monitoring or audits by any agency will be immaterial considering the financial statements as a whole.

**MUNICIPALITY OF SANTA ISABEL, PUERTO RICO
NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS
JUNE 30, 2002**

(12) DUE TO OTHER GOVERNMENTS UNITS

Due to other governmental units as of June 30, 2003 consists of liabilities that will be paid during the fiscal year 2003-2004 by the General Fund and a long term portion accounted for in the General Long Term Debt Account Group as follows:

General Fund:

Water and Sewer Authority of Puerto Rico	\$422,372
Administration of Retirement Systems of Puerto Rico	354,799
Association of the Employees of the Commonwealth of Puerto Rico	23,616
General Service Administration	4,317
Internal Revenue Services	658,567
Department of Labor and Human Resources	<u>70,653</u>
	<u>\$1,534,324</u>

General Long Term Debt Account Group:

ASES	927,516
Municipal Taxes Collection Center	1,242,655
Department of Treasury	<u>851,847</u>
	<u>\$3,022,018</u>

(13) PAYMENT PLANS:

The Municipality maintains two payment plans with other Governmental Agencies as follows:

- (1) Treasury Department by the amount of \$618,120, payable in monthly installments of \$29,975 due in October, 2003.
- (2) Municipal Revenue Collection Center (CRIM) by the amount of \$559,133, corresponding to the debt of the fiscal year 1997-1998, payable in (155) one hundred fifty five monthly installments of \$3,603 since July 1, 2002. The installments are deducted from the monthly reimbursement of real and personal property taxes collected by the Municipal Revenue Collection Center (CRIM).

MUNICIPALITY OF SANTA ISABEL, PUERTO RICO
NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS
JUNE 30, 2003

(14) DEBT OF WASTE DISPOSAL

The Municipality of Santa Isabel maintained a contract with Browning Ferries Industries Corporation (BFI) for waste disposal. The contract established the terms and conditions, payment method, penalties, among other operating and service commitments. During the month of August 1999, BFI Corporation discontinued the services for waste disposal. The account payable to BFI Corporation was \$570,000 as of June 30, 2003. However, there is a difference between the amount recognized by the Municipality and the amount recognized by BFI.

Also, the Municipality subsequently contract the services contracted the services of LM Waste Disposal, Inc. As of June 30, 2003 the amount due to LM amounted \$540,000.

(15) GASB 34

In June 1999, the Governmental Accounting Standards Board (GASB) issued GASB Statement No. 34 (Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments). GASB-34 will significantly change the way in which the Municipality reports its finances.

GASB-34 established two bases for reporting financial information: government-wide-financial statements and fund presentation. The government-wide financial statements method adopts the flow of economic resources measurement focus and accrual basis of accounting for both governmental activities and business-type activities. The basis for statements except the focus for presentation is on major funds rather than fund types. Capital assets and depreciation charges are reported on the entity-wide perspective financial statements. The Management's discussion and analysis information precedes the basic financial statements but is considered required supplementary information. Budgetary information is no longer presented in the financial statements but rather is presented as required supplementary information. GASB-34 will begin to take effect for the Municipality in fiscal year after June 15, 2002.

MUNICIPALITY OF SANTA ISABEL, PUERTO RICO
NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS
JUNE 30, 2003

(16) SUBSEQUENT EVENTS

The following subsequent events have occurred after the year ended June 30, 2003:

- (1) Municipality made a contract with LM services to re-open the municipalities landfill for 20 years. Contract with LM services to manage the landfill operations, is for 20 years. Fifty percent (50%) of annual municipality income will go to pay the municipality debt with LM of \$540,000 approximately. LM agreed to postpone the collection of such amount to obtain a contract with the Municipality to operates the landfill.
- (2) \$185,000 note payable issuance at interest of prevailing rate with a floor of 5%. The loan was obtained for the construction of improvements for capital projects. The loan was obtained by August, 2003. The loan will be paid annually by July 1, and has a maturity date of 25 years.

(17) PRIOR PERIOD ADJUSTMENTS

The prior period adjustments are related to corrections of transactions from previous years, mainly due to inter-fund transactions and accounts payable adjustments. The amount of these adjustments represents the net effect against such funds.

**MUNICIPALITY OF SANTA ISABEL, PUERTO RICO
SCHEDULE OF FEDERAL FINANCIAL ASSISTANCE
FOR THE YEAR ENDED JUNE 30, 2003**

FEDERAL GRANTOR PASS-THRU	FEDERAL GRANTOR NUMBER	EXPENDITURES
<u>Department of Housing and Urban Development:</u>		
<u>Direct Program:</u>		
Section 8: Rental Voucher Program	14.855	\$ <u>307,165</u>
<u>Pass-Through the Office of The Commissioner of Municipal Affairs (OCAM):</u>		
State Block Grant Program-Small	14.219	1,525,234
<u>US Department of Health and Human Services Pass-Through The Administration for Children and Families:</u>		
Early Head Start Programs	93.600	<u>1,513,865</u>
Community Services Block Grant	93.569	<u>21,591</u>
Child Care and Development Fund (SENDEC)	93.575	<u>749,752</u>
<u>US Department of Transportation:</u>		
Federal Transit-Capital Investment Grant	20.500	<u>160,668</u>
<u>US Department of Agriculture:</u>		
Rural Economic Development Loan	10.854	<u>131,333</u>
Total		<u>\$4,409,608</u>

See notes to the Schedule of Federal Financial Assistance.

**MUNICIPALITY OF SANTA ISABEL, PUERTO RICO
 NOTES TO THE SCHEDULE OF FEDERAL FINANCIAL ASSISTANCE
 FOR THE YEAR ENDED JUNE 30, 2003**

(1) GENERAL

The accompanying Schedule of Federal Financial Assistance presents the activity of all federal assistance programs of the Municipality of Santa Isabel, Puerto Rico. The Municipality of Santa Isabel is the reporting entity as defined in note 1 to the general purpose financial statements. Part of the federal financial assistance received were passed-through funds from Federal Agency to Office of Commissioner of Municipal Affairs (OCAM).

(2) BASIS OF ACCOUNTING

The accompanying Schedule of Federal Financial Assistance is presented using the modified accrual basis of accounting which is described in note 1 to the general purpose financial statements.

(3) RELATIONSHIP TO GENERAL PURPOSE FINANCIAL STATEMENTS

Expenditures included in the accompanying Schedule agree with the amounts included in the general purpose financial statements as follows:

<u>Funds</u>	<u>Federal Assistance</u>	<u>Municipal or State Assistance</u>	<u>Total included in the financial Statements</u>
<u>Special Revenues</u>			
Federal Assistance	\$ 2,592,937	\$ 763,465	\$ 3,356,402
<u>Capital Project</u>			
Capital Outlays	<u>1,816,671</u>	<u>587,518</u>	<u>2,404,189</u>
	<u>\$ 4,409,608</u>	<u>\$ 1,350,983</u>	<u>\$ 5,760,591</u>

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Association of Certified Fraud Examiners



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

To the Mayor and Municipal Assembly
Municipality of Santa Isabel
Santa Isabel, Puerto Rico

We have audited the general purpose financial statements of the Municipality of Santa Isabel as of and for the year ended June 30, 2003, and have issued our report thereon dated March 26, 2004, which were qualified because we were unable to audit the fixed assets and inter-fund transactions, among other scope limitations as described in the auditors' report over general purposes financial statements. Except as discussed in the auditors' report for general purpose financial statements, we conducted our audit in accordance with generally accepted auditing standards 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. In our report, our opinion was qualified as explained in the following four paragraphs.

The Municipality's accounting system and subsidiary record of property, plant and equipment did not provide competent evidence with respect to the amounts presented in the accompanying general-purpose financial statements. We were unable to satisfy ourselves about such amount. Therefore, we do not express an opinion on such amounts included in the general fixed assets account group.

The Municipality did not provide us sufficient evidence of inter-fund transactions, including inter-fund receivables and payables, with respect to the amounts presented in the accompanying general-purpose financial statements. Therefore, we were unable to satisfy ourselves about such transactions and amounts. We do not express an opinion on such transactions and amounts included in the general-purpose financial statements.

The Municipality did not provide for our review the details of certain accounts payable in the amount of \$269,173. Thus, we were unable to perform auditing procedures over these balances, which are included as part of the accounts payable for general fund.

The Municipality adjusted its beginning general, special revenue and capital project fund balances in the amount of \$840,700, (\$599,143) and \$161,430, respectively; for corrections of transactions and other adjustments to assets and liabilities. The adjustments were made against prior year fund balances without considering any effect, if any on the current year operations. As subscribed in paragraph four of this report, the Municipality maintain unreconciled differences in their inter fund cash transactions and because of the uncertainty of corrections of general, special and capital project funds balances were unable to determine the effect if any in 2003 operations. The Municipality recognized an account receivable in the amount of 389,987 in which we were unable to obtain evidential matters regarding the net realizable value of such account receivable.

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

Compliance

As a part of obtaining reasonable assurance about whether the Municipality of Santa Isabel's general purpose financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations contracts and grants, noncompliance with which could have a direct and material effect on the determination of general purpose 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 instances of noncompliance that is required to be reported under Government Auditing Standards and which are described in the Section II, Financial Statement Findings, identified as item 2003-II-1.

Internal control over financial reporting.

In planning and performing our audit, we considered Municipality of Santa Isabel's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing an opinion on the general purpose financial statements and do not provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect Municipality of Santa Isabel's ability to record, process, summarize, and report financial data consistent with the assertions of Management in the general purpose financial statements. Reportable conditions are described in the accompanying Section II, Financial Statement Findings, 2003-II-1.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the general purpose financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that all also considered to be material weaknesses. However, we believe that reportable conditions are material weaknesses, which are presented as material weaknesses the accompanying Schedule of Findings and Question Costs, as item 2003-II-1.

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

This report is intended for the information of the Audit Committee, Management, and federal awarding agencies and pass-through entities. However, this report is a matter of public record and its distribution is not limited.

San Juan, Puerto Rico
March 26, 2004

The stamp number 1944827
was affixed to the original of this report.

González Torres & Co. PSC
GONZÁLEZ TORRES & CO., PSC
Licence Number 96
Expires December 1, 2005



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

To the Mayor and Municipal Assembly
Municipality of Santa Isabel
Santa Isabel, Puerto Rico

We have audited the compliance of Municipality of Santa Isabel (The Municipality) with the types of compliance requirements described in the *U. S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2003. The Municipality's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of Municipality of Santa Isabel management. Our responsibility is to express an opinion on compliance based on our audit.

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

We were unable to obtain sufficient documentation supporting the compliance of the Municipality with all major federal programs identified in the Summary of Audits Results, regarding real property acquisitions and relocation assistance and reporting, nor were able to satisfy ourselves as to the Municipality's compliance with those requirements by other auditing procedures. In addition, no accounting records are maintained for some of the above mentioned major programs to assure that all disbursements and transactions are accounted for. The accounting transactions are recorded at year end. The general purpose financial statements for the year ended June 30, 2003 presented a qualified opinion.

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

In our opinion, except for the effects of such noncompliance, as described in the preceding paragraph, The Municipality complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2003. The results of our auditing procedures also disclosed other instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs.

Internal Control Over Compliance

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

We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgement, could adversely affect the Municipality's ability to administer a major federal program in accordance with the applicable requirements of laws, regulations, contracts, and grants. Reportable conditions are described in the accompanying schedule of findings and questioned costs as items 2003-III-1, 2 and 3.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts, and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions, and accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that material weaknesses exist and are presented in the accompanying the Financial Statements Findings, Section II, as item 2003-II-1.

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

Schedule of Expenditures of Federal Awards

We have audited the general purpose financial statements of Municipality of Santa Isabel as of June 30, 2003 and have issued a report dated March 26, 2004. In our report our opinion was qualified as described in the following paragraphs.

The Municipality's accounting system and subsidiary record of property, plant and equipment did not provide competent evidence with respect to the amounts presented in the accompanying general-purpose financial statements. We were unable to satisfy ourselves about such amount. Therefore, we do not express an opinion on such amounts included in the general fixed assets account group.

The Municipality did not provide us sufficient evidence of inter-fund transactions, including inter-fund receivables and payables, with respect to the amounts presented in the accompanying general-purpose financial statements. Therefore, we were unable to satisfy ourselves about such transactions and amounts. We do not express an opinion on such transactions and amounts included in the general-purpose financial statements.

The Municipality did not provide for our review the details of certain accounts payable in the amount of \$269,173. Thus, we were unable to perform auditing procedures over these balances, which are included as part of the accounts payable for general fund.

The Municipality adjusted its beginning general, special revenue and capital project fund balances in the amount of \$840,700, (\$599,143) and \$161,430, respectively; for corrections of transactions and other adjustments to assets and liabilities. The adjustments were made against prior year fund balances without considering any effect, if any on the current year operations. As subscribed in paragraph four of this report, the Municipality maintain unreconciled differences in their inter fund cash transactions and because of the uncertainty of corrections of general, special and capital project funds balances were unable to determine the effect if any in 2003 operations. The Municipality recognized an account receivable in the amount of 389,987 in which we were unable to obtain evidential matters regarding the net realizable value of such account receivable.

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

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

This report is intended for the information of the Audit Committee, Management, and federal awarding agencies and pass-through entities. However, this report is a matter of public record and its distribution is not limited.

San Juan, Puerto Rico
March 26, 2004

The stamp number 1944828
was affixed to the original of this report.


GONZÁLEZ TORRES & CO., PSC
Licence Number 96
Expires December 1, 2005



**MUNICIPALITY OF SANTA ISABEL, PUERTO RICO
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
JUNE 30, 2003**

SECTION I: SUMMARY OF AUDIT RESULTS

Part I Financial Statements:

1. Type of audit report:

<input type="checkbox"/> Unqualified opinion	<input checked="" type="checkbox"/> Qualified opinion
<input type="checkbox"/> Adverse opinion	<input type="checkbox"/> Disclaimer of opinion

2. Reportable conditions reported:

<input checked="" type="checkbox"/> Yes	<input type="checkbox"/> No
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3. Reportable conditions reported as a major weakness:

<input checked="" type="checkbox"/> Yes	<input type="checkbox"/> No
---	-----------------------------

4. Material noncompliance disclosed:

<input checked="" type="checkbox"/> Yes	<input type="checkbox"/> No
---	-----------------------------

Part II Federal Awards:

1. Type of report: on compliance for major programs:

<input type="checkbox"/> Unqualified opinion	<input checked="" type="checkbox"/> Qualified opinion
<input type="checkbox"/> Adverse opinion	<input type="checkbox"/> Disclaimer of opinion

2. Reportable conditions reported as a major weakness:

<input checked="" type="checkbox"/> Yes	<input type="checkbox"/> No
---	-----------------------------

3. Material noncompliance disclosed:

<input checked="" type="checkbox"/> Yes	<input type="checkbox"/> No
---	-----------------------------

**MUNICIPALITY OF SANTA ISABEL, PUERTO RICO
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
JUNE 30, 2003**

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

Yes No

5. Major Programs:

CFDA Number (s)	Name of Federal Program or Cluster
14.219	Community Development Block Grant - Small Cities
14.855	Section 8
93.575	Child care

6. Dollar threshold used to distinguish Type A and Type B programs:

\$300,000 or 3% of total federal awards expended

7. Low-risk auditee Yes No

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

Yes No

**MUNICIPALITY OF SANTA ISABEL, PUERTO RICO
SCHEDULED OF FINDINGS AND QUESTIONED COSTS
JUNE 30, 2003**

SECTION II: FINANCIAL STATEMENT FINDINGS

FINDING 2003- II - 1

Condition:

Our audit of the Municipality of Santa Isabel revealed material weaknesses in the accounting records for municipal and federal funds. The major deficiencies were the following:

1. The Municipality does not maintain general ledger for most of its funds, and no subsidiary records exist for most of its funds and accounts. The accounting transactions are reconciled at the year end only, through the year end closing of budget and actual.
2. The Municipality does not maintain a trial balance for some the following major and minor programs, State Block Grant Program (SBGP), Federal Transit Administration (FTA), UDAG, Rural Economic Development (RECDA), FEMA, COPS, Child Care, Community State Block Grant (CSBG).
3. The Municipality does not maintain subsidiary records for accounts receivable and accounts payable for all governmental fund types, except for general fund which a subsidiary record was presented.

Questioned cost:

Questioned costs cannot be determined by our tests.

Criteria:

Reporting requirements of Circular OMB-133 and accounting controls as per program requirements. The Municipality must maintain internal control over the compliance of requirement for its major programs and for the general accounting as a reporting entity.

Cause and effect:

The Municipality did not supervise the requirements established for major and non major programs. This represents that funds may be granted to participants whom are not qualified to receive federal funds and raised questioned costs.

Recommendation:

The Municipality should revise its accounting and finance operations in order to have a proper recognition of accounting transactions and monitor the compliance with GAAP and Federal Programs requirements.

**MUNICIPALITY OF SANTA ISABEL, PUERTO RICO
SCHEDULED OF FINDINGS AND QUESTIONED COSTS
JUNE 30, 2003**

SECTION III. FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Finding number 2003 - III - 1

**Section 8 CFDA 14.855
SBGP CFDA 14.219
Child Care CFDA 93.575**

Criteria and Condition

The OMB Circular A -133 (Compliance C), **Cash Management**, requires when funds are in advance, recipients must follow procedures to minimize the time elapsing between U.S. Treasury and program disbursement.

Cause

The administrative personnel are not following adequately the procedures to minimize the time elapse between the receipts of funds and their disbursement. For section 8 we found that most of housing assistant payments during the year were issued by the tenth of each month.

Effect

Program is maintaining high cash balances and therefore is not complying with program regulations.

Question costs

None.

Recommendation

To establish proper procedures when requesting cash advances in order to comply with cash disbursed time elapsing program requirements.

**MUNICIPALITY OF SANTA ISABEL, PUERTO RICO
SCHEDULED OF FINDINGS AND QUESTIONED COSTS
JUNE 30, 2003**

Section III. FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Finding number 2003 - III - 2

Section 8 CFDA 14.855

Criteria and Condition

The OMB Circular A -133 (Compliance B), **Allowable cost and Cost principle**, requires the cost items for federal programs.

Cause

A bank charged of \$5,978.21 was charged to program during the month of October 2002.

Effect

Program incurred in an unallowable cost item.

Questioned costs

None.

Recommendation

Management has to meet with banks officials to recover those charges.

Management Response

We will take action over these charges and we will meet with bank officials.

**MUNICIPALITY OF SANTA ISABEL, PUERTO RICO
SCHEDULED OF FINDINGS AND QUESTIONED COSTS
JUNE 30, 2003**

Section III. FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Finding number 2003 - III - 3

Section 8 CFDA14,855

Criteria and Condition

The OMB Circular A -133, (Compliance N), **Special Test**, requires certain compliance test for federal awards. For Section 8, the federal Department of Housing requires to do compliance test over inspections on housing participants, market rent evaluations and for proper procedures on getting new participants (waiting list). During our audit we found that Section 8's supervisor was doing housing inspection, in charged of the waiting list and participant's records maintenance by himself.

Cause

Municipality has not assign the proper number of employees to section 8 program, causing improper segregation of duties.

Effect

Program failed to comply with proper segregation of duties in an adequate internal control structure.

Questioned costs

None.

Recommendations

Management should assign proper personnel to the program.

Management response

Management will revise the program personnel structure in order to comply with federal regulations.

**MUNICIPALITY OF SANTA ISABEL, PUERTO RICO
SCHEDULED OF PRIOR YEAR FINDINGS AND QUESTIONED COSTS
JUNE 30, 2003**

I. Audit findings not corrected:

Findings 2002- 1 FEMA

Noncompliance related to disbursing procedures.

Questioned cost : \$44,995

Comments: Finding was cleared by fiscal agent.

Finding 2002- 2 FEMA, Section 8 and Head Start

Noncompliance related to disbursing procedures.

No questioned costs.

Comments: Finding has not been cleared by fiscal agent.

Finding 2002-3, 6 and 7 SBGP, Section 8, Head Start, FTA

Reportable conditions over cash management.

No questioned costs.

Comments: Findings has not been cleared by fiscal agent

Finding 2002- 4

Reportable condition over internal control related to participant eligibility.

No question costs.

Comments: Finding has not been cleared by fiscal agent.

Finding 2002- 5 FEMA

Reportable condition related to reporting (Compliance L)

No question costs.

Comment: Finding has not been cleared by fiscal agent.

**MUNICIPALITY OF SANTA ISABEL, PUERTO RICO
SCHEDULED OF PRIOR YEAR FINDINGS AND QUESTIONED COSTS
JUNE 30, 2003**

Audit Findings not corrected or partially corrected):

Finding number 2001 -1

Reportable condition over Fixed/Capital Assets and Expenditures-Subsidiary Ledger.

All Federal Programs.

No questioned costs.

Comments: Situation still prevails.

Finding number 2001 - 2

Reportable condition over Financial Reporting.

All Federal Programs.

No questioned costs.

Comments: Situation still prevails.

Finding number 2003 - 3

Reportable condition over Cash Receipt.

Section 8 and Head Start

No questioned costs.

Comments: Situation still prevails.

Finding number 2001 - 4

Reportable condition over Expenditures for Goods and Services.

All Federal Funds.

No questioned costs.

Comments: Situation still prevails.

MUNICIPALITY OF SANTA ISABEL, PUERTO RICO
SCHEDULED OF PRIOR YEAR FINDINGS AND QUESTIONED COSTS
JUNE 30, 2002
(CONTINUED)

Finding number 2001 - 5

Reportable condition over Payroll and Related Liabilities.

All Federal Programs

No questioned costs.

Comments: Situation still prevails.

Finding number 2001 - 6

Reportable condition over Activities Allowed or Unallowed.

SBGP

No questioned costs.

Comment: Situation corrected.

Finding number 2001 - 7

Reportable condition over Cash Management.

SBGP

No questioned costs.

Comment: Situation still prevails.

Finding number 2001 - 8

Reportable condition over Program Income.

SBGP

No questioned costs.

Comment: Situation corrected.

**MUNICIPALITY OF SANTA ISABEL, PUERTO RICO
SCHEDULED OF PRIOR YEAR FINDINGS AND QUESTIONED COSTS
JUNE 30, 2002
(CONTINUED)**

Finding number fifteen (15) (June 30, 2001)

Reportable condition over Equipment and Real Property Management.

SBGP

No questioned costs.

Comment: Situation still prevails.

III. Corrective Action taken is significantly different from corrective action previously reported:

None.

IV Audit Findings no longer valid.

None.