

**OFICINA DEL COMISIONADO DE ASUNTOS MUNICIPALES**  
**AREA DE ASESORAMIENTO, REGLAMENTACION E INTERVENCION FISCAL**  
**AREA DE ARCHIVO DIGITAL**

**MUNICIPIO DE SANTA ISABEL**  
**AUDITORIA 2004-2005**  
**30 DE JUNIO DE 2005**

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ASUNTOS MUNICIPALES

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Commonwealth of Puerto Rico  
Municipality of Santa Isabel  
Basic Financial Statements and  
Supplement Schedule  
June 30, 2005

González Torres & Co.  
Certified Public Accountants and Consultants

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SANTA ISABEL  
Basic Financial Statements and  
Supplemental Schedule  
June 30, 2005**

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# GONZÁLEZ TORRES & Co.

*Certified Public Accountants and Consultants*

Member of:  
Puerto Rico Society of Certified Public Accountants  
American Institute of Certified Public Accountants  
Association of Certified Fraud Examiners

## INDEPENDENT AUDITORS' REPORT

Honorable Mayor and Municipal Council  
Municipality of Santa Isabel, Puerto Rico  
Santa Isabel, Puerto Rico

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the Municipality of Santa Isabel, Puerto Rico, as of and for the year ended June 30, 2005, which collectively comprise the Municipality's financial statements as listed in the table of contents. These financial statements are the responsibility of the Municipality's Management. Our responsibility is to express an opinion of these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the respective financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the respective financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statements presentation. We believe that our audit and the report of other auditors provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information of the Municipality of Santa Isabel as of June 30, 2005, and the respective changes in financial position, therefore for the year then ended in conformity with the accounting principles generally accepted in the United States of America.

As described in Note 1, the Municipality has implemented a new financial reporting model, as required by the provisions of Governmental Accounting Standards Board ("GASB") Statement No. 34, Basic Financial Statements and Management's Discussion and Analysis for States and Local Governments.

In accordance with Government Auditing Standards, we have also issued our report dated December 8, 2005, on our consideration of the Municipality of Santa Isabel's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.

**INDEPENDENT AUDITORS' REPORT**  
(Continued)

The Management's Discussion and Analysis and budgetary comparison information on pages 4 through 13 and pages 64 through 66, are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Municipality of Santa Isabel's basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations, and is also not a required part of the basic financial statements of Municipality of Santa Isabel. The schedule of expenditures of federal awards have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

The accompanying financial statements have been prepared assuming that the Municipality of Santa Isabel will continue as a going concern. During several years, the Municipality of Santa Isabel has increased its deficit by exceeding its expenditures over its revenues. As of June 30, 2005, the unreserved accumulated deficit for its general fund (for government funds) amounted to \$7,261,639, with total liabilities in the amount of \$10,206,230 and total assets amounting \$2,944,591, including available cash of \$202,857 to pay mature liabilities within the current year. These conditions raised substantial doubt about its ability to continue as a going concern. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

December 8, 2005  
San Juan, Puerto Rico

The stamp number 2112906  
was affixed to the original of this report.

*González Torres & Co. PSC*  
GONZÁLEZ TORRES & CO., PSC  
License Number 98  
Expires December 1, 2008



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

Management of the Municipality of Santa Isabel of the Commonwealth of Puerto Rico (the Municipality) provides this *Management's Discussion and Analysis* (MD&A) for the readers of the Municipality's basic financial statements. This narrative represents an overview and analysis of the financial activities of the Municipality for the fiscal year ended June 30, 2005. Because this MD&A is designed to focus on the current year activities, resulting changes and currently known facts, we encourage readers to consider the information presented in this MD&A in conjunction with the additional information furnished in the accompanying basic financial statements.

During fiscal year ended June 30, 2004, the Municipality implemented the new required financial reporting standards established by Statement No. 34, *Basic Financial Statements – and Management's Discussion – and Analysis – for State and Local Governments*, issued by the Governmental Accounting Standards Board (GASB No. 34). According to this statement, significant required changes in content and structure have been made in the basic financial statements as of and for the fiscal years ended June 30, 2005 and 2004, which make them not easily comparable with prior years' financial statements. However, in future years, comparative analysis will be more meaningful and will go further in explaining the Municipality's financial position and results of operations.

**FINANCIAL HIGHLIGHTS**

**a) Government-Wide Highlights**

- **Assets** – The Municipality has reported assets amounting to \$24.1 millions in the accompanying statement of net assets, of which the most significant are capital assets, investments, cash and tax receivables amounting to \$15.9 millions, \$2.5 millions, \$2.7 millions and \$1.6 millions, respectively.
- **Liabilities** – The Municipality has reported liabilities amounting to \$20.7 millions in the accompanying statement of net assets, of which the most significant are deferred revenues, bonds payable, intergovernmental payable and notes payable, amounting to \$0.8 millions, \$6.1 millions, \$4.2 millions and \$7.5 millions, respectively.
- **Net assets** – The assets of the Municipality exceeded its liabilities by \$3.4 millions at June 30, 2005, which is presented as "net assets" in the accompanying statement of net assets. Restricted net assets and unrestricted deficit amounted to \$5.9 millions and (\$15.7) millions, respectively. Net assets invested in capital assets amounted to \$13.1 millions.
- **Net change in net assets** – The Municipality's net assets decreased by (\$1.9) millions during fiscal year ended June 30, 2005. Net assets at June 30, 2004 (as restated) amounted to \$5.3 millions. The decreased in net assets was principally for negative result of operations and decrease in the Municipality's overall financial position in comparison with the prior fiscal year.
- **Revenues** – The Municipality has reported total revenues amounting to \$13.0 millions in the accompanying statement of activities, of which the most significant are tax revenues, operating grants and capital grants, and contributions amounting to \$6.7 millions, \$4.5 millions, and \$1.2 million, respectively.

- **Expenses** – The Municipality has reported total expenses amounting to \$14.9 millions in the accompanying statement of activities.

**b) Governmental Funds Highlights**

- **Assets** – The Municipality’s governmental funds have reported combined assets amounting to \$10.4 millions in the accompanying balance sheet – governmental funds, of which the most significant are investments, cash and due from other funds, amounting to \$2.5 millions, \$2.7 millions, and \$2.2 millions, respectively.
- **Liabilities** – The Municipality’s governmental funds have reported combined liabilities amounting to \$11.8 millions in the accompanying balance sheet – governmental funds, of which the most significant are deferred revenues, accounts payable, due to other funds and intergovernmental payable amounting to \$3.1 millions, \$1.8 millions, \$2.2 millions, and \$4.2 millions respectively.
- **Governmental fund balances** – The Municipality’s governmental funds reported combined fund deficit amounting to (\$1.4) million, of which \$6.1 millions and (\$7.5) millions represent, reserved and unreserved fund balances, respectively.
- **Net change in governmental fund balances** – The Municipality’s governmental fund balances decreased by (\$5.0) millions during fiscal year ended June 30, 2005. Governmental fund balances at June 30, 2004, as restated, amounted to \$3.6 millions. The decrease in fund balances represents the excess of expenditures and other financing uses over revenues and other financing sources.
- **Revenues** – The Municipality’s governmental funds have reported combined revenues amounting to \$12.9 millions in the accompanying statement of revenues, expenditures and changes in fund balances – governmental funds, of which the most significant are property taxes, intergovernmental grants and contributions, municipal license and construction excise taxes amounting to \$5 millions, \$5.8 millions, \$1.0 millions and \$0.6 million, respectively.
- **Expenditures** – The Municipality’s governmental funds have reported combined expenditures amounting to \$18.2 millions in the accompanying statement of revenues, expenditures and changes in fund balances – governmental funds, of which the most significant are categorized as general government; culture recreation and education and urban and economic development amounting to \$4.1 millions, \$5.3 millions, and \$5.7 millions respectively.

**USING THIS ANNUAL REPORT**

This annual report consists of a series of financial statements similar to the previous financial statements. The focus is on both the Municipality as a whole (government-wide) and the major individual funds. Both perspectives (government-wide and major fund) allow the user to address relevant questions, broaden a basis for comparison (year to year or government to government) and enhance the Municipality’s accountability.

**OVERVIEW OF THE BASIC FINANCIAL STATEMENTS**

The Municipality’s financial statements include three components: (1) the government-wide financial statements, (2) the fund financial statements, and (3) the notes to the financial statements (collectively known as the basic financial statements). This report also contains additional required supplementary information (budgetary schedules) and other supplementary information (combined financial statements) in addition to the basic financial statements themselves. These components are described below:

## **Government-Wide Financial Statements**

The *government-wide financial statements* are designed to provide readers with a broad overview of the Municipality's operations and finances as a whole in a manner similar to private-sector business. These statements provide short-term and long-term information about the Municipality's financial position, which assist the Municipality's management to determine the economic condition at the end of the fiscal year. These financial statements are prepared using the flow of economic resources measurement focus and the accrual basis of accounting. This basically means that these financial statements follow methods that are similar to those used by most businesses. They take into account all revenues and expenses connected with the fiscal year ended June 30, 2005, even if cash involved have not been received or paid. The government-wide financial statements include: (1) the statements of net assets, and (2) the statement of activities.

### **Statement of Net Assets**

The statement of net *assets* presents all of the Municipality's assets and liabilities, with the difference between these two items reported as "net assets" (equity). Over time increases or decreases in the net assets, may serve as a useful indicator of whether the financial position of the Municipality is either improving or deteriorating.

### **Statement of Activities**

The statement of activities presents information showing how the Municipality's net assets changed during the fiscal year ended June 30, 2005. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will not result in cash flows until future fiscal periods (such as uncollected taxes, and earned but unused vacation leave). This statement also presents a comparison between direct expenses and program revenues for each function of the Municipality.

Both of the abovementioned financial statements present all the governmental activities of the Municipality, which consist mostly by taxes and intergovernmental revenues (such as federal grants). Most services provided by the Municipality fall into this category, including culture and education, general government, health and sanitation, public safety, public housing and welfare, etc.

## **Fund Financial Statements**

The Municipality's fund financial statements, which consist of: (1) the balance sheet – governmental funds, and (2) the statement of revenues, expenditures and changes in fund balances – governmental funds. These financial statements report the financial position and results of operations of the Municipality's governmental funds.

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The Municipality, like most other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. Each fund is considered an independent fiscal entity accounted for within a set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenue, and expenditures. Fund accounting segregates funds according to their intended purpose and is used to aid management in demonstrating compliance with legal, financial, and contractual provisions.

The fund financial statements focus on: (1) individual parts of the Municipality's government, and (2) reporting the Municipality's operations in more detail than the government-wide financial statements. For financial

reporting purposes, the Municipality classifies its funds within the following fund categories: (1) general fund, (2) debt service fund, (3) special revenue funds, and (4) capital projects funds (collectively known as the "governmental funds").

Governmental funds are used to account for all of the services provided by the Municipality. Governmental funds are used to account for essentially the same functions reported as governmental activities in the governmental-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on near-term inflows and outflows of spendable resources. They also focus on the balances of spendable resources available at the end of the fiscal year (June 30, 2005). This approach is known as using the flow of current financial resources measurement focus and the modified accrual basis of accounting. These statements provide a detailed short-term view of the Municipality's finances that assists in determining whether there will be adequate financial resources available to meet the current needs of the Municipality, that is, evaluating the Municipality's near-term financing requirements.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the fund information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the Municipality's near-term financial decisions.

For financial reporting purposes the Municipality has three major funds: (1) the general fund, (2) state legislature joint resolutions, and (3) the head start.

#### **Notes to the Basic Financial Statements**

The notes to the basic financial statements provide additional information that is essential to a full understanding of the data provided in the government-wide and the fund financial statements. The notes to the basic financial statements can be found immediately following the basic financial statements.

#### **Required Supplementary Information**

The basic financial statements are followed by a section of required supplementary information consisting of a budgetary comparison between actual operating results with the original budget and the final amended budget for the general fund.

#### **INFRASTRUCTURE ASSETS**

Historically, a government's largest group of assets (infrastructure – roads, bridges, traffic signals, underground pipes [unless associated with a utility], etc.) have not been reported nor depreciated in governmental financial statements. GASB 34 requires that these assets be valued and reported within the governmental column of the Government-Wide Financial Statements. Additionally, the government must elect to either (a) depreciate these assets over their estimated useful life or (b) develop a system of asset management designed to maintain the service delivery potential to near perpetuity. If the government develops the asset management system (modified approach) which periodically (at least every third year), by category, measures and demonstrates its maintenance of locally established levels of service standards, the government may record its cost of maintenance in lieu of depreciation. The information about the condition and maintenance of condition of the government infrastructure assets should assist financial statement users in evaluating a local government and its performance over time.

As of July 1, 2003, the Municipality retroactively recorded the historical costs of infrastructure assets. Also the Municipality elected to depreciate infrastructure assets instead of using the modified approach.

## FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE

### Net Assets

As noted earlier, net assets may serve over time as a useful indicator of the Municipality's financial position. In the case of the Municipality, net assets (excess of assets over liabilities) amounted to (\$3.4) millions at June 30, 2005, compared to (\$5.3) millions at the end of the previous year, as restated.

The largest portion of the Municipality's net assets are invested in capital assets net of their related debt (\$13.1 millions). The Municipality's net assets is also composed of net assets amounting to \$5.9 millions that are restricted for (1) future debt service payments, (2) the future acquisition or construction of capital assets, and (3) other purposes, mainly the financing of federal and state assisted programs. In addition, the Municipality's net asset are reported net of an unrestricted deficit of \$15.7 millions.

The unrestricted deficit is the consequence of previous budgets which did not provide funding for incurred long-term obligations such as compensated absences and others. Historically, such obligations have been budgeted on a pay as you go basis without providing funding for their future liquidation. Consequently, the Municipality cannot draw from its existing assets to provide services to its citizens and depends on its taxing ability to continue its operations.

The portion of the Municipality's net assets invested in capital assets such as land, buildings, equipment, etc., less any outstanding related debt used to acquire those assets, are used by the Municipality to provide services to its citizens; consequently these assets are not available for future spending. Although the Municipality's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from the debt service fund, since the capital assets themselves cannot be used to liquidate these liabilities.

The following is a condensed presentation of the Municipality's financial position, as reported in the government-wide financial statements:

#### Condensed Statement of Net Assets:

	2005	2004	Change	%
Current assets	\$ 8,139,031	\$ 9,989,054	(1,850,023)	(19%)
Noncurrent assets	15,974,627	13,609,573	2,365,054	17%
Total assets	<u>24,113,658</u>	<u>23,598,627</u>	515,031	2%
Current liabilities outstanding	9,047,157	6,387,013	2,660,144	42%
Noncurrent liabilities outstanding	11,633,058	11,909,457	(276,399)	(2%)
Total liabilities	<u>20,680,215</u>	<u>18,296,470</u>	2,383,745	13%
Net assets/(liabilities):				
Invested in capital assets, net of related debt	13,128,627	11,690,030	1,438,597	12%
Restricted	5,962,758	8,096,535	(2,133,777)	(26%)
Unrestricted	(15,657,942)	(14,484,408)	(1,173,534)	8%
Total net assets	<u>\$ 3,433,443</u>	<u>\$ 5,302,157</u>	<u>\$ (1,868,714)</u>	(35%)

## Changes in Net Assets

The Municipality's net assets decreased by \$1.9 millions. Approximately 52 percent of the Municipality's total revenues came from taxes, while 42 percent resulted from restricted and unrestricted capital and operating grants, contributions and reimbursements, including federal financial assistance. The Municipality's expenses cover a range of services. The largest expenses were for general government (26 percent), culture, recreation and education (23 percent), and urban and economic development (33 percent). The following is a condensed presentation of the Municipality's results of operations, as reported in the government-wide financial statements:

<u>Condensed Statement of Activities:</u>	<u>2005</u>	<u>2004</u>	<u>Change</u>	<u>%</u>
<b>Revenues:</b>				
<b>Program revenues:</b>				
Operating grants and contributions	\$ 4,506.913	\$ 5,374.902	\$ (867.989)	(16%)
Capital grants and contributions	1,231.615	5,388.340	(4,156.725)	(77%)
Charges for services	406.733	86.652	320.081	369%
<b>General revenues:</b>				
Property taxes	5,066.230	4,752.678	313.552	7%
Municipal license taxes	1,045.501	822.017	223.484	27%
Construction excise taxes	616.635	1,068.529	(451.894)	(42%)
Unrestricted intergovernmental contributions	57.062	1,251.723	(1,194.661)	(95%)
Unrestricted interest on deposits	85.410	121.550	(36.140)	(30%)
Miscellaneous	17.554	51.042	(33.488)	(66%)
Capital assets donations	-	154.075	(154.075)	(100%)
Special items	-	(1,030.000)	1,030.000	(100%)
Total revenues	<u>13,033.653</u>	<u>18,041.508</u>	<u>(5,007.855)</u>	<u>(28%)</u>
<b>Expenses:</b>				
General government	3,840.872	4,573.096	(732.224)	(16%)
Urban and economic development	4,939.379	2,129.453	2,809.926	132%
Public safety	848.829	635.047	213.782	34%
Health and sanitation	253.906	815.465	(561.559)	(69%)
Culture, recreation, and education	3,399.408	3,570.837	(171.429)	(5%)
Public housing and welfare	1,256.879	840.086	416.793	50%
Interest on bonds, notes, and capital leases	363.094	395.847	(32.753)	(8%)
Total expenses	<u>14,902.367</u>	<u>12,959.831</u>	<u>1,942.536</u>	<u>15%</u>
Net increase in net assets	(1,868.714)	5,081.677	(6,950.391)	(137%)
Net assets - at beginning of year, as restated	5,302.157	220.480	5,081.677	2305%
Net assets - at end of year	<u>\$ 3,433.443</u>	<u>\$ 5,302.157</u>	<u>(1,868.714)</u>	<u>(35%)</u>

## FINANCIAL ANALYSIS OF THE MUNICIPALITY'S GOVERNMENTAL FUNDS

As discussed earlier, the Municipality uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. **Governmental Funds** - The focus of the Municipality's *governmental funds* is to provide information on near-term inflows, outflows, and balance of *spendable resources*. Such information is useful in assessing the Municipality's financing requirements. In particular, *unreserved fund balance* may serve as a useful measure of a government's net resources available for spending at the end of fiscal year. The following is a condensed presentation of the Municipality's balance sheet and results of operations of governmental funds:

### Condensed Balance Sheet - Governmental Funds:

	2005	2004	Change	%
Total assets - major funds	\$ 7,785,758	\$ 8,981,042	\$ (1,195,284)	(13%)
Total assets - nonmajor funds	2,599,897	2,630,303	(30,406)	(1%)
Total assets	<u>10,385,655</u>	<u>11,611,345</u>	<u>(1,225,690)</u>	<u>(11%)</u>
Total liabilities - major funds	10,796,700	6,950,095	3,846,605	55%
Total liabilities - nonmajor funds	1,036,252	1,088,999	(52,747)	(5%)
Total liabilities	<u>11,832,952</u>	<u>8,039,094</u>	<u>3,793,858</u>	<u>47%</u>
<b>Fund Balances:</b>				
Reserved - major funds	4,520,274	6,805,344	(2,285,070)	(34%)
Reserved - nonmajor funds	1,563,645	1,749,481	(185,836)	(11%)
Unreserved - nonmajor funds	-	-	-	
Unreserved - major funds	(7,531,216)	(4,982,574)	(2,548,642)	51%
Total net assets	<u>\$ (1,447,297)</u>	<u>\$ 3,572,251</u>	<u>(5,019,548)</u>	<u>(141%)</u>

### Condensed Statement of Operations - Governmental Funds:

Total revenues - major funds	\$ 9,769,599	\$ 15,279,361	(5,509,762)	(36%)
Total revenues - nonmajor funds	3,133,665	3,452,739	(319,074)	(9%)
Total revenues	<u>12,903,264</u>	<u>18,732,100</u>	<u>(5,828,836)</u>	<u>(31%)</u>
Total expenditures - major funds	14,423,883	11,517,214	2,906,669	25%
Total expenditures - nonmajor funds	3,763,415	3,826,076	(62,661)	(2%)
Total expenditures	<u>18,187,298</u>	<u>15,343,290</u>	<u>2,844,008</u>	<u>19%</u>
Other financing sources - major funds (excluding transfers among funds)	<u>264,486</u>	<u>2,113,303</u>	<u>(1,848,817)</u>	<u>(87%)</u>
Special items, net	-	(1,030,000)	1,030,000	(100%)
Net change in fund balances	<u>\$ (5,019,548)</u>	<u>\$ 4,472,113</u>	<u>(9,491,661)</u>	<u>(212%)</u>

## **CAPITAL ASSETS AND DEBT ADMINISTRATION**

### **Capital Assets**

The accompanying statement of net assets reported total gross capital assets, at cost, amounting to \$19,888,694 of which \$12,195,303 represents buildings, structures, and buildings improvements assets at June 30, 2005. The related accumulated depreciation and amortization of capital assets amounted to \$3,914,067, of which \$1,653,410 is related to buildings, structures, and buildings improvements assets at June 30, 2005. This investment in capital assets includes land, buildings, improvements, equipment, infrastructure, and construction in progress. Infrastructure assets are items that are normally immovable and of value only to the municipal government, such as roads, bridges, streets and sidewalks, drainage systems, lighting systems, and similar items.

Actual costs incurred to purchase or construct capital assets were \$2,843,955 for the year ended June 30, 2005. Depreciation and amortization charges for the year totaled \$488,360.

The Municipality finances a significant portion of its construction activities through bond issuances and state and federal grants. The proceeds from bond issuances designated for construction activities are committed in its entirety for such purposes and cannot be used for any other purposes.

### **Debt Administration**

The laws and regulations of the Commonwealth of Puerto Rico have established a limitation for the issuance of general obligation municipal bonds and notes for the payment of which the good faith, credit, and taxing power of each municipality may be pledged.

The applicable laws and regulations also require that in order for a municipality to be able to issue additional general obligation bonds and notes, such municipality must have sufficient "payment capacity". Act No. 64 provides that a municipality has sufficient "payment capacity" to incur additional general obligation debt if the deposits in such municipality's Redemption fund and the annual amounts collected with respect to such municipality's Special Additional Tax (as defined below), as projected by the Government Development Bank for Puerto Rico, will be sufficient to service to maturity the Municipality's outstanding general obligation debt and the additional proposed general obligation debt ("Payment Capacity").

The Municipality is required under applicable laws and regulations to levy the Special Additional Tax in such amounts as shall be required for the payment of its general obligation municipal bonds and notes. In addition, principal and interest on all general obligation municipal bonds and notes, and on all municipal notes issued in anticipation of the issuance of general obligation bonds issued by the Municipality constitute a first lien on the Municipality's Basic Tax revenues. Accordingly, the Municipality's Basic Tax revenues would be available to make debt service payments on general obligation municipal bonds and notes to the extent that the Special Additional Tax Levied by the Municipality, together with moneys on deposit in the Municipality's Redemption Fund, are not sufficient to cover such debt service. It has never been necessary to apply Basic Taxes to pay debt service on general obligation debt of the Municipality.

### **ECONOMIC FACTORS AND NEXT BUDGETS AND RATES**

The Municipality relies primarily on property and municipal license taxes, as well as, federal and state grants to carry out the governmental activities. Historically, property and municipal license taxes have been very predictable with increases not generally exceeding ten percent. Federal grant revenues may vary if new grants are available but the revenue is also very predictable.

Those factors were considered when preparing the Municipality's budget for the 2004-2005 fiscal year. There were no significant changes between the budget for fiscal year 2004-2005 and the one for fiscal year 2005-2006.

## **FINAL COMMENTS**

The Municipality of Santa Isabel is a governmental entity whose powers and authority vested on its executive and legislative branches are specifically established in the Municipal Autonomous Act approved in August 1991. By virtue of such powers, it provides a wide range of services to its constituents which includes, among others, public works, education, public safety, public housing, health, community development, recreation, waste disposal, welfare, and others. The Municipality's principal sources of revenues are derived from property taxes, municipal license taxes, subsidies from the Commonwealth of Puerto Rico's General Fund and contributions from the Traditional and Electronic Lottery sponsored by said Government.

The Municipality's general fund deficit presents a continuous and consistent growth each year for the past three fiscal years as the consequence principally of: a) adoption of budgets with budgeted revenues that at the end of each year were less than actual revenues collected, and which did not provide funding for all of incurred obligations; and b) the high percentage of budget encumbered with payroll, fringe benefits, and statutory obligations. Based on this reality, the municipal administration has adopted an ambitious program to reduce the general fund expenditures and stop the continuous and consistent Municipality's general fund financial condition deterioration, and then, improve it. The Municipality's executive branch, with the approval of the legislative branch (for items a and b), places in force various actions including the following actions after year ended June 30, 2005:

### ***a) \$1,410,000 Operational Loan***

On July 5, 2005 the Government Development Bank for Puerto Rico (GDB) approved a special obligation bond issuance with original issue amounts of \$1,410,000 to pay general fund current liabilities due and payable at June 30, 2005. This bond issuance was authorized by the Municipality's legislative branch on July 28, 2005 through the Ordinance number 4, 2005-2006 Series.

### ***b) Workforce Displacement Plan***

The Municipality's general fund budget for the fiscal year ended on June 30 2005, and the approved budget for the fiscal year 2005-2006 were encumbered principally for payroll, fringe benefits, and statutory expenditures. Therefore, the Municipality's executive branch, taking in consideration this reality, started actions to develop a workforce displacement plan in order principally to reduce the Municipality's payroll and fringe benefits expenditures, with the final objective to stop the continuous Municipality's general fund financial condition deterioration. On June 27, 2005 the Municipality's legislative branch issue the Ordinance number 28, 2004-2005 Series to approve a workforce displacement plan. On October 17, 2005 the Municipality's legislative branch issue the Ordinance number 21, 2005-2006 Series to amend the workforce displacement plan approved on June 27, 2005 through the Ordinance number 28, 2004-2005 Series. On October 18, 2005 and October 19, 2005 the Municipality place in force the workforce displacement plan developed by the Municipality's executive branch and approved by the legislative branch.

### ***c) Domestic Solid Waste Collection Services Privatization***

The Municipality executive branch has determined that the domestic solid waste collection services privatization is an alternative to reduce the general fund expenditures, and therefore, an alternative to stop the continuous Municipality's general fund financial condition deterioration. On December 17, 2005 the Municipality published in a general circulation newspaper a request for proposal from interested parties to privatize the domestic solid

waste collection services in the Municipality's urban and rural areas. On December 27, 2005 the Municipality received three proposals from private companies interested to provide domestic solid waste collection services to the Municipality. These proposals have been subject to a detailed review in order to select the best offer to protect the public interest.

**FINANCIAL CONTACT**

The Municipality's financial statements are designed to present users (citizens, taxpayers, customers, investors, and creditors) with a general overview of the Municipality's finances and demonstrate the Municipality's accountability. If you have any questions about the report or need additional financial information, contact the Municipality's Director of Finance, Mr. Irma M. Vargas Aguirre, at P.O. Box 725, Santa Isabel, P.R. 00757.

**Commonwealth of Puerto Rico  
Municipality of Santa Isabel  
Statement of Net Assets  
June 30, 2005**

**Assets**

**Current assets:**

Cash in commercial banks	\$	428,914
Accounts receivable, net of allowance for doubtful accounts:		
Property taxes		1,626,920
Intergovernmental		1,223,795
Restricted assets :		
Cash with commercial banks		627,623
Cash with fiscal agent		1,708,551
Investments		2,523,228
Total current assets		8,139,031

**Noncurrent assets:**

Capital assets, net of accumulated depreciation and amortization of \$3,914,067		15,974,627
Total noncurrent assets		15,974,627
Total assets	\$	24,113,658

**Current Liabilities (due within one year):**

Accounts payable	\$	1,820,558
Intergovernmental payables		4,191,734
Accrued interest payable on long-term debt		261,642
Deferred revenues		832,285
Current portion of long-term obligations:		
Bonds payable		277,000
Other debts		1,663,938
Total current liabilities		9,047,157

**Noncurrent liabilities (due in more than one year):**

Total liabilities		11,633,058
	\$	20,680,215

**Net assets (liabilities):**

Invested in capital assets, net of related debt	\$	13,128,627
Restricted for:		
Capital projects		4,588,584
Debt service		340,692
Other specified purposes		1,033,482
Unrestricted net assets		(15,657,942)
Total net assets	\$	3,433,443

The accompanying notes to the basic financial statements are an integral part of this statement.

Commonwealth of Puerto Rico  
Municipality of Santa Isabel  
Statement of Activities  
June 30, 2005

Functions/programs	Expenses	Charges for services	Program Revenues		Net Expenses and Charges in Net Assets
			Operating grants and contributions	Capital grants and contributions	
Governmental activities :					
General government	\$ 3,840,872		\$ 160,640		\$ (3,680,232)
Urban and economic development	4,939,379	\$ 300,811	16,984	\$ 1,012,003	(3,609,581)
Public safety	848,829	15,825	84,577	45,812	(702,615)
Health and sanitation	253,906	2,845	70,453		(180,608)
Culture, recreation and education	3,399,408	87,252	3,245,245	170,500	103,589
Welfare and housing assistance	1,256,879		929,014	3,300	(324,565)
Interest on long-term obligation	363,094				(363,094)
Total governmental activities	<u>\$ 14,902,367</u>	<u>\$ 406,733</u>	<u>\$ 4,506,913</u>	<u>\$ 1,231,615</u>	<u>\$ (8,757,106)</u>

General Revenues:

Taxes:

Property taxes	5,066,230
Municipal license taxes	1,045,501
Construction excise taxes	616,635
Total taxes	<u>6,728,366</u>
Grants and contributions, not restricted to specific programs	57,062
Interests on deposits	85,410
Miscellaneous	17,554
Total general revenues	<u>6,888,392</u>
Net changes in net assets	(1,868,714)
Net assets at beginning of the year, as restated	5,302,157
Net assets at the end of the year	<u>\$ 3,433,443</u>

The accompanying notes to the basic financial statements are an integral part of this statement

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SANTA ISABEL**

Balance Sheet  
Governmental Funds  
June 30, 2005

	<b>MAJOR FUNDS</b>				
	General Fund	State Legislative Joint Resolutions	Head Start	Other Nonmajor Fund	Total Governmental Funds
<b>ASSETS</b>					
Cash in commercial banks	\$ 202,857	\$ -	\$ -	\$ 226,057	\$ 428,914
Account receivable, net of doubtful accounts:					
Property taxes	1,483,917	-	-	143,003	1,626,920
Due from other funds	367,208	1,877,852	-	1,564	2,246,624
Due from governmental entities	742,193	-	155,393	326,209	1,223,795
Restricted assets:					
Cash in commercial bank	-	284,307	387	342,929	627,623
Cash in fiscal agent	148,416	-	-	1,560,135	1,708,551
Investments	-	2,523,228	-	-	2,523,228
<b>TOTAL ASSETS</b>	<b>\$ 2,944,591</b>	<b>\$ 4,685,387</b>	<b>\$ 155,780</b>	<b>\$ 2,599,897</b>	<b>\$ 10,385,655</b>
<b>LIABILITIES</b>					
Accounts payable	\$ 1,175,711	\$ 434,690	\$ 18,240	\$ 191,917	\$ 1,820,558
Intergovernmental	4,191,734	-	-	-	4,191,734
Due to other funds	1,876,316	-	137,540	232,768	2,246,624
Deferred revenue	2,962,469	-	-	95,925	3,058,394
Matured bonds due and payable	-	-	-	254,000	254,000
Matured interests due and payable	-	-	-	261,642	261,642
<b>Total liabilities</b>	<b>10,206,230</b>	<b>434,690</b>	<b>155,780</b>	<b>1,036,252</b>	<b>11,832,952</b>
<b>FUND BALANCE</b>					
Reserved for:					
Encumbrances	121,161	-	-	-	121,161
Debt service	-	-	-	340,692	340,692
Capital projects	-	4,250,697	-	337,887	4,588,584
Other specified purposes	148,416	-	-	885,066	1,033,482
Unreserved, reported in:					
General fund	(7,531,216)	-	-	-	(7,531,216)
<b>Total fund balances</b>	<b>(7,261,639)</b>	<b>4,250,697</b>	<b>-</b>	<b>1,563,645</b>	<b>(1,447,297)</b>
<b>TOTAL LIABILITIES AND FUND BALANCE</b>	<b>\$ 2,944,591</b>	<b>\$ 4,685,387</b>	<b>\$ 155,780</b>	<b>\$ 2,599,897</b>	<b>\$ 10,385,655</b>

The accompanying notes to the basic financial statements are an integral part of this statement

**MUNICIPALITY OF SANTA ISABEL**  
 Reconciliation of the Balance Sheet - Governmental Funds  
 to the Statement of Net Assets  
 June 30, 2005

Aggregate fund balance reported in the balance sheet - governmental funds:	\$ (1,447,297)
Governmental activities' amounts reported in the statement of net assets and the balance sheet - governmental funds are different because:	
Assets not available to pay current period expenditures not reported in the governmental funds:	
Capital assets used in governmental activities are not financial resources, therefore, are not reported in the governmental funds:	15,974,627
Deferred (unavailable) revenues in the governmental funds that are recorded as revenues in the statement of activities:	2,226,109
The following liabilities are not due (mature) in the current period, therefore, are not reported in the governmental funds:	
Accrued employees' christmas bonus	(202,831)
Compensated absences	(1,841,371)
Bonds and notes payable	(5,852,000)
Debt to intergovernmental agencies	(4,492,621)
Landfill closure and postclosure care costs	<u>(931,173)</u>
Net assets as reported in the accompanying statement of net assets	<u>\$ 3,433,443</u>

The accompanying notes to the basic financial statements are an integral part of this statement.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF SANTA ISABEL**  
Statement of Revenues, Expenditures and  
Changes in Fund Balance - Governmental Funds  
Year Ended June 30, 2005

	MAJOR FUNDS				
	General Fund	State Legislative Joint Resolutions	Head Start	Other Nonmajor Funds	Total Governmental Funds
<b>REVENUES</b>					
Taxes:					
Property taxes	\$ 4,478,197	-	-	511,183	\$ 4,989,380
Municipal license	1,045,501	-	-	-	1,045,501
Construction excise taxes	616,635	-	-	-	616,635
Charges of service	323,381	-	-	83,352	406,733
Intergovernmental grants and contributions:					
Federal government	-	-	1,935,358	1,906,902	3,842,260
State government	758,461	509,209	-	632,121	1,899,791
Investment earnings	45,349	39,954	-	107	85,410
Miscellaneous	17,554	-	-	-	17,554
<b>Total Revenues</b>	<u>\$ 7,285,078</u>	<u>549,163</u>	<u>1,935,358</u>	<u>3,133,665</u>	<u>\$ 12,903,264</u>
<b>EXPENDITURES</b>					
Current:					
General government	4,137,817	-	-	72	4,137,889
Urban and economic development	3,341,432	754,639	-	1,577,365	5,673,436
Public safety	663,862	1,000	-	130,834	795,696
Health and Sanitation	167,930	-	-	67,190	235,120
Culture, recreation and education	581,077	1,836,262	1,935,358	971,838	5,324,535
Welfare and housing assistance	999,217	5,289	-	329,022	1,333,528
Debt service:					
Principal	-	-	-	324,000	324,000
Interest	-	-	-	363,094	363,094
<b>Total Expenditures</b>	<u>9,891,335</u>	<u>2,597,190</u>	<u>1,935,358</u>	<u>3,763,415</u>	<u>18,187,298</u>
<b>Excess (Deficiency) of Revenues over expenditures</b>	<u>(2,606,257)</u>	<u>(2,048,027)</u>	<u>-</u>	<u>(629,750)</u>	<u>(5,284,034)</u>
<b>OTHER FINANCING SOURCES (USES)</b>					
Transfer in from other funds	-	-	-	179,500	179,500
Transfer out to other funds	(179,500)	-	-	-	(179,500)
Special Items	-	-	-	-	-
Proceeds from issuance of long term debt	-	-	-	264,486	264,486
<b>Total Other Financing Sources (uses)</b>	<u>(179,500)</u>	<u>-</u>	<u>-</u>	<u>443,986</u>	<u>264,486</u>
<b>NET CHANGE IN FUND BALANCES</b>	(2,785,757)	(2,048,027)	-	(185,764)	(5,019,548)
<b>FUND BALANCE AT BEGINNING OF YEAR, AS RESTATED</b>	(4,475,882)	6,298,724	-	1,749,409	3,572,251
<b>FUND BALANCE AT END OF YEAR</b>	\$ (7,261,639)	\$ 4,250,697	-	\$ 1,563,645	\$ (1,447,297)

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The accompanying notes to the basic financial statements are an integral part of this statement.

**Commonwealth of Puerto Rico**  
**Municipality of Santa Isabel**  
 Reconciliation of Statement of Revenues, Expenditures and Changes  
 in Fund Balance - Governmental Funds to the Statements of Activities  
 For the Year Ended June 30, 2005

Net change in fund balances- total governmental funds: \$ (5,019,548)

Governmental activities amounts reported in the statement of activities and the statement of Revenues, expenditures and changes in fund balances governmental funds are different because:

Revenues in the statement of activities that not provide current financial resources, therefore are not reported as revenues in the funds:

Net Change in Property Tax Revenue Deferred in FFS	76,850
Net Change in PREPA Contribution in Lieu of Taxes Revenue Deferred in FFS	57,062
Net Change in State Treasury Department Christmas Bonus Reimbursement Deferred in FFS	(3,524)

Under the modified accrual basis of accounting used in the governmental funds, expenditures are not recognized for transactions that are not normally paid with expendable financial resources. In the Statements of Activities, however, which is presented in the accrual basis, expenses, and liabilities are presented regardless of when financial resources are available:

Net Change in Compensated Absences Liability	(223,049)
Net Change in Christmas Bonus	7,584
Debt issued costs amortization	(30,541)
Legal Claims	29,685
Landfill Closure and Post closure care costs	(44,342)
Net Change in PREPA Contribution in Lieu of Taxes Liability	(57,060)
2004-2005 CRIM Property Tax Final Settlement	(47,896)

Governmental funds report capital outlays as expenditures. However in the statement of activities, the cost of those assets is allocated over their estimated useful lives as depreciation and amortization expenses. This is the amount by which capital outlays exceed depreciation expenses: 2,395,595

Repayment of principal of long-term obligation is an expenditure in the governmental funds, but the repayment reduces long-term liabilities in the statement of net assets: 1,254,956

Proceeds on issuance of long-term debt (bonds) are recorded as other financing sources in the fund financial statements, but the issuances increase long-term liabilities in the statement of net assets: (264,486)

Net changes in net assets reported in the accompanying statements of activities \$ (1,868,714)

The accompanying notes to the basic financial statements are an integral part of this statement.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF SANTA ISABEL**  
**Notes to Basic Financial Statements**  
**June 30, 2005**

**1. Summary of Significant Accounting Policies**

The Municipality of Santa Isabel of the Commonwealth of Puerto Rico (the "Municipality") is a local government with full legislative, fiscal and administrative powers to operate as a government under Law No. 81 of August 30, 1991, as amended, known as the *Autonomous Municipalities Act of the Commonwealth of Puerto Rico (Law No. 81)*.

The Municipality's governmental system consists of executive and legislative branches. The Constitution of the Commonwealth of Puerto Rico (the "Commonwealth") provides for the separation of powers of the executive, legislative, and judicial branches. A Mayor, elected every four years by the citizens, exercises the executive power of the Municipality. The legislative power is exercised by the Municipal Legislature, which is also elected every four years. The General Justice Court System of the Commonwealth, which has jurisdiction over the Municipality, exercises the judiciary power.

The Municipality assumes responsibility for providing services to its citizens related to public housing, welfare, public safety, health, sanitation, education, culture, recreation, urban and economic development, and many other general and administrative duties.

**a) New Financial Reporting Model**

The accompanying basic financial statements present the financial position and the results of operations of the Municipality as a whole, and its various governmental funds as of and for the year ended June 30, 2005, in conformity with accounting principles generally accepted in the United States of America, as prescribed by the Governmental Accounting Standards Board (GASB).

In June 1999, GASB issued Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments* (GASB No. 34). This statement established new financial reporting requirements for state and local governments. On July 1, 2003, the Municipality adopted the provisions of GASB No. 34 as well as other statements referred to below.

According to the new financial reporting model established by GASB No. 34, the minimum required financial statements presentation applicable to the Municipality is composed of the following elements: (1) government-wide financial statements (GWFS), (2) governmental fund financial statements (GFFS), (3) notes to basic financial statements, and (4) required supplementary information (RSI).

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF SANTA ISABEL**  
**Notes to Basic Financial Statements**  
**June 30, 2005**

The RSI, which consists of a management discussion and analysis (MD&A), is information presented along with, but separate from, the Municipality's basic financial statements. The MD&A is a narrative report that introduces the accompanying basic financial statements and provides an analytical overview of the Municipality's financial activities for the year ended June 30, 2005, based on the Municipality's knowledge of the transactions, events, and conditions reflected in the basic financial statements. The MD&A also highlights certain key fiscal policies that control the Municipality's operations.

As previously mentioned, on July 1, 2003, other statements and interpretations were also adopted in conjunction and simultaneously with GASB No. 34. Those statements and interpretations are: (1) GASB Statement No. 33 – *Accounting and Financial Reporting for Non-exchange Transactions*, (2) GASB Statement No. 37 – *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments: Omnibus*, (3) GASB Statement No. 38 – *Certain Financial Statement Note Disclosures*, and (4) GASB Interpretation No. 6 – *Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements*.

GASB No. 34 also required that the accounting for all governmental activities reported in the GWFS be based on applicable pronouncements issued by the Financial Accounting Standards Board (FASB) and its predecessor bodies, such as the Accounting Principles Board (APB), issued on or before November 30, 1989, provided those pronouncements do not conflict with or contradict GASB pronouncements. Accordingly, in conjunction and simultaneously with the adoption of GASB No. 34, the Municipality also adopted the following pronouncements: (1) APB Opinion No. 20 – *Accounting Changes*, (2) APB Opinion No. 21 – *Interest on Receivables and Payables*, (3) FASB Statement No. 5 – *Accounting for Contingencies* and (4) FASB Statement No. 16 – *Prior Period Adjustments*. The Municipality has elected to not apply all statements and interpretations issued by FASB after November 30, 1989.

**b) Financial Reporting Entity**

The accompanying basic financial statements include all departments, agencies, and municipal entities that: (1) are under the legal and administrative control of the Mayor, and (2) whose funds are under the legal custody and control of the Municipality's Director of Finance and Budget, as prescribed by Law No. 81.

The Municipality's management has considered all potential component units for which it may be financially accountable and other legally separate organizations for which the nature and significance of their relationship with the Municipality may be such that exclusion of their basic financial statements from those of the Municipality would cause the Municipality's basic financial statements to be misleading or incomplete.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF SANTA ISABEL**  
**Notes to Basic Financial Statements**  
**June 30, 2005**

GASB Statement No. 14 - *The Financial Reporting Entity* (GASB No. 14) has set forth criteria to be considered in determining financial accountability. These criteria include appointing a voting majority of an organization's governing body, and (1) the ability of the Municipality to impose its will on that organization or (2) the potential for the organization to provide specific financial benefits to, or impose specific financial burdens on the Municipality.

On July 1, 2003, the Municipality adopted the provisions of GASB Statement No. 39 - *Determining Whether Certain Organizations are Component Units* (GASB No. 39). This statement provides additional guidance in determining whether certain organizations for which the primary government is not financially accountable should be reported as component units based on the nature and significance of their relationship with the primary government. Generally, GASB No. 39 requires reporting a component unit if an organization rises and holds economic resources for the direct benefit of a governmental unit.

The Municipality's management has concluded that, based on the aforementioned criteria, there are no legally separate entities or organizations that should be reported as component units of the Municipality as of June 30, 2005 nor for the year then ended.

**c) *Government-wide Financial Statements***

The accompanying GWFS are composed of: (1) the statement of net assets, and (2) the statement of activities. These financial statements do not report fund information but rather report information of all of the Municipality's governmental activities. These statements are aimed at presenting a broad overview of the Municipality's finances through reporting its financial position and results of operations as a whole, using methods that are similar to those used by most private businesses.

The focus of the GWFS is not on compliance with budgets, regulatory requirements or on the use of available or currently expendable financial resources (referred to as fiscal accountability), but on operational accountability information about the Municipality as a single economic unit. Operational accountability is the Municipality's responsibility to report to the extent to which it has met its operating objectives efficiently and effectively, using all resources available for that purpose. It focuses on the Municipality's principal operating objective, which is to provide services to its citizens.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF SANTA ISABEL**  
**Notes to Basic Financial Statements**  
**June 30, 2005**

The accompanying statement of net assets provides short-term and long-term information about the Municipality's financial position and condition by presenting all of the Municipality's assets and liabilities, with the difference between these two items reported as "net assets" (equity). This statement assists management in assessing the level of services that can be provided by the Municipality in the future, and its ability to meet its obligations as they become due. In addition, this statement reports the extent to which the Municipality has invested in capital assets, including infrastructure, and discloses legal and contractual restrictions on resources.

Net assets are classified in the accompanying statement of net assets within the following three categories:

- **Invested in capital assets, net of related debt** – These consist of capital assets, net of accumulated depreciation and amortization, reduced by the outstanding balances of bonds, notes, and other debt that are attributed to the acquisition, construction or improvement of those assets. For the purposes of determining the outstanding debt attributed to capital assets, the total long-term debt related to the acquisition, construction or improvement of capital assets have been reduced by any related unspent debt proceeds and any related unamortized debt issuance costs.
- **Restricted net assets** – These consist of net assets restricted by external parties (such as creditors, grantors, contributors, laws or regulations of other governments, etc.), or net assets for which constraints are imposed by constitutional provisions or enabling legislation. Enabling legislation is defined as legislation that authorizes the Municipality to assess, levy, charge or otherwise mandate payment of resources (from external resource providers). Enabling legislation establishes restrictions if it includes a legally enforceable requirement that those resources be used only for the specific purposes stipulated in the legislation.

The classification of restricted net assets identifies resources that have been received or earned by the Municipality with an explicit understanding between the Municipality and the resource providers that the resources would be used for specific purposes. Grants, contributions, and donations are often given under those kinds of conditions. Bond indentures also often limit the use of bond proceeds to specific purposes.

Internally imposed designations of resources, including earmarking, are not reported as restricted net assets. These designations consist of management's plans for the use of resources, which are subject to change at the discretion of the Municipal Legislature.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF SANTA ISABEL**  
**Notes to Basic Financial Statements**  
**June 30, 2005**

- **Unrestricted net assets** – These consist of net assets that are neither externally or legally restricted, nor invested in capital assets. However, unrestricted net assets often are designated to indicate that management does not consider them to be available for general operations. Unrestricted net assets often have constraints that are imposed by management, but can be removed or modified.

When both restricted and unrestricted resources are available for use, it is the Municipality's policy to generally use restricted resources first, and then unrestricted resources as they are needed.

The accompanying statement of activities presents the results of the Municipality's operations by showing how the Municipality's net assets changed during the year ended June 30, 2005, using a net (expense) revenue format. This statement presents the cost of each function/program as well as the extent to which each of the Municipality's functions, programs or other services either contributes to or draws from the Municipality's general revenues (such as property taxes, municipal license taxes, construction excise taxes, etc.).

A function/program describes a group of activities that are aimed at accomplishing a major service or regulatory responsibility. The functions/programs reported in the accompanying basic financial statements are: (1) general government, (2) urban and economic development, (3) public safety, (4) health and sanitation, (5) culture, recreation and education, and (6) welfare and housing assistance. The governmental operations of the Municipality's departments and operational units are classified within the following functions/programs in the accompanying basic financial statements:

**General Government:**

- Municipal Legislature
- Mayor's Office
- Department of Finance and Budget
- Department of Human Resources
- Department of Municipal Secretary
- Department of Internal Audit
- Department of Public Relations

**Urban and Economic Development:**

- Department of Public Works

**Public Safety:**

- Department of Municipal Police
- Office of Emergency Management

**Health and Sanitation:**

- Department of Health
- Department of Sanitation

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF SANTA ISABEL**  
**Notes to Basic Financial Statements**  
**June 30, 2005**

**Culture, Recreation and Education:**

Department of Recreation and Sports

**Welfare and Housing Assistance:**

Department of Elderly Affairs

Department of Service to Citizen

The statement of activities demonstrates the degree to which program revenues offset direct expenses of a given function/program or segments. Direct expenses are those that are clearly identifiable with a specific function, segment or operational unit. This statement reports revenues in two broad categories: (1) program revenues and (2) general revenues.

Program revenues are generated directly from a program itself or may come from parties outside the Municipality's taxpayers or citizens. In the statement of activities, program revenues reduce the costs (expenses) of the function/program to arrive at the net cost of the function/program that must be financed from the Municipality's general revenues. The accompanying statement of activities separately reports the following categories of program revenues:

- **Charges for services** – These generally consist of exchange or exchange-like transactions involving charges to customers or applicants who purchase, use or directly benefit from the goods, services or privileges provided, or are otherwise directly affected by the services. These include fees charged for specific services, charges for licenses and permits, and fines and forfeitures, among others.
  
- **Program-specific capital and operating grants and contributions** – These consist of transactions that are either mandatory or voluntary non-exchange transactions with other governments, organizations, or individuals that restrict the resources for use in a particular program. Capital grants and contributions consist of capital assets or resources that are restricted for capital purposes – to purchase, construct or renovate capital assets associated with a specific program. Operating grants and contributions consist of resources that are required to be used to finance the costs of operating a specific program or can be used either for operating or capital purposes of a specific program. Restricted capital and operating grants and contributions are program revenues because they are specifically attributable to a program and reduce the net expense of that program to the Municipality. They are reported net of estimated uncollectible amounts.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF SANTA ISABEL**  
**Notes to Basic Financial Statements**  
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General revenues are the default category for revenues. It includes all revenues and gains that do not meet the definition of program revenues. Property taxes, municipal license taxes and construction excise taxes are reported as general revenues. All other non-tax revenues (including unrestricted investment earnings, grants and contributions not restricted for specific programs and miscellaneous revenues) that do not meet the definition of program revenues are classified as general revenues. Resources that are dedicated internally by the Municipality are reported as general revenues rather than as program revenues. All general revenues are reported net of estimated uncollectible amounts, which are recorded as reduction of revenues rather than as expenses.

The *general government* function/program reported in the accompanying statement of activities, includes expenses that are, in essence, indirect or overhead expenses of the Municipality's other functions/programs. Even though some of these costs have been charged to other funds in the governmental fund financial statements as indirect cost allocations permitted under some federal programs, the Municipality has reported these indirect expenses as direct expenses of the general government function. Accordingly, the Municipality does not allocate general government (indirect) expenses to other functions.

The effects of all interfund governmental activities (revenues, expenditures and other financing sources/uses among governmental funds) have been removed from the accompanying statements of net assets and activities.

The Municipality classifies all of its activities as governmental activities in the accompanying GWFS. These are activities generally financed through taxes, intergovernmental revenues, and other non-exchange revenues that can be used to support the Municipality's programs or services. These governmental activities are also generally reported in the governmental fund financial statements.

The Municipality has no fiduciary activities, which are those in which the Municipality would be holding or managing net assets for specific individuals or other external parties in accordance with trust agreements or other custodial arrangements. In addition, the Municipality has no operations or activities that are primarily financed and operated in a similar manner to private business enterprises, where the costs of providing goods or services to the general public is financed primarily through user charges.

**d) *Governmental Fund Financial Statements***

The accompanying GFFS are composed of: (1) the balance sheet – governmental funds and (2) the statement of revenues, expenditures and changes in fund balances – governmental funds. These financial statements report the financial position and results operations of the Municipality's governmental funds by presenting sources, uses, and balances of current financial resources. Some of these financial statements have a budgetary orientation and focus primarily on: (1) the Municipality's major funds, as defined below, (2) the fiscal accountability, and (3) the individual parts of the Municipality's government. Fiscal accountability represents the Municipality's responsibility to justify that its actions in the current year have complied with public decisions concerning the raising and spending of public moneys in the short term (one fiscal year).

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Each governmental fund is considered an independent fiscal entity accounted for within a set of self-balancing accounts that comprise its assets, liabilities, fund equity or deficit, revenue, and expenditures. The accompanying GFFS segregate governmental funds according to their intended purpose and are used in demonstrating compliance with legal, financial, and contractual provisions. The minimum number of governmental funds is maintained consistent with legal and self-imposed managerial requirements established by the Municipality. For financial reporting purposes, the Municipality classifies its governmental funds within the following categories:

- **General fund** – The general fund is the Municipality’s main operating and major fund, as defined below, used to account for all financial resources and governmental activities, except for financial resources required to be accounted for in another fund. It is presumed that the Municipality’s governmental activities have been reported in the general fund except for transactions for which one of the following compelling reasons has required the use of another fund: (1) legal requirements, (2) GAAP requirements, or (3) the demands of sound financial administration requiring the use of a governmental fund other than the general fund.
- **Special revenue funds** – The special revenue funds are Major funds, as defined below, used by the Municipality to account for revenues derived from grants or other revenue sources (other than major capital projects) that are either self-restricted by the Municipality or legally restricted by outside parties for use in specific purposes. The uses and limitations of each special revenue fund are specified by municipal ordinances or federal and state statutes. However, resources restricted to expenditure for purposes normally financed from the general fund are reported in the Municipality’s general fund, providing that all applicable legal requirements are appropriately satisfied. In this case, a special revenue fund to account for such kind of transactions will be used only if legally mandated.
- **Debt service fund** – The debt service fund is a Non-major fund, as defined below, used by the Municipality to account for the accumulation of resources for, and the payment of, principal and interest for: (1) bonds and notes for which debt service payments are legally mandated to be accounted for in a debt service fund, and/or (2) general long-term debt for which the Municipality is being accumulating financial resources in advance, to pay principal and interest payments maturing in future years. Principal and accrued interest due on July 1 of the following fiscal year related to long-term debt for which debt service payments are accounted for in the debt service fund, are recorded as debt service fund’s liabilities at June 30, if resources are available at June 30 for its payment.

General long-term debts for which debt service payments do not involve the advance accumulation of resources (such as obligations under capital leases, compensated absences, claims and judgments, and notes payable, among others) are accounted for in the accompanying statement of net assets. The debt service payments of such debts are generally accounted for in the general fund.

- **Capital projects funds** – Capital projects funds are major and non-major funds, as defined below, used to account for the financial resources used in the acquisition or construction of major capital facilities, other assets, and permanent improvements. Significant capital outlays financed from general obligation bond proceeds are accounted for also in the capital projects funds.

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The use of the capital projects funds has been reserved for major capital acquisitions or construction activities that would distort financial resources trend data if not reported separately from the other Municipality's operating activities. The routine purchases of minor capitalizable assets (such as certain vehicles and other minor capital assets) have been reported in the fund from which financial resources were used for the purchase.

Prior to GASB No. 34, the Municipality was required to report governmental fund financial statements that presented a single aggregated column for each fund type. Each column presented the combined total of all funds of a particular type. Fund types are no longer the focus of the accompanying governmental fund financial statements. Under GASB No. 34, the focus of the governmental fund financial statements is on major funds, which generally represent the Municipality's most important funds. Accordingly, the Municipality is required to segregate governmental funds among major and non-major within the governmental fund financial statements. Major individual governmental funds are reported individually as separate columns in the governmental fund financial statements, while data from all non-major governmental funds are aggregated into a single column, regardless of fund type.

By definition, the Municipality's general fund is always considered a major governmental fund for financial reporting purposes. In addition, any other fund is considered a major fund for financial reporting purposes if its total assets, liabilities, revenues or expenditures of that individual governmental fund are at least 10 percent of the corresponding element total (assets, liabilities, revenues or expenditures) for all governmental funds. For the purposes of applying the aforementioned major fund criteria, no eliminations of interfund balances have been made. Total revenues for these purposes means all revenues, including operating and non-operating revenues (net of allowances), except for other financing sources. Total expenditures for these purposes mean all expenditures, including operating and non-operating expenditures, except for other financing uses.

Based on the aforementioned criteria, the Municipality's major governmental funds reported in the accompanying governmental fund financial statements are: (1) the general fund, (2) the state legislative joint resolutions fund, and (3) Head Start fund.

The state legislative joint resolutions fund is a major fund used to account for financial resources derived from capital and operating grants awarded each year by the Commonwealth's Senate and House of Representatives (the Commonwealth's Legislature). The purpose of the amounts awarded by the Commonwealth's Legislature vary from year to year, but are generally restricted to (1) partially subsidize certain qualifying administrative and operational activities of the Municipality, (2) provide specific multipurpose services to citizens, and (3) finance the acquisition or construction of capital assets approved by the Commonwealth's Legislature.

The Head Start fund is a major fund used to account for financial resources derived from Federal grants from the Administration for Children and Families of the United States Department of Health and Human Services related to Head Start and Early Head Start Programs. The purpose of the amounts awarded by the Grantor is restricted to (1) provide specific services to eligible participants.

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*e) Measurement Focus and Basis of Accounting*

**Government-wide financial statements** – The accompanying GWFS are prepared using the economic resources measurement focus and the accrual basis of accounting. Subject to the additional rules and limitations detailed below, revenues (including interest income) are generally recorded when earned and expenses are generally recorded when a liability is incurred, regardless of the timing of related cash flows.

All revenues, expenses, gains, losses, assets, and liabilities resulting from exchange and exchange-like transactions are generally recorded when the exchange takes place. In exchange transactions, each party to the transaction receives and gives up essentially equal values.

An exchange-like transaction is one in which there is an identifiable exchange and the values exchanged, though related, may not be quite equal. Nevertheless, the exchange characteristics of the exchange-like transaction are strong enough to justify treating it as an exchange for accounting purposes (examples include fees for licenses and permits, charges for services, and miscellaneous revenues, which are recorded as revenues when collected because they are generally not measurable until actually received).

All revenues, expenses, gains, losses and assets resulting from non-exchange transactions are recorded using the criteria set forth by GASB Statement No. 33, *Accounting and Financial Reporting for Non-exchange Transactions* (GASB No. 33), which the Municipality adopted on July 1, 2003. GASB No. 33 established accounting and reporting standards for non-exchange transactions involving cash and financial or capital resources (for example, most taxes, grants, and private donations). In a non-exchange transaction, the Municipality gives (or receives) value without directly receiving (or giving) equal value in return. This is different from an exchange transaction, in which each party receives and gives up essentially equal values. According to GASB No. 33, the Municipality groups its non-exchange transactions into the following four classes in the accompanying basic financial statements: (a) derived tax revenues, (b) imposed non-exchange revenues, (c) government mandated non-exchange transactions, and (d) voluntary non-exchange transactions.

In the case of derived tax revenue transactions (such as municipal license taxes), which result from assessments the Municipality places on exchange transactions, receivables and revenues are recorded when the underlying exchange has occurred (that generally is, when the taxpayers' net sales or revenues subject to tax take place).

In the case of imposed non-exchange revenue transactions (such as property taxes), which result from assessments made by the Municipality on nongovernmental entities, including individuals, other than assessments on exchange transactions, receivables are generally recorded in the period when an enforceable legal claim has arisen. Property taxes are generally recorded as revenues (net of amounts considered not collectible) in the period when resources are required to be used or the first period that the use of the resources is permitted.

Government-mandated non-exchange transactions (such as grants and contributions) result when a government at one level (such as the federal or state government) provides resources to another government (such as the Municipality), and the provider government requires the recipient government to

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use those resources for a specific purpose or purposes established in the provider's enabling legislation. In these types of transactions, receivables, and revenues are generally recorded as follows:

- For reimbursement-type (commonly known as "expenditure-driven awards"), receivables and revenues are recorded when all eligibility requirements imposed by the provider have been met. The Municipality must expend resources on the specific purpose or project before the provider reimburses any amounts. Revenue is, therefore, generally recognized as qualifying reimbursable expenditures are incurred.
- For other types of grants (mainly grants and contributions with purpose restrictions but with no time requirements), receivables and revenues are recorded when all applicable eligibility requirements are met. When the provider is a government (including the government of the United States of America) the applicable recognition period for both, the provider and the recipient, is the provider's fiscal year and begins on the first day of that year.

Voluntary non-exchange transactions (such as donations, certain grants, and entitlements) result from legislative or contractual agreements, other than exchanges, entered into willingly by two or more parties. In these types of transactions, receivables and revenues are generally accounted for in the same manner as government-mandated non-exchange transactions discussed above.

Receipts of any type of revenue sources collected in advance for use in the following period are recorded as deferred revenues.

Events that are neither exchange nor non-exchange transactions are recorded when it is probable that a loss has been incurred and the amount of loss is reasonably estimable.

The measurement focus and the basis of accounting used in the accompanying GWFS differ significantly from the measurement focus and basis of accounting used in the preparation of the accompanying GFFS. Therefore, the accompanying GFFS include reconciliations to better identify the relationship between the GWFS and the GFFS.

**Governmental fund financial statements** – The accompanying GFFS are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are generally recognized as soon as they are both measurable and available. Revenues are generally considered to be available when they are collectible within the current year or soon enough thereafter to pay liabilities of the current year. For this purpose, the Municipality considers most revenues to be available if collected within 90 days after June 30, 2005, except for property taxes for which the availability period is 60 days. Revenue sources not meeting this availability criterion or collected in advance are recorded as deferred revenues at June 30, 2005. The principal revenue sources considered susceptible to accrual include property taxes, municipal license taxes, intergovernmental grants and contributions and interest income. These principal revenue sources meet both measurability and availability criteria in the accompanying GFFS, except for amounts recorded as deferred revenues.

In a manner similar to the GWFS, but subject to and limited by the availability criteria discussed above, all revenues, expenses, gains, losses, assets, and liabilities resulting from exchange and exchange-like

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transactions are also generally recorded when the exchange takes place. Accordingly, fees for licenses and permits, charges for services and miscellaneous revenues are recorded as revenues when collected because they are generally not measurable until actually received.

All revenues, expenses, gains, losses, and assets resulting from non-exchange transactions are recorded in a similar manner to the GWFS, using the previously discussed criteria set forth by GASB No. 33 for non-exchange transactions, but subject to and limited by the availability criteria discussed above. Accordingly, municipal license tax receivables and revenues are generally recorded when the underlying exchange has occurred. Property tax receivables are also generally recorded in the period when an enforceable legal claim has arisen while property tax revenues (net of amounts considered not collectible) are also generally recorded in the period when resources are required to be used or the first period that the use of the resources is permitted. Receivables and revenues from reimbursement-type grants, contributions, donations, and entitlements are also generally recorded as qualifying reimbursable expenditures are incurred, while receivables and revenues from other types of grants are recorded when all eligibility requirements imposed by the provider have been met.

Interest income is recorded when earned only if collected within 90 days after year-end since these would be considered both measurable and available.

As previously discussed, on July 1, 2003, the Municipality adopted the provisions of GASB Interpretation No. 6, *Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements* (GASBI No. 6), which modifies the recognition criteria for certain expenditures and liabilities reported under the modified accrual basis of accounting and clarifies a number of situations in which the Municipality should distinguish between governmental fund liabilities and general long-term liabilities.

Pursuant to the provisions of GASBI No. 6, in the absence of an applicable accrual modification, governmental fund liabilities and expenditures should be accrued. Liabilities that governments normally pay in a timely manner and in full from expendable available financial resources (for example, salaries, and utilities) should be recognized when incurred, without regard to the extent to which resources are currently available to liquidate the liability.

Modifications to the accrual basis of accounting include:

- Employees' accumulated vacation, sick leave, and compensatory time (compensated absences) are recorded as expenditures when consumed. The amount of the unpaid compensated absences has been reported only in the accompanying statements of net assets.
- Principal and interest on bonds and notes payable are recorded when they mature (when payment is due), except for principal and interest due in July 1 of the following fiscal year, which are recorded when resources are available in the debt service fund (generally June 30).
- Obligations under capital leases, amounts subject to claims and judgments under litigation and other long-term obligations are recorded only when they mature (when payment is due).

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- Accounts payable and accrued liabilities not expected to be liquidated with available and expendable financial resources are recorded in the accompanying statement of net assets but not in the governmental funds.
- Execute purchase orders and contracts are recorded as a reservation of fund balance in the GFFS.

Liabilities outside the bounds of these exceptions or modifications are reported as governmental fund liabilities when incurred (including salaries, professional services, supplies, utilities, etc.) since these liabilities normally are paid in a timely manner and in full from current financial resources.

The measurement focus of the GFFS is on decreases in net financial resources (expenditures) rather than expenses. Most expenditures are measurable and are recorded when the related governmental fund liability is incurred. Allocation of costs, such as depreciation and amortization, are recorded in the accompanying statement of activities, but are not recorded in the accompanying GFFS.

Under the new financial reporting model established by GASB No. 34, all general capital assets and the unmatured long-term liabilities (determined using the modified accrual basis of accounting) are no longer reported in account groups within the governmental fund balance sheet but are incorporated into the accompanying statement of net assets since July 1, 2003.

*f) Stewardship, Compliance, and Accountability*

**Budgetary Control**

According to the Autonomous Municipalities Act of the Commonwealth of Puerto Rico, the Mayor and its Administrative Cabinet prepare annual budgets each fiscal year for the Municipality's general fund and debt service fund. Such legally adopted budgets are based on expected expenditures by program and estimated resources by source for both funds. The annual budgets are developed using elements of performance-based program budgeting and zero-based budgeting, and include estimates of revenues and other resources for the ensuing fiscal year under laws and regulations existing at the time the budget is prepared.

The Mayor must submit an annual budgetary resolution project (the Project) to the Commissioner of Municipal Affairs of Puerto Rico (the Commissioner) and the Municipal Legislature no later than each May 10 and May 15, respectively. The Commissioner preliminary verifies that the Project complies with all the applicable laws and regulations and may provide comments and suggestions to the Mayor on or before each June 13.

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The Municipal Legislature has 10 business days, up to June 13, to discuss and approve the Project with modifications. The Municipal Legislature may amend the budgets submitted by the Mayor but may not increase any items so far to cause a deficit without imposing taxes or identifying other sources of revenue to cover such deficit. After the Municipal Legislature modifies and preliminarily approves the Project, the modified Project is sent back to the Mayor for his approval or rejection within 6 days. The Mayor may decrease or eliminate any line item but may not increase or insert any new line item in the budgets. The Mayor may also veto the budgets in their entirety and return its to the Municipal Legislature with his objections. If the Mayor rejects the Project, the Municipal Legislature will have up to 8 days to adopt or reject the recommendations or objections of the Mayor. The approved Project is sent again to the Mayor, which then would have 3 days to sign and approve it.

If the budgets are not adopted prior to the end of the deadlines referred to above, the annual budgets for the preceding fiscal year, as approved by the Legislature and the Mayor, are automatically renewed for the ensuing fiscal year until the Municipal Legislature and the Mayor approve new budgets. This permits the Municipality to continue making payments for its operations and other purposes until the new budgets are approved.

The annual budgets may be updated for any estimate revisions as well as year-end encumbrances and may include any additional information requested by the Municipal Legislature. The Mayor may request subsequent amendments to the approved budgets, which are subject to the approval of the Municipal Legislature.

The Municipality's Department of Finance and Budget has the responsibility to ensure that budgetary spending control is maintained. For day-to-day management control, expenditures plus encumbrances may not exceed budgeted amounts at the expenditure-type level of each cost center (activity within a program within a fund). The Mayor may transfer unencumbered appropriations within programs within funds. The Municipal Legislature may transfer amounts among programs within and among funds.

The legal level of budgetary control (i.e., the level at which expenditures may not legally exceed appropriation) is at the functions/program level (general government, urban and economic development, public safety, health and sanitation, culture, recreation and education, and public housing and welfare) within a fund.

Under the laws and regulations of the Commonwealth, the appropriations made for any fiscal year shall not exceed the total revenue, including available surplus, estimated for said fiscal year unless the imposition of taxes sufficient to cover said appropriations is provided.

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**Budgetary Accounting**

The Municipality's annual budgets are prepared under the budgetary (statutory) basis of accounting, which is not in accordance with GAAP.

Under the budgetary basis of accounting, revenue is generally recognized when cash is received. Short-term and long-term borrowings may be used to finance budgetary excess of expenditures over revenues.

The Municipality uses encumbrance accounting to record the full amount of purchase orders, contracts and other commitments of appropriated resources as deductions from the appropriation prior to actual expenditure. In the governmental funds, encumbrance accounting is a significant aspect of budgetary control. Accordingly, expenditures are generally recorded when the related expenditure is incurred or encumbered. Available appropriations and encumbrances are established to lapse one year after the end of the fiscal year. Amounts required to settle claims and judgments against the Municipality, and certain other liabilities, are not recognized until they are encumbered or otherwise processed for payment. Unencumbered appropriations and encumbrances lapse at year-end. Other appropriations, mainly capital projects appropriations, are continuing accounts for which the Municipal Legislature has authorized that an unspent balance from the prior year be carried forward and made available for current spending.

The accompanying budgetary comparison schedule provides information about the general fund's original budget, the amendments made to such budget, and the actual general fund's results of operations under the budgetary basis of accounting for the fiscal year ended June 30, 2005. Further details of the Municipality's budgetary control at the legal level may be obtained from the Budgetary Liquidation Report for the fiscal year ended June 30, 2005. Copies of that report may be obtained by writing to the Municipality's Director of Finance and Budget.

Accounting principles applied for purposes of developing data on a budgetary basis differ significantly from those used to present the governmental fund financial statements in conformity with GAAP. Accordingly, the accompanying budgetary comparison schedule is accompanied by a reconciliation of the differences between the budgetary basis and GAAP actual amounts.

The Municipality does not legally adopt budgets for the state legislative joint resolutions capital fund. The financial resources received by these funds are not subject to budgeting by the Municipality since the resources received each year from the respective grantors varies from year to year, and the respective amounts are granted at their discretion.

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***g) Unrestricted and Restricted Deposits***

The Municipality's deposits are composed of cash on hand, demand deposits, and cash equivalents in: (1) commercial banks, (2) the Government Development Bank for Puerto Rico (GDB), a governmental bank and a major component unit of the Commonwealth, who is statutorily designated as fiscal agent of the Municipality, and (3) the Municipal Revenue Collection Center (CRIM, by its Spanish acronyms), a governmental entity responsible for the imposition and collection of property taxes on behalf of all municipalities of Puerto Rico.

The Municipality follows the practice of pooling cash. The balance in the pooled cash account is available to meet current operating requirements. Under the laws and regulations of the Commonwealth, public funds deposited by the Municipality in commercial banks must be fully collateralized for the amounts deposited in excess of the federal depository insurance generally provided by the Federal Deposits Insurance Corporation (FDIC). All securities pledged as collateral are held by agents designated by the Secretary of the Treasury of the Commonwealth, but not in the Municipality's name.

Restricted assets include cash and cash equivalents in commercial banks, GDB and CRIM. These cash balances are classified as restricted assets since its use is limited for the specified purposes discussed below, which are established by applicable agreements or required by law.

Restricted cash with fiscal agent in the general and debt service funds represent property tax collections which are retained and restricted for the payment of the Municipality's debt service, as established by law. Restricted cash in fiscal agent in other governmental funds consists of unspent proceeds of bonds and notes, and the balance of interest and non-interest bearing accounts which are restricted for: (1) the acquisition, construction or improvement of major capital assets and the operations of federal and state funded programs.

Restricted cash includes cash equivalents amounting to \$2,523,228 at June 30, 2005, consisting of certificates of deposit with original maturities of three months or less. These cash equivalents are recorded in the state legislative joint resolutions fund, consequently, are restricted for use in specific activities accounted for in such fund.

***h) Unrestricted and Restricted Accounts and Notes Receivable***

In the accompanying GWFS, receivables consist of all revenues earned but not collected at June 30, 2005. Major receivable balances for the governmental activities include property taxes and intergovernmental receivables.

Tax receivables in the general fund represent uncollected property taxes. Restricted tax receivables in the debt service fund consist of uncollected property taxes, which are restricted for the payment of the Municipality's debt service, as established by law.

Intergovernmental receivables are composed of: (1) amounts owed to the Municipality for reimbursement of expenditures incurred pursuant to federal and state funded programs (recorded in the general fund.

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special revenue funds and capital project funds), and (2) contributions in lieu of taxes from the Puerto Rico Electric Power Authority, recorded in the general fund.

These accounts receivables are stated net of estimated allowances for uncollectible accounts, which are determined, based upon past collection experience, historical trends, current economic conditions, and the periodic aging of accounts receivable.

Activities among funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as either "due to/from other funds" (i.e. the current portion of interfund loans) or "advances to/from other funds" (i.e., the non-current portion of interfund loans). All other outstanding balances between funds are reported as "due to/from other funds". Advances between funds, as reported in the GFFS, are offset by a fund balance reserve account in applicable governmental funds to indicate that they are not available for appropriation and are not expendable available financial resources.

**i) *Inventories and Other Current Assets***

Inventories and other current assets consist of materials, supplies, food, and medicine inventories held for consumption, and prepaid costs. Generally, inventories and other current assets are capitalized (consumption method). Inventories are stated at cost using the first-in, first-out method (FIFO).

**j) *Capital Assets***

Capital assets used in governmental activities include land and land improvements, buildings, structures and building improvements, machinery and equipment, furniture and fixtures, licensed vehicles, construction in progress, and infrastructure. These assets are capitalized and reported in the accompanying statement of net assets. Infrastructure assets are generally stationary in nature and include roads, bridges, streets and sidewalks, drainage systems, and other similar assets.

The Municipality defines capital assets as assets with an individual cost of \$500 or more at the date of acquisition or construction, and with useful lives extending beyond one year. All assets with individual costs under \$500 or with useful lives not exceeding one year, are charged directly to expense in the accompanying statement of activities. In the governmental funds, all capital assets are recorded as expenditures.

In the statement of net assets, all capital assets are recorded at cost or estimated historical cost if actual cost was unavailable, except for donated capital assets, which are recorded at their estimated fair value at the date of donation. Estimated historical costs based on deflated current costs were used to value a significant portion of the infrastructure and certain land, buildings, structures and building improvements constructed or acquired prior to June 30, 2003. The method to deflate the current costs using an approximate price index was used only in the case of certain items for which their historical cost documentation was not available. Actual historical costs were used to value the infrastructure, land, building, structures, building improvements, construction in progress, machinery and equipment, and licensed vehicles constructed or acquired during or after the year ended June 30, 2004.

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Major outlays for capital assets and improvements are capitalized in the statement of net assets as projects are constructed. The costs of normal maintenance and repairs that do not add value to the asset or materially extend capital asset lives are not capitalized.

Depreciation and amortization expense is recorded only in the government-wide statement of activities. However, there is no depreciation or amortization recorded for land and construction-in-progress. Depreciable capital assets are generally depreciated or amortized over their estimated useful lives under the straight – line method, except for machinery and equipment held under capital leases which is depreciated over the shorter of its estimated useful life or the lease term. The estimated useful lives of major capital asset categories are:

	<u>Years</u>
Land improvements	20
Buildings, structures and building improvements	30 to 50
Infrastructure	20 to 50
Licensed vehicles	8
Furniture and fixtures	5 to 20
Machinery and equipment, excluding those held under capital leases	5 to 20

Depreciation and amortization expense on capital assets are recorded as direct expenses of the function/program specifically identified with the asset. Depreciation and amortization of infrastructure is not allocated to various functions/programs but reported as direct expenses of the urban and economic development function.

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**k) *Deferred Revenues***

The Municipality reports deferred revenue on its GFFS and GWFS. In the GFFS, deferred revenue arises when:

- Potential revenue does not meet both the “measurable” and “available” criteria for revenue recognition in the current period. As previously discussed, available is defined as due (or past due) at June 30, and collected within 90 days (60 days for property taxes) thereafter to pay obligations due at June 30, or;
- The Municipality receives resources before it has a legal claim to them. In subsequent periods, when the revenue recognition criterion is met, the liability for deferred revenue is removed and revenue is recognized.

Deferred revenues at the government-wide level arise only when the Municipality receives resources before it has a legal claim to them.

**l) *Compensated Absences***

Compensated absences are accounted for under the provisions of Statement No. 16, *Accounting for Compensated Absences*, issued by GASB (GASB No. 16). Compensated absences include paid time off made available to employees in connection with vacation, sick leave and compensatory time. The liability for compensated absences recorded in the accompanying statement of net assets is limited to leave that: (1) is attributable to services already rendered on or before June 30, 2005, and (2) is not contingent on a specific event (such as illness) that is outside the control of the Municipality and the employee. The liability for compensated absences includes salary-related costs, which are directly and incrementally related to the amount of salary paid to the employee (such as employer’s share of social security taxes and medicare taxes).

The vacation policy of the Municipality is established by law and provides for the accumulation of regular vacations at a rate of 2.5 days per month (30 days per year) per employee. Employees accumulate regular sick leave at a rate of 1.5 days per month (18 days per year). Employees accumulate compensatory time at a rate of 1.5 times the overtime worked. All vacation and sick leave days accumulated by employees in excess of 30 days and 90 days, respectively, are paid to employees each year, if not consumed, as required by law. In the case of compensatory time, the excess of 240 hours is paid to employees each year, if not consumed.

Upon termination of employment, an employee receives compensation for all accumulated unpaid regular vacation leave at the current rate. In the case of regular sick leave, if the employee terminates his or her employment with the Municipality before reaching 10 years of services, such regular sick leave is not paid to the employee, if not consumed. Upon termination of employment, an employee does not receive compensation for compensatory time, if not consumed. After 10 years of services any regular sick leave balance is paid to the employee. Accumulated vacation time is fully vested to the employee at any time.

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The liability for compensated absences is reported in the statement of net assets. A liability for compensated absences is reported in the GFFS only if they have matured, for example, as a result of employee resignations and retirements.

**m) Long-term Debt**

The long-term liabilities reported in the accompanying statements of net assets include the Municipality's bonds, notes, obligation under capital leases, compensated absences, and legal claims and judgments.

All long-term debt to be repaid from governmental resources is reported as liabilities in the accompanying statement of net assets. Principal and interest payments on bonds due in July 1 of the following fiscal year are recorded as fund liabilities in the GFFS when resources are available in the debt service fund (generally at June 30). In the GFFS, the face amount of debt issued is reported as other financing sources when issued.

On July 1, 2003, the Municipality adopted the provisions of APB Opinion No. 21, *Interest on Receivables and Payables* (APB No. 21), to account for certain non-interest bearing notes payable to: (1) CRIM, a discretely presented component unit of the Commonwealth, and (2) Puerto Rico Treasury Department, an agency (governmental unit) of the primary government of the Commonwealth.

According to APB No. 21, the Municipality has recorded such notes at present value with an imputed interest rate that approximates the rate that would have been used, using the same terms and conditions, if it had been negotiated by an independent lender. In the accompanying statement of net assets, such notes payable are reported net of the applicable unamortized discount, which is the difference between the present value and the face amount of the notes.

**n) Accounting for Pension Costs**

For the purpose of applying the requirements of GASB Statement No. 27, *Accounting for Pensions by State and Local Government Employers* (GASB No. 27), the Commonwealth of Puerto Rico is considered to be the sponsor of the Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS) and System 2000, the two retirement systems in which the employees of the Municipality participate. Accordingly, the Municipality is considered a participant and not a sponsor of these retirement systems since the majority of the participants in the aforementioned pension trust funds are part of the financial reporting entity of the Commonwealth. Accordingly, no portion of the net pension obligation (NPO) related to ERS has been allocated to the Municipality in the accompanying basic financial statements. The basic financial statements of the Commonwealth account for the total amount of the net pension obligation of ERS, including any amount that may be allocated to the Municipality.

According to GASB No. 27, the Municipality accounts for pension costs from the standpoint of a participant in a multiple-employer cost-sharing plan. Accordingly, pension costs recognized in the accompanying basic financial statements are equal to the statutorily required contributions, with a liability recorded for any unpaid required contributions.

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***o) Risk Management***

The Municipality carries commercial insurance covering casualty, theft, tort claims, and other losses. Insurance policies are negotiated by the Puerto Rico Treasury Department (the Treasury Department) on behalf of all municipalities of Puerto Rico. The Treasury Department pays the insurance premiums on behalf of the Municipality and then is reimbursed each year through monthly equal payments deducted from the Municipality's gross property tax collections made by CRIM.

The Municipality carries insurance coverage for death and bodily injuries caused by automobile accidents. This insurance is obtained through the Automobile Accidents Compensation Administration ("ACAA", by its Spanish acronym), a discretely component unit of the Commonwealth. This insurance is compulsory for all licensed vehicles used on public roads and highways in Puerto Rico. The annual premium is \$35 per licensed motor vehicle, which is paid directly to ACAA.

The Municipality obtains workers' compensation insurance coverage through the State Insurance Fund Corporation ("FSE" by its Spanish acronym), a component unit of the Commonwealth. This insurance covers workers against injuries, disability or death because of work or employment-related accidents, or because of illness suffered as a consequence of their employment. Workers' compensation insurance premiums are also paid through monthly deductions made by CRIM from the Municipality's gross property tax collections.

The Municipality obtains unemployment compensation, non-occupational disability, and drivers' insurance coverage for its employees through various insurance programs administered by the Commonwealth's Department of Labor and Human Resources (DOL). These insurance programs cover workers against unemployment and provide supplementary insurance coverage for temporary disability, or death because of work or employment-related accidents or because of illness suffered as a consequence of their employment. Unemployment compensation, non-occupational disability and drivers' insurance premiums are paid directly to DOL on a quarterly basis.

The Municipality also obtains medical insurance coverage for its employees. The current insurance policies have not been cancelled or terminated at June 30, 2005. In the past three years, the Municipality has not settled claims that exceeded insurance coverage.

***p) Reservations of Fund Balances***

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

- ***Encumbrances*** – Represent future expenditures under purchase orders, contracts, and other commitments. These committed amounts represent reservations of unexpired appropriations and generally will become liabilities in future periods as the goods or services are received.

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- **Capital Projects** – Represent the reservation of amounts to be used for future expenditures for capital projects under contracts and other commitments. These committed amounts generally will become liabilities in future periods as the projects are completed.
- **Debt Service** – Represent fund balances available to finance future debt service payments.
- **Advances**– Represent the reservation of resources set aside for long-term accounts, notes and interfund receivables, which are not considered current available financial resources.
- **Inventories and other current assets** – Represent the reservation of resources set aside for inventories and prepaid costs, which are not considered current available financial resources.
- **Other Specified Purposes** – Represent resources set aside for use in federal and state grant programs accounted for in the special revenue funds.

**q) Interfund Activities**

Permanent reallocations of resources among the Municipality's funds are classified as interfund transfers. The Municipality has the following types of activities recorded among funds in the accompanying GFFS:

- **Operating Transfers** – Represent legally required transfers that are reported when incurred as "operating transfers-in" by the recipient fund and as "operating transfer-out" by the disbursing fund.
- **Intra-entity Activities** – Represent transfers among funds that are reported as interfund transfers with receivables and payables presented as amounts due to and due from other funds.
- **Advances** – Represent amounts advanced among funds, which are not considered to be currently available financial resources.

In the GFFS, interfund activity has not been eliminated, as permitted by GAAP.

**r) Use of Estimates**

The preparation of the accompanying basic financial statements in conformity with GAAP requires management to make significant estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the basic financial statements, and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

**s) Future Adoption of Accounting Pronouncements**

On November 18, 2003, the GASB issued its Statement No. 42 (GASB No. 42), *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. This statement requires governments to report the effects of capital asset impairment in their financial statements. This

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statement also requires all governments to account for insurance recoveries in the same manner. The provisions of GASB No. 40 are effective for the Municipality's fiscal year commencing on July 1, 2005.

The Municipality's management has concluded that the future adoption of GASB Statement No. 42 will not have a significant impact on the Municipality's basic financial statements.

**2. DEPOSITS**

The Municipality maintains its deposits of cash in various commercial banks located in Puerto Rico, GDB, and CRIM. The balances deposited in commercial banks are insured by the Federal Deposit Insurance Corporation ("FDIC") up to a maximum of \$100,000 per depositor.

Under the laws and regulations of the Commonwealth, public funds deposited in commercial banks must be fully collateralized for the amounts deposited in excess of federal depository insurance. All securities pledged as collateral are held by the agents of the Commonwealth's Secretary of the Treasury, in the Municipality's name.

The Municipality's bank balance of deposits with financial institutions is categorized to provide an indication of the level of collateral risk assumed by the Municipality at June 30, 2005. Risk categories are described as follows:

- Category 1:** Deposit is insured or collateralized with securities held by the Secretary of the Treasury's agents in the Municipality's name.
- Category 2:** Deposit is collateralized with securities held by pledging financial institution's trust department or agent in the Municipality's name.
- Category 3:** Deposit is uncollateralized; including any bank balance that is collateralized with securities held by the pledging financial institution or by its trust department or agent but not in the Municipality's name.

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The carrying amount (book balance) of cash at June 30, 2005 consists of the following:

	<u>General fund</u>	<u>joint resolution funds</u>	<u>Head Start</u>	<u>Nonmajor funds</u>	<u>Totals</u>
Unrestricted (category 1):					
Cash in commercial banks	\$ 202,857	\$ -	\$ -	\$ 226,057	\$ 428,914
Restricted (category 1):					
Cash in commercial banks	-	284,307	387	342,929	627,623
Restricted (category 3):					
Cash in GDB or CRIM, as fiscal agents	148,416	-	-	1,560,135	1,708,551
Total deposits	<u>\$ 351,273</u>	<u>\$ 284,307</u>	<u>\$ 387</u>	<u>\$ 2,129,121</u>	<u>\$ 2,765,088</u>

The Municipality's bank balances in commercial banks amounting to \$1,056,537 at June 30, 2005 were fully collateralized (Category 1). The bank balance of deposits in GDB and CRIM, which is uninsured and uncollateralized (Category 3), amounted to \$1,708,551 at June 30, 2005.

**3. MUNICIPAL LICENSE TAXES**

The Municipality is authorized by Law No. 81 to impose and collect municipal license taxes on all trade or business activities operated by any natural or legal person within the territorial area of Santa Isabel. This is a self-assessed tax generally based on the business volume measured by gross sales. The Municipality establishes the applicable tax rates. At June 30, 2005, the municipal tax rates imposed by the Municipality were 1.50% for financing institutions and 0.30% for other types of taxpayers. Any taxpayers that have been granted with partial tax exemptions under any of the incentive tax laws of the Commonwealth ultimately pay municipal license taxes at reduced tax rates, generally between 60% and 90% under standard rates.

Each taxpayer must assess his/her corresponding municipal license tax by declaring his/her volume of business through a tax return to be filed every April 15, based on the actual volume of business generated in the preceding calendar year.

Taxpayers with a sales volume of \$1 million or more must include audited financial statements with their tax returns. The tax can be paid by the taxpayer in two equal installments due on July 15 and January 15, subsequent to the filing of the declaration.

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The first installment of the tax covers the six-month period ended December 31, subsequent to the filing date of the declaration, while the second installment of the tax covers the six-month period ended June 30 of the subsequent calendar year. If a taxpayer elects to pay the tax in full on the filing date of the declaration (generally April 15), a 5% discount is granted automatically on the total tax amount due.

Any municipal license taxes collected in advance (that is, pertaining to a future period) are recorded as deferred revenues. Deferred municipal license tax revenues recorded in the accompanying GWFS and GFFS amounted to \$736,360 at June 30, 2005, which represents municipal licenses collected in advance for the taxable year 2005-2006.

**4. PROPERTY TAXES**

The Municipality is authorized by Law No. 81 to impose and collect personal and real property taxes. Under the laws and regulations of the Commonwealth, personal property taxes can be imposed to any natural or legal person that at January 1 of each year is engaged in trade or business and is the owner of personal property used in trade or business.

Personal property taxes are self-assessed by taxpayers every year generally using the book value of personal property assets owned by the taxpayer at January 1 (assessment date) and reporting such taxable value through a personal property tax return filed on May 15, subsequent to the assessment date. The total personal property tax rate in force at June 30, 2005 was 6.53% (of which taxpayers pay 6.33% and 0.20% is reimbursed by the Department of Treasury). Real property taxes are assessed by CRIM. The assessment on real property is made every January 1 and is based on estimated current values of the property deflated to 1957 market prices. The total real property tax rate in force at June 30, 2005 was 8.53% (of which 8.33% is paid by taxpayers and 0.20% is also reimbursed by the Department of Treasury).

Residential real property occupied by its owner is exempt by law from property taxes on the first \$15,000 of the assessed value (at 1957 market prices). For such exempt amounts, the Department of Treasury assumes payment of the basic tax (4% and 6% for personal and real property, respectively) to the Municipality, except for property assessed of less than \$3,500 (at 1957 market prices), for which no payment is made.

CRIM is responsible for the billing and collections of real and personal property taxes on behalf of the Municipality. Prior to the beginning of each fiscal year, CRIM informs the Municipality of the estimated amount of property tax expected to be collected for the ensuing fiscal year. Throughout the year, CRIM advances funds to the Municipality based on the initial estimated collections. 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. This settlement has to be completed on a preliminary basis not later than each December 31. If CRIM remits to the Municipality property tax advances, which are less than the property tax actually collected, an additional property tax receivable is recorded at June 30. However, if advances exceed the amount actually collected by CRIM, an intergovernmental payable is recorded at June 30.

Law No. 81 provides for the levy of an annual special tax of 1.03% of the assessed value of all real and personal property not exonerated from taxation. Such special tax is levied and collected by CRIM. Collections of this special tax are remitted to the Commonwealth's debt service fund for payment of debt service on general obligations of the Commonwealth.

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In addition, 1.50% of the total personal and real property taxes collected by CRIM is restricted for the Municipality's debt service requirements and is retained by GDB for such purposes.

The Additional Lottery System of the Commonwealth (the "Additional Lottery") is an operational unit reported as an enterprise fund of the Commonwealth, which currently operates several betting alternatives to the citizens of Puerto Rico. The Additional Lottery is required every year to distribute a portion of its excess of revenues over expenses as follows:

- i. Thirty five percent (35%) of its net earnings (defined as the excess of revenues over expenses less an amount earmarked for the Fund for Rent and Home Improvement Subsidy Program for the Low-Income Qualifying Elderly) is earmarked to the municipalities of the Commonwealth, of which a maximum of \$26 million, on an annual basis, is distributed to the Municipal Equalization Fund held by CRIM to cover operating expenses and permanent improvements of the municipalities.
- ii. An additional amount not exceeding \$16 million, on an annual basis, is distributed to the Municipal Equalization Fund, provided it is within the 35% corresponding to the municipalities of the Commonwealth. When the accumulated municipal appropriations from the municipalities' Puerto Rico Health Reform are covered up to June 30, 1997, these resources will be assigned to the Health Insurance Administration, a component unit of the Commonwealth.

Total property tax receivable, net of an allowance for uncollectible accounts of \$5,079,532 amounted to \$1,483,917 at June 30, 2005. The composition of the property tax receivable and the related allowance for doubtful accounts is as follows:

	Fund
Property tax receivable	\$ 6,706,452
Allowance for doubtful accounts	5,079,532
Net property tax receivable	\$ 1,626,920
Deferred (unavailable) property tax revenues in GFFS	\$ 1,483,917

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**5. DUE FROM (TO) GOVERNMENTAL ENTITIES**

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

	Commonwealth Entities	Federal Government
Puerto Rico Power Authority (PREPA) 2004-2005 contribution in lieu of taxes	\$ 647,984	\$ -
State Office of Commissioner of Municipal Affairs –CDBG		12,701
US Department of Health and Human Services – Head Start		155,393
State Administration for Child Care and Development (ACUDEN) – Child Care and Development Block Grant		199,089
State Administration for Child Care and Development (ACUDEN) – Community Services Block Grant		28,558
State Department of Labor- Law 52	12,734	
State Department of Education – Child and Adult Food Program		11,095
Puerto Rico Department of Treasury – Christmas bonus reimbursement	94,209	
State Police Department	62,032	
<b>Total</b>	<b>\$ 816,959</b>	<b>\$ 406,836</b>

The amount due from Puerto Rico Department of Treasury – Christmas bonus (\$94,209) and (\$647,984) from PREPA are recorded as deferred revenues in the governmental funds statements (general fund) since is not available as required by modified accrual basis of accounting.

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

	Governmental Entities
State Treasury Department	\$ 1,322,359
State Retirement System Administration	1,052,863
Internal Revenue Services	937,990
Puerto Rico Water and Sewer Authority	519,952
State Department of Labor	140,296
Commonwealth Employees Association	129,705
State Office of Commissioner of Municipal Affairs	42,180
State Public Service Commission	17,532
State Solid Waste Administration	14,610
State Treasury Department	9,572
State Department of Recreation and Sports	4,310
Puerto Rico General Services Administration	365
<b>Total</b>	<b>\$ 4,191,734</b>

**6. INTERFUND BALANCES**

On July 1, 2003 the Municipality adopted the provisions of Statement No. 38, *Certain Financial Statement Note Disclosures*, issued by the Governmental Accounting Standards Board. This statement requires the disclosure of the flow of resources between funds and to assess the collectibility of interfund balances. Interfund balances at June 30, 2005 consisted of the following:

	Operating transfers-in:	
Operating transfers-out:	Nonmajor governmental funds	Total
Major funds:		
General fund	\$ 179,500	\$ 179,500
<b>Total</b>	<b>\$ 179,500</b>	<b>\$ 179,500</b>

The amount reported as interfund transfers were for debt service retirement (\$174,500) and a matching share contribution required by a federal grant (\$5,000).

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Due from:				
Major funds				
Due to:	General fund	State legislative joint resolutions fund	Non-major governmental funds	Total
Major funds:				
General fund	\$ -	\$ -	\$ 64	\$ 64
State legislative joint resolution funds	-	-	-	-
I lead Start	137,540	-	-	137,540
Non-major governmental funds	229,668	1,600	1,500	232,768
<b>Total</b>	<b>\$ 367,208</b>	<b>\$ 1,600</b>	<b>\$ 1,564</b>	<b>\$ 370,372</b>

At June 30, 2005 all amounts due to among funds are considered collectible by the Municipality's management.

Advances from:			
Major funds			
Advances to:	General fund	State legislative joint resolutions fund	Total
Major funds:			
General fund	\$ -	\$ 1,876,252	\$ 1,876,252
<b>Total</b>	<b>\$ -</b>	<b>\$ 1,876,252</b>	<b>\$ 1,876,252</b>

The amounts payable to the State legislative joint resolutions fund represents loans made to the general fund to satisfy general fund cash flow needs. None of the balance is scheduled to be collected in the subsequent year. Therefore, at June 30, 2005 these amounts was reported in the fund financial statements as advances between funds, with and offset by a fund balance reserve account in the State legislative joint resolutions fund to indicate that they are not available for appropriation and are not expendable available financial resources.

**7. CAPITAL ASSETS**

Capital asset activity for the year ended June 30, 2005, was as follows:

Depreciation and amortization of capital assets were charged to functions/activities in the accompanying government-wide statement of activities as follows:

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	Balance at June 30, 2004	Additions/ increases	Disposals/ decreases	Balance at June 30, 2005
<b>COST BASIS:</b>				
Cost basis of capital assets, not subject to depreciation and amortization:				
Land	\$ 1,165,285		\$ -	\$ 1,165,285
Construction in progress	2,163,723	1,900,211	(2,236,373)	1,827,561
Total cost basis of capital assets, not subject to depreciation and amortization	3,329,008	1,900,211	(2,236,373)	2,992,846
Cost basis of capital assets, subject to depreciation and amortization:				
Buildings, structures and building improvements	9,547,183	2,648,120	-	12,195,303
Infrastructure	1,918,270	482,376	-	2,400,646
Land Improvements	39,800	23,000	-	62,800
Licensed vehicles	1,536,668	22,481	-	1,559,149
Machinery and equipment	673,810	4,140	-	677,950
Total cost basis of capital assets subject to depreciation and amortization	13,715,731	3,180,117	-	16,895,848
Total cost basis of capital assets	\$ 17,044,739	\$ 5,080,328	\$ (2,236,373)	\$ 19,888,694

	Balance at June 30, 2004	Depreciation and Amortization Expense	Reclassifications	Balance at June 30, 2005
<b>ACCUMULATED DEPRECIATION AND AMORTIZATION:</b>				
Buildings, structures and building improvements	\$ 1,437,485	\$ 215,925	\$ -	\$ 1,653,410
Infrastructure	990,901	59,354	-	1,050,255
Land Improvements	285	1,035	-	1,320
Licensed vehicles	784,173	126,723	-	910,896
Machinery and equipment	252,863	45,323	-	298,186
Total accumulated depreciation and amortization	3,465,707	448,360	-	3,914,067

<b>CAPITAL ASSETS, NET</b>	<b>\$ 13,579,032</b>	<b>\$ 15,974,627</b>
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The depreciation expense is detailed as follow:

General government	15,930
Public safety	49,758
Welfare and housing assistance	8,100
Culture recreation and education	203,930
Health and sanitation	9,090
Urban and economic development	161,552
Total depreciation and amortization expense	<u>\$ 448,360</u>

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**8. EMPLOYEES RETIREMENT SYSTEM**

The Municipality's employees participate in the Employees' Retirement System of the Government of Puerto Rico and its instrumentalities (the "System"). The System is the administrator of a multi-employer cost-sharing (as related to the Municipality's reporting entity) defined pension plan established by the Commonwealth. The System was created under Act. No. 447 approved on May 15, 1951, as amended, and became effective on January 1, 1952. The System covers all regular employees of the Commonwealth and its instrumentalities, the Municipality and other municipalities of the Commonwealth.

The System is independent, thus assets may not be transferred to another system or used for any purpose other than to benefit each system's participants. The System issues financial reports that include its basic financial statements and required supplementary information for each of them, including required six-year trend information. Those reports may be obtained by writing to the administrator of the System.

The System provides for retirement, death and disability benefits. Death and disability retirement benefits are available to members for occupational and non-occupational death and disabilities. Retirement benefits depend upon age at retirement and number of years of credited service. Benefits vest after 10 years of plan participation.

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 percent of the average compensation.

On September 24, 1999, an amendment to Act No. 447 of May 15, 1951, which created the System, was enacted with the purpose of establishing a new pension system ("System 2000"). System 2000 became effective on January 1, 2000. Employees participating in the current system as of December 31, 1999, had the option to either stay in the defined benefit plan or transfer to the new program. Persons joining the government on or after January 1, 2000, are the only required becoming members of System 2000.

System 2000 is a hybrid defined contribution plan, also known as cash balance plan. Under this new plan, there is a pool of pension assets, which will be invested by the System, together with those of the current defined benefit plan. The Commonwealth and the Municipality will not guarantee benefits at retirement age. The annuity will be based on a formula which assumes that each year the employees' contribution (with a minimum of 8.275 percent of the employees' salary up to a maximum of 10.00 percent) will be invested in an account which will either: (1) earn a fixed rate based on the two-year Constant Maturity U.S. Treasury Note; (2) earn a rate equal to 75 percent of the return of the System 2000's investment portfolio (net of management fees); or (3) earn a combination of both alternatives. Participants receive periodic account statements similar to those of defined contribution plans showing their accrued balances.

Disability pensions are not being granted under System 2000. The employer's contributions (9.275 percent of the employees' salary which is applicable to the Municipality) will be used to fund the current plan.

System 2000 reduced the retirement age from 65 years to 60 for those employees who joined the current plan on or later January 1, 2000.

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**Funding Policy:**

Contribution requirements are established by law and are as follows:

Municipality	9.275% of gross salary
Employees:	
Hired on or before March 31, 1990	5.775% of gross salary up to \$6,600 8.275 of gross salary over \$6,600
Hired on or after April 1, 1990	8.275% of gross salary

On August 12, 2000, Act No. 174 was approved to allow certain participants of the ERS to be eligible for early retirement upon attaining at least age 55 with 25 years of service, provided they made their election on or before April 1, 2001. Those who elected early retirement under this law will receive monthly benefits of 75 percent (if 25 or more year of service and 55, or 30 or more years or services and age 50) or benefits of 65 percent (if 25 years of service by less than age 55) of their average compensation which is computed based on the highest 36 months of compensation recognized by the System. In these cases, the employer (including the Municipality) is responsible for contributing to the System the amount needed to cover the benefit payments and employer contribution with respect to the participants covered until the participants reaches the normal retirement age.

Historically, the Commonwealth has reported the System as a single-employer plan (as relates only to the financial reporting entity of the Commonwealth) in its comprehensive annual financial report. Accordingly, any actuarial deficiency that may exist or arise related to the Municipality's participating employees will be assumed by the Commonwealth since the System does not allocate any actuarial deficiencies pertaining to municipal employees participating in the System. The Municipality is only required by law to make statutory contributions in the rates mentioned above. As a result, no net pension obligation nor net pension asset that may be allocable to the

Municipality's participating employees, if any, has been recorded in the accompanying basic financial statements.

The Municipality's actual contributions for the current year, which are equal to the statutory required contributions, are as follows:

<u>Fiscal year ended June 30,</u>	<u>Act No. 447</u>	<u>System 2000</u>
2005	\$60,901	\$20,862

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**9. LONG-TERM DEBT**

The Municipality's Legislature is legally authorized to determine the contracting of debts of the Municipality. Nevertheless, the laws and regulations of the Commonwealth also provide that:

- Direct obligations of the Municipality (evidenced principally by bonds and notes) are backed by the full faith, credit and taxing power of the Municipality; and
- Direct obligations are not to be issued if the amount of the principal of, and interest on, such bonds and notes (and on all such bonds and notes issued thereafter) which are payable in any fiscal year, together with any amount paid by the Municipality in the preceding fiscal year on account of bonds or notes guaranteed by the Municipality, exceed 10 percent of the total assessed value of the property located within the Municipality plus the balance of the ad valorem taxes in the debt service fund, for bonds payable to be repaid with the proceeds of property taxes restricted for debt service.

In addition, before any new bonds or notes are issued, the revenues of the debt service fund should be sufficient to cover the projected debt service requirement. At June 30, 2005, the Municipality is in compliance with the debt limitation requirements. The general long-term debt activity for the year ended June 30, 2005 was as follows:

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	Balance at June 30, 2004, as restated	Borrowings or Additions	Payments or Deductions	Balance at June 30, 2005	Due Within One Year
Bonds and bond anticipation note payables	\$ 6,191,514	\$ 264,486	\$ (350,000)	\$ 6,106,000	\$ 277,000
Notes payable to:					
Puerto Rico Treasury Department:					
Financing agreement for the excess of property tax advances over collections	195,825	-	(37,902)	157,923	37,902
Financing agreement to settle two legal claims	1,825,469		(192,155)	1,633,314	192,155
CRIM					
Act No. 42 - Financing agreement for the excess of property tax advances over collections through fiscal year 2000	548,885	-	(7,372)	541,513	7,834
Act No 146 -Financing of delinquent property tax accounts sold	688,000	-		688,000	-
HMS Reimbursement	145,255	-	(15,881)	129,374	16,840
Fiscal Year 2005-2005 Final Settlement	-	47,896	-	47,896	-
State Department of Labor- Financing Agreement	17,578	-	(17,578)	-	-
State Insurance Fund Corporation	120,068	-	(120,068)	-	-
Health Insurance Administration	646,617	-		646,617	-
Compensated absences	1,618,322	1,059,298	(836,249)	1,841,371	558,392
Claims and judgments	29,685		(29,685)	-	-
Estimated landfill closure and postclosure care costs	886,831	44,342	-	931,173	-
Puerto Rico Power Authority - Fiscal year power utility expense	590,922	647,984	(590,922)	647,984	647,984
I. M. Waste Management	540,000		(540,000)	-	-
Christmas bonus	210,415	202,831	(210,415)	202,831	202,831
Total	<u>\$ 14,255,386</u>	<u>\$ 2,266,837</u>	<u>\$ (2,948,227)</u>	<u>\$ 13,573,996</u>	<u>\$ 1,940,938</u>

**a) Bonds Payable**

The Municipality issues general and special (public improvements) obligations bonds and notes to provide for the acquisition and construction of major capital facilities and equipment, as well as, to cover certain operating needs. Bonds and notes payable at June 30, 2005 is composed of the following debts:

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<u>General and Special Obligations:</u>	<u>Outstanding Amount</u>
\$1,850,000 special obligation bonds series of 2003 payable in semi annual installments ranging from \$30,000 to \$140,000 through July 2027, interest from 5% to 6.50%	\$ 1,785,000
\$730,000 special obligation bonds series of 2003 payable in semi annual installment ranging from \$10,000 to \$55,000 through July 2027, interest from 5% at 6.50%	705,000
\$155,000 notes payable series of 2002 in semi annual installments ranging from \$20,000 to \$25,000 through July, 2008, interest ranging from 2.70% to 5.00%	95,000
\$33,000 public improvement bonds series of 1994 payable in annual installments ranging from \$1,000 to \$2,000 through January 2018, interest at 4.50%	22,000
\$205,000 general obligation bonds series of 1997 payable in semi annual installments ranging from \$5,000 to \$20,000 through July 2022, interest from 4.86% to 6.71%	170,000
\$215,000 public improvement bonds series of 1994 payable in annual installments ranging from \$5,000 to \$15,000 through January 2018, interest at 4.5%	147,000
\$235,000 general obligation bonds series of 2000 payable in semi annual installments ranging of \$10,000 to \$30,000 through July 2011, interest from 2.70% to 7.81%	165,000
\$324,000 public improvement bonds series of 1987 payable in annual installments ranging from \$7,000 to \$23,000 through January 2011, interest at 5.00%	120,000
\$361,000 public improvement bonds series of 1992 payable in annual installments ranging from \$9,000 to \$25,000 through January 2016, interest at 5.00%	221,000
\$230,000 rent bond series of 2003 payable in annual installments ranging from \$9,000 to \$22,500 through July 2019, interest ranging 4.50% to 6.00%	230,000
\$390,000 public improvement bonds series of 1984 payable in annual installments ranging from \$15,000 to \$26,000 through January 2009, interest at 5.00%	98,000
\$580,000 general obligations bonds series of 2001 payable in semi annual installments ranging of \$35,000 to \$80,000 through July 2010, interest ranging from 5% to 8.0%	405,000
\$630,000 general obligations bonds series of 1997 payable in semi annual installments ranging of \$10,000 to \$60,000 through July 2020, interest from 4.7% to 6.63%	530,000
\$755,000 general obligation bonds series of 2001 payable in semi annual installments ranging of \$5,000 to \$65,000 through July 2025, interest ranging from 5% to 7.5%	710,000
\$185,000 general obligation bonds series 2004 payable in semi annual installments ranging from \$5,000 to \$ 15,000 through July 2028, interest ranging 5.0% to 6.5%	180,000
\$185,000 general obligation bonds series 2004 payable in semi annual installments ranging from \$5,000 to \$ 15,000 through July 2028, interest ranging 5.0% to 6.0%	180,000
\$55,000 general obligation note series of 2003 payable in semi annual installments ranging of \$5,000 to \$10,000 through July 2010, interest ranging from 5% to 6%	50,000
\$300,000 general obligation bond series of 2001 payable in annual installments ranging of \$7,000 to \$21,000 through July 2029, interest at 4.75%	293,000
<b>Total bonds:</b>	<u><u>\$6,106,000</u></u>

**COMMONWEALTH OF PUERTO RICO**  
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These bonds are payable from the ad valorem property tax of 1.5% which is restricted for debt service and retained by the Government Development Bank for Puerto Rico for such purposes.

The laws and regulations of the Commonwealth provide that public debt of the Municipality will constitute a first claim on the available revenue of the Municipality. Public debt includes bonds and notes payable. The good faith, credit and taxing power of the Municipality are irrevocably pledged for the prompt payment of the principal and interest of the bonds and notes payable.

The Municipality levies an annual additional special tax of 1.50% of the assessed value of personal and real property. The proceeds of this additional special tax are deposited in a sinking fund established at GDB whereby sufficient funds must be set aside to redeem the bonds in minimum annual or biannual principal and interest payments. The proceeds of this special tax are recorded in the debt service fund.

Interest rates on serial bonds subject to variable rates are reviewed periodically by GDB and are based on the fluctuation of GDB's weighted average rate for its commercial paper program, not to exceed 8%. Under this program, GDB issues commercial paper in the U.S. taxable and tax-exempt markets, in the Eurodollar market and to corporations that have tax exemption under the Commonwealth's Industrial Incentives Act and qualify for benefits provided by the U.S. Internal Revenue Code Section 936.

Annual debt service requirements of maturity for bonds payable are as follows:

<u>Year ended June 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2006	\$ 277.000	308.622	\$ 585.622
2007	300.000	357.440	657.440
2008	314.000	349.110	663.110
2009	340.000	330.876	670.876
2010	308.500	302.647	611.147
2011-2015	1,219.000	1,263.697	2,482.697
2016-2020	1,277.500	885.572	2,163.072
2021-2025	1,270.000	463.009	1,733.009
2026-2030	800.000	80.752	880.752
Totals	<u>\$ 6,106.000</u>	<u>4,341.725</u>	<u>\$ 10,447.725</u>

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*b) Notes Payable to Puerto Rico Treasury Department*

**Financing of the excess of property tax advances over collections** - On November 1999 the Municipality entered into a financing agreement with the Puerto Rico Treasury Department to pay a debt related to the excess of property tax advances over collections made by the Puerto Rico Treasury Department prior to the creation of CRIM in 1993. The outstanding principal balances of the note payable to CRIM amounted to \$157,923 at June 30, 2005. The principal and implicit interest maturities are as follows:

<u>Year ending June 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2006	32,089	5,813	37,902
2007	33,563	4,338	37,901
2008	35,105	2,797	37,902
2009	36,718	1,184	37,902
2010	6,281	35	6,316
Total	<u>\$ 143,756</u>	<u>14,167</u>	<u>\$ 157,923</u>

**Loan for payment of legal settlement** - On December 1, 2003 the Municipality obtained a loan from the Puerto Rico Treasury Department to pay a legal settlement. The face amount of the loan was \$1,921,548 at no interest. This note has an imputed interest rate of 5.00% and was originally recorded at its present value of \$1,509,718, net of an unamortized discount of \$411,830, at inception. At June 30, 2005, the balance of this note, net of the unamortized discount of \$304,937, amounted to \$1,328,377. The principal and discount amortization maturities are as follows:

<u>Year ending June 30,</u>	<u>Principal amortization</u>	<u>Discount amortization</u>	<u>Total</u>
2006	128,658	63,497	192,155
2007	135,240	56,915	192,155
2008	142,159	49,995	192,154
2009	149,432	42,722	192,154
2010	157,078	35,077	192,155
2011-2014	615,810	56,731	672,541
Total	<u>\$ 1,328,377</u>	<u>\$ 304,937</u>	<u>\$ 1,633,314</u>

**COMMONWEALTH OF PUERTO RICO**  
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*c) Notes Payable to CRIM*

**Act No. 42** – Act No. 42 of January 26, 2000 was enacted to authorize CRIM to enter into a financing agreement of up to \$200 million, for a term not exceeding 30 years. The financing agreement allows for the financing of a debt that the municipalities of Puerto Rico have with CRIM, arising from the final settlements of property tax advances versus actual collections through fiscal year 2000. The amounts that the municipalities will collect from the additional property taxes resulting from the increases in the subsidy from the Commonwealth to the municipalities are assigned through this law to repay such loan. The increase in this subsidy was the result of the Public Law No. 238 of August 15, 1999.

In addition, on February 12, 2003, the Municipality entered into a repayment agreement with GDB and CRIM to pay off the remaining \$559,133 of excess of property tax advances through fiscal year 2000 and 2001. CRIM retains the principal and interest from the property tax advances of the Municipality. The amounts retained by CRIM are remitted to GDB on July 1 of each year through July 1, 2032. The repayment agreement bears interest at variable rates determined by GDB. The outstanding principal balances of the note payable to CRIM amounted \$541,513, at June 30, 2005. The principal and interest maturities are as follows:

Year ending June 30,	Principal	Interest	Total
2006	\$ 7,834	\$ 33,387	\$ 41,221
2007	8,327	32,895	41,222
2008	8,850	32,371	41,221
2009	9,406	31,815	41,221
2010	9,997	31,224	41,221
2011-2015	60,234	145,872	206,106
2016-2020	81,689	124,417	206,106
2021-2025	110,786	95,320	206,106
2026-2030	150,251	55,856	206,107
2031-2033	94,139	8,915	103,054
Total	<u>\$ 541,513</u>	<u>\$ 592,072</u>	<u>\$ 1,133,585</u>

**Financing of delinquent property tax accounts sold** - On April 22, 2002, the Municipality entered into a financing agreement with CRIM in the amount of \$688,000 for the payment of delinquent property tax account sold to private investors. During the first five years, the financing agreement in the form of a line of credit bearing interests at 6.50%, and variable interests 125 points over LIBOR rate will be during the next 25 years. At June 30, 2005, the outstanding principal balances amounted to \$688,000. The principal and interest maturities are as follows:

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF SANTA ISABEL**  
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<u>Year ending June 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2006	\$ -	\$ 44,720	\$ 44,720
2007	-	44,720	44,720
2008	-	44,720	44,720
2009	11,360	44,385	55,745
2010	12,120	43,625	55,745
2011-2015	73,920	204,805	278,725
2016-2020	102,219	176,506	278,725
2021-2025	141,352	137,374	278,726
2026-2030	195,463	83,263	278,726
2031-2032	151,566	15,670	167,236
Total	<u>\$ 688,000</u>	<u>\$ 839,788</u>	<u>\$ 1,527,788</u>

**LIMS** - On June 28, 2001, the Municipality entered into a financing agreement with CRIM for the payment of the Municipality's share of the cost of an information management system, acquired by CRIM on behalf of all municipalities, for the management of a digital database of taxpayers properties located in Puerto Rico. The face amount of the loan was \$181,113 and bears no interest. The note is payable in monthly installments of \$2,024 through December 1, 2011. This note has an imputed interest rate of 5.95%. At June 30, 2005, the balance of this note, net of the unamortized discount of \$28,519, amounted to \$129,374. The principal and discount amortization (recorded as interest expense) maturities are as follows.

<u>Year ending June 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2006	16,840	7,451	24,291
2007	17,857	6,434	24,291
2008	18,935	5,356	24,291
2009	20,079	4,212	24,291
2010	21,292	3,000	24,292
2011-2012	34,371	2,066	36,437
Total	<u>\$ 129,374</u>	<u>\$ 28,519</u>	<u>\$ 157,893</u>

**d) Health Insurance Administration (ASES)**

The Municipality entered into a financing agreement with ASES for the payment of the Municipality's indebtedness on the payment of the government's health insurance for fiscal years 1994-1995 thru 1996-1997. The face amount of the loan was \$927,516 and bears no interest. The note is payable with the municipality's share on the state's electronic lottery as per Act 29 of the 1<sup>st</sup> of July 1997. During fiscal year the municipality received no deduction of its balance. The balance at June 30, 2005 is \$646,617.

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*e) Puerto Rico Power Authority (PREPA)*

The Municipality owned to PREPA for the payment of the power utility for current fiscal year which amount to \$647,984. The outstanding balance will be paid from the PREPA annual contribution in lieu of taxes during next fiscal year. Therefore, an account receivable of \$647,984 to PREPA was accrued in the GWFS and general fund at June 30, 2005. The receivable in the general fund was charged against deferred revenue because it was not a current available financial resource at June 30, 2005.

*f) Compensated Absences*

At June 30, 2005, the liability for compensated absences is composed as follows:

	<u>Due within One year</u>	<u>Due after one year</u>	<u>Total</u>
Vacations and sick leave	\$ 1,185,579	\$ 558,392	\$1,743,971
Compensatory time	<u>97,400</u>	<u>-</u>	<u>97,400</u>
Total	<u>\$ 1,282,979</u>	<u>\$ 558,392</u>	<u>\$1,841,371</u>

**10. LANDFILL CLOSURE AND POSTCLOSURE CARE COSTS OBLIGATIONS**

State and federal laws and regulations require the Municipality to place a final cover on its landfill site when closed and perform certain maintenance and monitoring functions at the landfill site for 30 years after closure. Although closure and postclosure care costs will be paid only near or after the date that the landfill stops accepting waste, the Municipality reports a portion of these closure and postclosure care costs as an operating expense in each period based on landfill capacity used as of each statement of net assets date. The \$931,173 reported as landfill closure and postclosure care liability at June 30, 2005, represents the cumulative amount reported to date based on the percentage used of the estimated capacity of the landfill. The Municipality will recognize the remaining estimated cost of closure and postclosure care \$66,511 as the remaining estimated capacity is filled. These amounts are based on what it would cost to perform all closure and postclosure care in 2004. The estimated closing date of the landfill is the year 2006, but the Municipality expect to expand the boudaries of the existing landfill to extend the usefull life of the landfill. Actual cost may be higher due to inflation, changes in technology, or changes in regulations.

**11. COMMITMENTS AND CONTINGENCIES**

*Litigations*

The Municipality is a defendant in a number of lawsuits arising principally from claims against the Municipality for alleged improper actions, and other legal matters that arise in the ordinary course of the Municipality's activities.

With respect to pending and threatened litigation, the Municipality has reported liabilities of approximately \$309,967 in the general fund for awarded unfavorable judgment. This amount was included in the financial

**COMMONWEALTH OF PUERTO RICO**  
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statements and represents the amount estimated as probable liability or a liability with a fixed or expected due date, which will require future available financial resources for its payment.

It is management's opinion, based on the advice of the legal counsel, that the potential claims against the Municipality not covered by insurance will not materially affect the financial resources for its payment.

**Federal Programs**

The municipality participates in a number of federal financial assistance programs. These programs are subject to audit on behalf the grantors to assure compliance with grant provisions. If expenditures are disallowed due to noncompliance with grant programs requirements, the Municipality may be required to reimburse, these costs, to the grantor agency. It is the Municipality's Management opinion, that any amount disallowed by federal agencies, will be immaterial to the financial statements.

**Commitments**

The Municipality has reported, outstanding encumbrances amounting to \$121,161 in the general fund at June 30, 2005. The municipality intends to honor these encumbrances, which will continue to be liquidated under the current year's budget during a lapse of period that extends into the subsequent fiscal year.

**12. CHRISTMAS BONUS**

The \$ 202,831 balance represents the accrued portion corresponding to fiscal year 2004-2005 of the Christmas bonus to be paid in December 2005.

**COMMONWEALTH OF PUERTO RICO  
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June 30, 2005**

**13. RESTATEMENTS**

The following schedule reconciles the June 30, 2004 fund balances as previously reported by the Municipality to the beginning fund balances, as restated:

	<u>June 30, 2004, fund balance, as previously Reported</u>	<u>Reclassifications and adjustments</u>	<u>June 30, 2004 fund balance, as restated</u>
Major Funds:			
General Fund	(\$3,832,308)	(\$643,574)	(\$4,475,882)
Non Major Funds	\$1,541,306	208,103	1,749,409
Totals	<u>(\$2,291,002)</u>	<u>\$435,471</u>	<u>(\$2,726,473)</u>

The following schedule reconciles the June 30, 2004 net assets previously reported by the Municipality to the beginning net assets, as restated:

	<u>June 30, 2004, net assets, as previously Reported</u>	<u>Reclassifications and adjustments</u>	<u>June 30, 2004 net assets, as restated</u>
Net Assets	\$5,737,106	(\$434,949)	\$5,302,157
Totals	<u>\$5,737,106</u>	<u>(\$434,949)</u>	<u>\$5,302,157</u>

**14. SUBSEQUENT EVENTS**

As shown below, the Municipality's general fund deficit presents a continuous and consistent growth each year for the past three fiscal years as the consequence principally of: a) adoption of budgets with budgeted revenues that at the end of each year were less than actual revenues collected, and which did not provide funding for all of incurred obligations; and b) the high percentage of budget encumbered with payroll, fringe benefits, and statutory obligations.

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Notes to Basic Financial Statements  
June 30, 2005**

	June 30, 2005 general fund deficit, as reported	June 30, 2004 general fund deficit, as restated	June 30, 2003 general fund deficit, as restated
General Fund	(\$7,261,639)	(\$4,475,882)	(\$3,625,220)
Totals	(\$7,261,639)	(\$4,475,882)	(\$3,625,220)

Based on this situation, the municipal administration has adopted an ambitious program to reduce the general fund expenditures and stop the continuous and consistent Municipality's general fund financial condition deterioration, and then, improve it. The Municipality's executive branch, with the approval of the legislative branch (for items a and b) places in force various actions including the following actions after year ended June 30, 2005:

***a) \$1,410,000 Operational Loan***

On July 5, 2005 the Government Development Bank for Puerto Rico (GDB) approved a special obligation bond issuance with original issue amounts of \$1,410,000 to pay general fund current liabilities due and payable at June 30, 2005. This bond issuance was authorized by the Municipality's legislative branch on July 28, 2005 through the Ordinance number 4, 2005-2006 Series.

***b) Workforce Displacement Plan***

The Municipality's general fund budget for the fiscal year ended on June 30 2005 and the approved budget for the fiscal year 2005-2006 were encumbered principally for payroll, fringe benefits, and statutory expenditures. Therefore, the Municipality's executive branch, taking in consideration this reality, started actions to develop a workforce displacement plan in order principally to reduce the Municipality's payroll and fringe benefits expenditures, with the final objective to stop the continuous Municipality's general fund financial condition deterioration.

On June 27, 2005 the Municipality's legislative branch issue the Ordinance number 28, 2004-2005 Series to approve a workforce displacement plan.

On October 17, 2005 the Municipality's legislative branch issue the Ordinance number 21, 2005-2006 Series to amend the workforce displacement plan approved on June 27, 2005 through the Ordinance number 28, 2004-2005 Series.

On October 18, 2005 and October 19, 2005 the Municipality place in force the workforce displacement plan developed by the Municipality's executive branch and approved by the legislative branch.

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**Notes to Basic Financial Statements**  
**June 30, 2005**

*c) Domestic Solid Waste Collection Services Privatization*

The Municipality executive branch has determined that the domestic solid waste collection services privatization is an alternative to reduce the general fund expenditures, and therefore, an alternative to stop the continuous Municipality's general fund financial condition deterioration.

On December 17, 2005, the Municipality published in a general circulation newspaper a request for proposal from interested parties to privatize the domestic solid waste collection services in the Municipality's urban and rural areas. On December 27, 2005, the Municipality received three proposals from private companies interested to provide domestic solid waste collection services to the Municipality. These proposals have been subject to a detailed review in order to select the best offer to protect the public interest.

**COMMONWEALTH OF PUERTO RICO  
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June 30, 2005**

**BUDGETARY COMPARISON SCHEDULE – GENERAL FUND**

**COMMONWEALTH OF PUERTO RICO**  
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**Budgetary Comparison Schedule- General Fund**  
**(See Notes to Budgetary Comparison Schedule)**  
**June 30, 2005**

	Budgeted Amounts		Actual amounts (budgetary basis) (see note 1)	Variance with final budget - over (under)
	Original	Final		
<b>Revenues:</b>				
Property Taxes	\$ 4,248,085	\$ 4,248,085	\$ 4,478,197	\$ 230,112
Municipal Licence taxes	950,000	950,000	1,045,501	95,501
Construction Excise taxes	975,000	975,000	616,635	(358,365)
Charges for Services	545,112	545,112	323,381	(221,731)
Intergovernmental	811,259	811,259	758,461	(52,798)
Interest	80,000	80,000	45,349	(34,651)
Miscellaneous	1,139,782	1,139,782	17,553	(1,122,229)
Total revenues	<u>8,749,238</u>	<u>8,749,238</u>	<u>7,285,077</u>	<u>(1,464,161)</u>
<b>Expenditures:</b>				
Current:				
General Government	2,954,335	3,021,910	3,209,767	(187,857)
Urban and Economic Development	2,856,024	2,951,257	3,118,777	(167,520)
Public Safety	813,423	716,811	664,492	52,319
Health and Sanitation	183,311	178,049	167,930	10,119
	687,300	630,865	583,661	47,204
Welfare and Housing Assistance	1,042,995	1,038,496	1,000,217	38,279
Operating Transfer Out	211,850	211,850	174,500	37,350
Total expenditures	<u>8,749,238</u>	<u>8,749,238</u>	<u>8,919,344</u>	<u>(170,106)</u>
Excess (deficiency) of revenues over expenditures	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (1,634,267)</u>	<u>\$ (1,634,267)</u>

**Explanation of Differences:**

**Sources/inflows of financial resources:**

Actual amounts (budgetary basis) "available for appropriations" from the budgetary comparison schedule	\$ 7,285,077
Differences - budget basis to GAAP: Nonbudgeted revenues	
Total revenues as reported on the statement of revenues, expenditures and changes in fund balances - governmental funds	<u>\$ 7,285,077</u>

**Uses/outflows of financial resources:**

Actual amounts (budgetary basis) "total charges to appropriations" from the budgetary comparison schedule	\$ 8,919,344
Differences - budget basis to GAAP: Expenditures considered for GAAP purposes but not for budgetary purposes	165,106
Expenditures considered for budgetary purposes but not for GAAP purposes	(52,311)
Nonbudgeted expenditures	1,038,696
Total expenditures and other financial uses as reported on the statement of revenues, expenditures and changes in fund balances - governmental funds	<u>\$ 10,070,835</u>

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**Notes to Budgetary Comparison Schedule- General Fund**  
**June 30, 2005**

**1. STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY**

**A. Budgetary Control**

The Municipality's annual budget is prepared on the budgetary basis of accounting, which is not in accordance with GAAP, and represents departmental appropriations recommended by the Mayor and approved by the Municipal Legislature prior to the beginning of the fiscal year. Amendments to the budget require the approval of the Municipal Legislature. Transfers of appropriations within the budget, known as Mayor's Resolutions, do not require the approval of the Municipal Legislature.

The Municipality prepares its annual budget including the operations of the general fund.

For budgetary purposes, encumbrance accounting is used. The encumbrances (i.e., purchase orders, contracts) are considered expenditures when incurred. For GAAP reporting purposes, encumbrances outstanding at year-end are reported as reservations of fund balances and do not constitute expenditures or liabilities because the commitments will be honored during the subsequent year.

The unencumbered balance of any appropriation at the end of the fiscal year will lapse at the end of such fiscal year. Other appropriations, mainly capital project appropriations, are continuing accounts for which the Municipal Legislature has authorized that an unspent balance from the prior year be carried forward and made available for current spending.

The annual budget as presented in the Budgetary Comparison Schedule-General Fund is the budget ordinance at June 30, 2005 representing the original budget. There were no supplemental appropriations for the year ended June 30, 2005.

**B. Excess Expenditures, Encumbrances and Other Financial Sources Over Budget**

The Municipality's general fund had excess of expenditures, encumbrances and other financial uses over appropriations at the legal level of budgetary control in the following functions/programs:

<u>Expenditures, Encumbrances and Other Financing Uses:</u>	<u>Appropriations</u>	<u>Actual Amounts</u>	<u>Excess</u>
General Government	3,021,910	3,209,767	(187,857)
Urban and Economic Development	2,951,258	3,118,777	(167,519)

**REPORTS REQUIRED UNDER THE OMB CIRCULAR A-133**

# GONZÁLEZ TORRES & Co.

*Certified Public Accountants and Consultants*

Member of:  
Puerto Rico Society of Certified Public Accountants  
American Institute of Certified Public Accountants  
Association of Certified Fraud Examiners



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

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

We have audited the accompanying financial statements of governmental activities, each major fund and aggregated fund information of **Municipality of Santa Isabel**, as for and for the year ended June 30, 2005, which collectively comprise **Municipality of Santa Isabel's** basic financial statements and have issued our report thereon dated December 8, 2005. The report on basic financial statements described above includes an explanatory paragraph to describe that financial statements have been prepared assuming that Municipality of Santa Isabel will continue as a going concern. During several years, the Municipality of Santa Isabel has increased its deficit by exceeding its expenditures over its revenues. As of June 30, 2005, the accumulated deficit for its general fund (for government funds) amounted to \$7,261,639, with total liabilities in the amount of \$10,206,230 and total assets amounting \$2,944,591, including available cash of \$202,857 to pay mature liabilities within the current year. These conditions raised substantial doubt about its ability to continue as a going concern. The financial statements do not include any adjustments that might result from the outcome of this uncertainty. 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 of America.

### 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 our opinions on the financial statements and not to provide an opinion 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 financial statements. Reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs, Section II as item 2005-II-1.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we considered that reportable condition described above is a material weakness, identify as Finding 2005-II-1.

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

**Compliance and Other Matters**

As part of obtaining reasonable assurance about whether **Municipality of Santa Isabel's** financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under Government Auditing Standards which are described in the accompanying Schedule of Findings and Questioned Cost, identified as items 2005-III-1 thru 2005-III-9.

This report is intended solely for the information and use of the Management, state agencies, federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

San Juan, Puerto Rico  
December 8, 2005

The stamp number 2112907  
was affixed to the original of this report.

*González Torres & Co. PSC*  
GONZÁLEZ TORRES & CO., PSC  
LIC. 96  
Expires on December 1, 2008





## 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

### Compliance

We have audited the compliance of the **Municipality of Santa Isabel**, with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement that are applicable to each of its major federal programs for the year ended June 30, 2005. **Municipality of Santa Isabel'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's** management. Our responsibility is to express an opinion on **Municipality of Santa Isabel's** compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in the 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's** compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of **Municipality of Santa Isabel's** compliance with those requirements.

In our opinion, **Municipality of Santa Isabel**, complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2005. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying Schedule of Findings and Questioned Costs -Section III as items 2005-III-1 thru 2005-III-9.

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

**Internal Control Over Compliance**

Management of **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 **Municipality of Santa Isabel's** internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on the internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might material weaknesses. However, we consider that none of the reportable conditions described above to be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level risk that noncompliance with applicable requirements of laws, regulations contracts, and grants caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving internal control over compliance and its operations that we consider to be material weaknesses.

This report is intended solely for the information and use of the Management, state agencies, federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

San Juan, Puerto Rico  
December 8, 2005

The stamp number 2112908  
was affixed to the original of this report.



*Gonzalez Torres & Co. P.R.*  
GONZALEZ TORRES & CO.,PSC  
Lic. 96  
Expires on December 1, 2008

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SANTA ISABEL  
Schedule of Expenditures Federal Awards  
June 30, 2005

Federal Grantor/Pass-Through Grantor/Program Title	Federal CFDA Number (note B)	Pass-Through Grantor's Number (note C)	Expenditures (note A)
<b><u>U.S. Department of Agriculture</u></b>			
_____ Program:			
Direct Program:			
Community Facilities Loans and Grants	10.766	N/A	29,552
_____ Program:			
Passed through the P.R. Department of Education:			
Child and Adult Care Food Program	10.558	N/AV	<u>80,080</u>
<b>Total U.S. Department of Agriculture</b>			<u><b>109,632</b></u>
<b><u>U.S. Department of Housing and Urban Development</u></b>			
_____ Program:			
Direct Program:			
Section 8 Housing Choice Vouchers	14.871	N/A	274,884
_____ Program:			
Passed through the Office of Commissioner of Municipal Affairs:			
Community Development Block Grant - State's Program	14.218	N/AV	<u>532,243</u>
<b>Total U.S. Department of Housing and Urban Development</b>			<u><b>807,127</b></u>
<b><u>U.S. Department of Health and Human Services</u></b>			
_____ Program:			
Direct Program:			
Head Start and Early Head Start	93.600	N/A	1,935,358
_____ Program:			
Passed through the P.R. Department of Family - Child Care and Development Administration (ACUDEN):			
Child Care and Development Block Grant	93.575	N/AV	571,727
Community Services Block Grant	93.569	N/AV	<u>54,138</u>
<b>Total U.S. Department of Health and Human Services</b>			<u><b>2,561,223</b></u>

The accompanying notes are an integral part of this schedule.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SANTA ISABEL  
Shedule of Expenditures Federal Awards  
June 30, 2005

Federal Grantor/Pass-Through Grantor/Program Title	Federal CFDA Number (note B)	Pass-Through Grantor's Number (note C)	Expenditures (note A)
<b><u>U.S. Department of Justice</u></b>			
Program:			
Passed through the P.R. Police Department:			
Local Law Enforcement Block Grant	16.592	N/A	42,189
<b>Total U.S. Department of Justice</b>			<b>42,189</b>
<b><u>U.S. Department of Homeland Security</u></b>			
Program:			
Passed through the P.R. Governor Authorized Representative (GAR):			
Public Assistance Grant	83.544	N/A	67,190
<b>Total U.S. Department of Homeland Security</b>			<b>67,190</b>
<b><u>U.S. Department of Transportation</u></b>			
Program:			
Passed through the P.R. Department of Public Works - P.R. Highway Authority:			
Transit - Capital Investment Grants	20.500	N/A	156,251
<b>Total U.S. Department of Transportation</b>			<b>156,251</b>
<b><u>U.S. Department of Commerce</u></b>			
Program:			
Direct Program:			
Grant for Public Works and Economic Development Facilities	11.300	N/A	31,842
<b>Total U.S. Department of Commerce</b>			<b>31,842</b>
<b>Total federal awards expenditures</b>			<b>\$ 3,775,454</b>

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SANTA ISABEL  
Notes to Schedule of Expenditures Federal Awards  
June 30, 2005

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

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of the Municipality and is presented on the modified accrual basis of accounting. Expenditures are recognized when the related liability is incurred. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, Audits of States, Local Government and Nonprofit Organizations.

**NOTE B - FEDERAL CFDA NUMBER**

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

**NOTE C - PASS -THROUGH GRANTOR'S NUMBER**

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

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

Description	Head Start	Other Nonmajor Funds
14.871	\$ -	\$ 274,884
14.218	-	532,243
10.766	-	29,552
10.558	-	80,080
16.592	-	12,189
20.500	-	156,251
11.300	-	31,842
83.544	-	67,190
93.600	1,935,358	-
93.575	-	571,727
93.569	-	54,138
Total federal awards expenditures	<u>1,935,358</u>	<u>1,840,096</u>
Total nonfederal awards expenditures	-	<u>1,923,319</u>
Total expenditures, fund statements	<u>\$ 1,935,358</u>	<u>\$ 3,763,415</u>

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SANTA ISABEL  
SCHEDULE OF CURRENT YEAR FINDINGS AND QUESTIONED COSTS  
June 30, 2005

**SECTION I-SUMMARY OF AUDITOR'S RESULTS**

**Part I Financial Statements:**

1. Type of audit report:
  - Unqualified opinion  Qualified opinion
  - Adverse opinion  Disclaimer of opinion
2. Reportable conditions reported
  - Yes  No
3. Reportable condition reported as a major weakness:
  - Yes  No
4. Material noncompliance disclosed:
  - Yes  No

**Part II Federal Awards**

Type of report: on compliance for major programs:

- Unqualified opinion  Qualified opinion
- Adverse opinion  Disclaimer of opinion

Reportable condition reported as a major weakness:

- Yes  No

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SANTA ISABEL  
SCHEDULE OF CURRENT YEAR FINDINGS AND QUESTIONED COSTS  
June 30, 2005

**SECTION I-SUMMARY OF AUDITOR'S RESULTS (Continued)**

**Part II Federal Awards (Continued):**

Material noncompliance disclosed:

Yes  No

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

Yes  No

Major Programs:

<b>CFDA Number (s)</b>	<b>Federal Program Grantor and Program Name</b>
14.218	<i>US Department of Housing and Urban Development:</i> Community Development Block Grants
93.600	<i>US Department of Health and Human Services:</i> Head Start
93.575	Child Care

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

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

Low-risk auditee

Yes  No

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

Yes  No

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SANTA ISABEL  
SCHEDULE OF CURRENT YEAR FINDINGS AND QUESTIONED COSTS  
June 30, 2005

**SECTION II- FINANCIAL STATEMENTS FINDINGS**

**PROGRAM: CDBG, CHILD CARE AND GENERAL FUND**

**MATERIAL WEAKNESS:**

**INTERNAL CONTROL FINDING**

**Finding 2005-II-1**

**DESCRIPTION OF FINDING:**

Our audit revealed that Municipality's Management did not maintain monthly reconciled accounting records for the most of its special revenue funds, for some of its federal funds and for the general fund. We found that monthly financial statements do not represent the adequate financial position of the Municipality due to the lack of reconciled accounting books. The Management did not have a reconciling process to monitor the financial reports maintained on regular basis. The areas as accounts payable, accounts receivable, and other current liabilities are not reconciled during the year, thus, the Municipality lack of recent and accurate financial information. The Municipality's Management does not have current information of the amount expended by the Municipality for each one of its funds, including its encumbrances. This condition does not provide Management the actual financial condition of the Municipality.

During several years, the Municipality of Santa Isabel has increased its deficit by exceeding its expenditures over its revenues. As of June 30, 2005, the accumulated deficit for its general fund (for government funds) amounted to \$7,261,639, with total liabilities in the amount of \$10,206,230 and total assets amounting \$2,944,591, including available cash of \$202,857 to pay mature liabilities within the current year. These conditions raised substantial doubt about its ability to continue as a going concern. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

At the year end, the Municipality reconciled, reprocessed and provided reconciled accounting records for our review.

**RECOMMENDATION:**

The Management should develop a process to perform a monthly closing of its accounting records in order to obtain a current and actual financial condition of the Municipality. Also, the Management should maintain its accounting records updated in order to have current and accurate financial information for the decision making process.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SANTA ISABEL  
SCHEDULE OF CURRENT YEAR FINDINGS AND QUESTIONED COSTS  
June 30, 2005

**SECTION III-FEDERAL FUNDS FINDINGS**

**PROGRAM: CDBG**

**COMPLIANCE: Financial Administration**

**Finding 2005-III-1**

**DESCRIPTION OF FINDING:**

**Criteria:** As required by 24 CFR 85.20, accurate, current and complete disclosure of the financial results of financially assisted activities must be made in accordance with the financial reporting requirements of the grant and sub-grant.

**Cause:** The cash balance of CDBG funds as of June 30, 2005, did not match with the accounting records by \$3,609, as follows:

Cash balance per bank reconciliation	\$ 6,088.46
Cash balance as reported	<u>2,479.30</u>
Difference	\$ 3,609.16

**Effect:** Municipality did not comply with standards for financial management system

**Recommendations:** The Municipality must establish procedures to adequately maintain financial records and should comply with the standards for financial management system.

**PROGRAM: CDBG**

**Finding 2005-III-2**

**COMPLIANCE: Equipment & Real Property Management**

**DESCRIPTION OF FINDING:**

**Criteria:** As required by OMB Circular A-102 Common Rule, equipment records shall be maintained, a physical inventory of equipment shall be taken at least once every two years and reconciled to the equipment records, an appropriate control system shall be used to safeguard equipment, and equipment shall be adequately maintained.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SANTA ISABEL  
STATUS OF PRIOR YEARS FINDINGS AND QUESTIONED COSTS  
June 30, 2005

**Cause:** According to the Management, no Equipment and/or Real Property was acquired during the year ended June 30, 2005 with CDBG Funds. However, we could not determine if equipment acquired in prior years with CDBG Funds are properly managed and in existence. A detail of equipment acquired in prior years was provided, but it does not identify the equipment acquired with federal funds.

**Effect:** Municipality did not comply with the Equipment & Real Property Management requirements.

**Recommendations:** The Municipality must establish procedures to adequately maintain and safeguard equipment, and to segregate or identify equipment acquired with federal funds.

**PROGRAM:** CDBG

**COMPLIANCE:** Period of Availability of  
Federal Funds

**Finding 2005-III-3**

**DESCRIPTION OF FINDING:**

**Criteria:** As required by OMB Circular A-102 Common Rule, where a funding period is specified, an entity only may charge to the award costs resulting from obligations incurred during the funding period. The entity shall liquidate all obligations incurred under the award not later than 90 days after the end of the funding period.

**Cause:** Prior years CDBG Grants awarded, remain open at the date of our report in spite of the funding period has been closed. A detail of CDBG Grants awarded is summarized as follows:

Grants awarded for the years from 1997 through 2003 - funding period expired as of 12/31/05.

Municipality could not provide details of obligations for each award year. Therefore we could not test the compliance with the availability of funds requirements.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SANTA ISABEL  
SCHEDULE OF CURRENT YEAR FINDINGS AND QUESTIONED COSTS  
June 30, 2005

**Effect:** Municipality did not comply with availability of funds requirements.

**Recommendations:** The Municipality must establish procedures to adequately maintain financial records and should comply with the availability of funds requirements.

**PROGRAM: CDBG**

**COMPLIANCE:** Cash Management

**Finding 2005-III-4**

**DESCRIPTION OF FINDING:**

**Criteria:** As required by 31 CFR 205 the sub recipients must establish procedures to minimize the time elapsing between the transfer of funds from the recipients and the disbursements. We found the Municipality is not following the procedures to minimize the time elapsing in disbursements federal funds.

**Cause:** The Municipality personnel is requesting funds but the time elapsing between the transfer of funds and the disbursements, exceeded the programs requirements.

**Effect:** We could not proof the Municipality compliance with the cash management requirement of requesting funds.

**Recommendations:** The Municipality must establish procedures to minimize the time elapsing between the transfer of funds and the disbursement. The cancelled checks must be found to support the related expenditures and the cash management requirements must be followed.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SANTA ISABEL  
STATUS OF PRIOR YEARS FINDINGS AND QUESTIONED COSTS  
June 30, 2005

**PROGRAM: HEAD START**

**COMPLIANCE:** Reporting

**Finding 2005-III-5**

**DESCRIPTION OF FINDING:**

**Criteria:** As required by 24 CFR 85.20, accurate, current and complete disclosure of the financial results of financially assisted activities must be made in accordance with the financial reporting requirements of the grant and sub-grant.

**Cause:** The funding period of the Grant Program end in April 30<sup>th</sup>, while the fiscal year end in June 30<sup>th</sup>. However, an adequate cut-off to test reporting for the year ended June 30, 2005, was not provided.

The amount of expenditures reported in the Financial Status Report did not match with the accounting records, without justifications, as follow:

<u>Expenditures Funding Period 4/30/05</u>		<u>Accounting records vs. Budget</u>	
Accounting records	\$ 1,820,262	Accounting records	\$ 1,820,262
Financial Status Report	<u>1,839,181</u>	Budget	<u>1,889,817</u>
Difference	<u>\$ 18,919</u>		<u>\$ 69,555</u>

**Effect:** Municipality did not comply with standards for financial management system and reporting requirements.

**Recommendations:** The Municipality must establish procedures to adequately maintain financial records and should comply with the standards for financial management system. Any differences between amount reported and accounting records must be explained.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SANTA ISABEL  
SCHEDULE OF CURRENT YEAR FINDINGS AND QUESTIONED COSTS  
June 30, 2005

**PROGRAM: CHILD CARE**

**COMPLIANCE:** Reporting

**Finding 2005-III-6**

**DESCRIPTION OF FINDING:**

**Criteria:** Code of Federal Regulations 45, Subpart C, Section 92.20 (b) (2) states that the grantees and sub grantees must maintain records, which adequately identify the source and application of funds, provided for financially-assisted activities. These records must contain information pertaining to grant or sub grant awards and authorizations, obligations, unobligated balances, assets, liabilities, outlays or expenditures, and income.

During our audit, we noted that the Municipality did not maintain, for the Child Care, a reliable set of accounting records that present the financial position of the program and the results of operations. The accounting records maintained by the Program accountant were not in sufficient detail which adequately identify the use of funds at the budgetary level authorized by the pass-through grantor, and therefore, the quarterly reports could not be prepared and submitted promptly to the pass-through grantor, and could not permit an easily audit trial of such reports to the accounting records.

**Cause:** The accounting records maintained by the Program accountant consist only of a budgetary control register using the chart of account adopted by the Municipality, instead of a set of accounting records adapted to the pass-through grantor budgetary level and reporting requirements.

**Effect:** The Municipality is not in compliance with Code of Federal Regulation 45, Subpart C, Section 92.20 (b) (2). Also, such condition did not permit a timely submission of financial reports to the pass-through grantor.

**Recommendation:**

We recommend to the Municipality management to instruct, and if necessary, to provide technical support to the program accountant to develop a full set of accounting records adapted to the pass-through grantor budgetary level and reporting requirements which include, as a minimum, the following records:

- a. Develop a chart of accounts (including real and nominal accounts) based on reporting requirements established by the pass-through grantor.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SANTA ISABEL  
SCHEDULE OF CURRENT YEAR FINDINGS AND QUESTIONED COSTS  
June 30, 2005

- b. Maintain General Ledger which includes all necessary accounts to properly report financial results as required by the pass-through grantor.
- c. Maintain a General Journal Ledger to summarize the Revenue and Disbursement Registers transactions using the double entry accounting procedure.
- d. Maintain a Revenue Register to support transactions to be posted in the General Ledger.
- e. Maintain a Disbursement Register to support transactions to be posted in the General Ledger.

**PROGRAM: CHILD CARE**

**COMPLIANCE:** Cash Management

**Finding 2005-III-7**

**DESCRIPTION OF FINDING:**

**Criteria:** As required by 31 CFR 205 the sub recipients must establish procedures to minimize the time elapsing between the transfer of funds from the recipients and the disbursements.

**Cause:** The Municipality personnel is requesting funds but the time elapsing between the transfer of funds and the disbursements, exceeded the programs requirements.

**Effect:** We could not proof the Municipality compliance with the cash management requirement of requesting funds.

**Recommendations:** The Municipality must establish procedures to minimize the time elapsing between the transfer of funds and the disbursement.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SANTA ISABEL  
STATUS OF PRIOR YEARS FINDINGS AND QUESTIONED COSTS  
June 30, 2005

**PROGRAM: CHILD CARE**

**COMPLIANCE:** Equipment & Real Property Management

**Finding 2005-III-8**

**DESCRIPTION OF FINDING:**

**Criteria:** As required by OMB Circular A-102 Common Rule, equipment records shall be maintained, a physical inventory of equipment shall be taken at least once every two years and reconciled to the equipment records, an appropriate control system shall be used to safeguard equipment, and equipment shall be adequately maintained.

**Cause:** A detail of property was submitted for our review. However, no evidence of property inventory as taken during at least the last two years, was provided.

**Effect:** Municipality did not comply with the Equipment & Real Property Management requirements.

**Recommendations:** The Municipality must establish procedures to adequately maintain and safeguard equipment.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SANTA ISABEL  
STATUS OF PRIOR YEARS FINDINGS AND QUESTIONED COSTS  
June 30, 2005

**PROGRAM: CHILD CARE**

**COMPLIANCE:** Reporting

**Finding 2005-III-9**

**DESCRIPTION OF FINDING:**

**Criteria:** As required by 24 CFR 85.20, accurate, current and complete disclosure of the financial results of financially assisted activities must be made in accordance with the financial reporting requirements of the grant and sub-grant.

**Cause:** According to the Grant Agreement with ACUDEN, a financial report at the Grant Program year-end (9/30/05) must be submitted fifteen (15) days after year-end for "Balance de Comprobación" and thirty (30) days after year-end for "Informe de Cierre Anual CC-006". However, the corresponding reports for the year ended September 30, 2005 have not been submitted at the date of our visit.

**Effect:** Municipality did not comply with Reporting requirements.

**Recommendations:** The Municipality must establish procedures to adequately maintain financial records, in order to comply with Financial Reporting Requirements.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SANTA ISABEL  
STATUS OF PRIOR YEARS FINDINGS AND QUESTIONED COSTS  
June 30, 2005

**FINANCIAL STATEMENTS FINDINGS-YEAR 2004**

**Program: CDBG  
CHILD CARE**

**Finding Number  
2004-11-1**

**Accounting Records**

**Condition**

Section 20 of OMB Circular A-102 of the Common Rule, requires adequate accounting records, should be maintained for each federal program.

We did not received from program personnel trial balance for CDBG and Child Care.

**Status provided by Management**

For CDBG program, Partially corrective action has been taken. Actually, the Municipality post all of its Program transactions in a cash basis manual records that consist of the following records:

- a) Cash Receipt Books (a Book per each Grant Award)– To record all receipts from the Pass-through Grantor; each receipt is posted in detail under each account title, and at the end of the month each column total is posted to the General Ledger.
- b) Cash Disbursement Books (a Book per each Grant Award)– To record all cash disbursements made by the Official Payer; each cash disbursement is posted in detail under each account title, and at the end of the month each account total is posted to the General Ledger.
- c) General Ledgers (a Book per each Grant Award)– To summarize monthly cash receipt and cash disbursement transactions charged to each account.
- d) Check Register – To records all disbursements issued from the CDBG program cash bank account.

The Program accountant prepared quarterly a trial balance for each grant award using each grant award general ledger, but some trial balances were not self balanced, and therefore, we instruct him to revise past transactions in order to correct such differences.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SANTA ISABEL  
STATUS OF PRIOR YEARS FINDINGS AND QUESTIONED COSTS  
June 30, 2005

**Program: CHILD CARE**

**Finding Number  
2004-II-2**

**Interfund Transactions**

**Condition**

Section 20 of OMB Circular A-102 of the Common Rule and municipality state laws, requires adequate accounting records and financial management should be maintained for each municipal fund.

We noted that the Internal Revenue Service (IRS) seized approximately \$577,000 from the municipality's certificates of deposits, in order to cover a receivable from the municipality based on unpaid social security taxes. The funds of the certificates of deposit seized came from state joint resolutions funds for restricted or specified purposes.

**Status provided by Management**

Since January 2005, the Municipal Administration put in place an ambitious program to reduce the general fund deficit, including a special obligation bond issuance with original issue amounts of \$1,410,000 to pay general fund current liabilities due and payable at June 30, 2005, a workforce displacement plan in order principally to reduce the Municipality's payroll and fringe benefits expenditures, the privatization of the domestic solid waste collection services in the Municipality's urban and rural areas, formalization of debt amortization agreements for past due current debts with governmental and private entities, within others.

Also, we are planning to request a special obligation bond to the Government Development Bank (GDB) in order to reimburse to the state joint resolutions cash bank account the cash seized by the Internal Revenue Services.

**GENERAL FUND**

**Finding Number  
2004-II-3**

**Payroll Taxes**

**Condition**

Municipality must comply with state and federal laws and regulations on the payment of payroll taxes.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SANTA ISABEL  
STATUS OF PRIOR YEARS FINDINGS AND QUESTIONED COSTS  
June 30, 2005

**Status provided by Management**

Partially corrective action has been taken. On July 5, 2005 the Government Development Bank for Puerto Rico (GDB) approved a special obligation bond issuance with original issue amounts of \$1,410,000 to pay general fund current liabilities due and payable at June 30, 2005, including total amount owned to the Internal Revenue Services at June 30, 2005, that was paid off on August 2005. But, we have a debt with the Puerto Rico Treasury Department for income tax withhold; we are in the process to negotiate a debt amortization plan with the Puerto Rico Treasury Department in order to liquidate such debt through monthly installments based on our cash flow capacity.

**Finding Number**  
**2004-II-4**

**Budget**

**Condition**

Municipalities's state laws, requires an adequate accounting records and a good financial management should be maintained for each of the municipality's funds.

We noted that were a material overstatement, of \$1.8 millions, on budgeted revenues over actual revenues collections for fiscal year 2003-2004, as per general fund's budgetary report in financial statements report.

**Status provided by Management**

Partially corrective action has been taken. Since January 2005, the Municipal Administration put in place an ambitious program to reduce the general fund deficit, including a special obligation bond issuance with original issue amounts of \$1,410,000 to pay general fund current liabilities due and payable at June 30, 2005, a workforce displacement plan in order principally to reduce the Municipality's payroll and fringe benefits expenditures, the privatization of the domestic solid waste collection services in the Municipality's urban and rural areas, formalization of debt amortization agreements for past due current debts with governmental and private entities, within others.

Also, we are planning to request a special obligation bond to the Government Development Bank (GDB) in order to reimburse to the state joint resolutions cash bank account the cash transferred to the General Fund current bank account recorded in the Financial Statements as an interfund debt as of June 30, 2005.

COMMONWEALTH OF PUERTO RICO  
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STATUS OF PRIOR YEARS FINDINGS AND QUESTIONED COSTS  
June 30, 2005

**FEDARL FUNDS FINDINGS-YEAR 2004**

<b>Programs: CDBG CHILD CARE</b>	<b>Finding Number 2004-III-1</b>
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**Cash Management**

**Condition**

As per OMB C-A 133, compliance C, when entities are funded on a reimbursement basis, program costs must be paid for by entity funds before reimbursement is requested from the Federal Government. When funds are advanced, recipients must follow procedures to minimize the time clapsing between the transfer of funds from the U.S. Treasury and disbursement. When advance payment procedures are used, recipients must establish similar procedures for sub recipients.

During our audit we found, for CDBG, that the program has a high cash balance of \$111,220 at 6/30/04 and for Child Care we found that the program has a high cash balance of \$ 162,233.81 at 6/30/04.

**Status provided by Management**

For CDBG program no corrective action has been taken. To correct the condition reported by the external auditors we are going to start the disbursement process when the requisitions of funds were submitted to the Office of the Commissioner of Municipal Affairs (OCAM) in order to assure that when the funds were transferred by the Pass-through Grantor we will disburse its funds immediately.

For Child Care and Development Block Grant, the requisition of funds system established by the Commonwealth of Puerto Rico Child Care and Development Administration (ACUDEN) has been designed to request funds quarterly. Therefore, each quarter, we complete and submit the request of funds form provided by ACUDEN, reporting the amounts of funds received to date, the total award expended to date, a forecast of expenditures for the next three months (payroll, fringe benefits, contractual services, etc.), and the total amount of cash requested based on the refereneed information.

The funds requested and received from ACUDEN each quarter are disbursed during each quarter period principally to reimburse the payroll and fringe benefits paid by the General Fund and to pay the monthly portion of contractual services.

COMMONWEALTH OF PUERTO RICO  
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STATUS OF PRIOR YEARS FINDINGS AND QUESTIONED COSTS  
June 30, 2005

Therefore, is our opinion that the requisition of funds system established by the Pass-through Grantor, who is the non-federal entity who maintain closely monitoring to our Program operations, has been followed by us in compliance with the grant agreement clauses.

**Program: CDBG**

**Finding Number  
2004-III-2**

**Procurement, Suspension and Debarment**

**Condition**

As per OMB Circular A-133, states, and governmental subrecipients of States, shall use the same State policies and procedures used for procurements from non-Federal funds. They also shall ensure that every purchase order or other contract includes any clauses required by Federal statutes and executive orders and their implementing regulations. Non-Federal entities are prohibited from contracting with or making subawards under covered transactions to parties that are suspended or debarred or whose principals are suspended or debarred.

During our audit we could not observe any suspension and debarment clauses or certifications regarding to, in two construction contracts were program funds were expended during fiscal year.

**Status provided by Management**

Corrective action was taken. Actually, all contracts totally of partially financed with federal funds adding to each contract clauses the suspension and debarment certification.

**Program: CDBG**

**Finding Number  
2004-III-3**

**Special Tests**

**Condition**

When CDBG funds are used for housing rehabilitation, the grantee must assure that the work is properly completed (24 CFR section 570.506).

1. As per our tests, we observed the following participant's contracts were not adequately filled out in all required blanks and the housing deficiencies to be corrected were not correctly described in the initial inspections documents.

COMMONWEALTH OF PUERTO RICO  
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STATUS OF PRIOR YEARS FINDINGS AND QUESTIONED COSTS  
June 30, 2005

2. In one case, supplies paid by the municipality were not delivered by supplier to participant and the municipality, and we did not observe required follow up in this case.

**Status provided by Management**

To remedy the transactions reported in the external auditors' condition, we are going to assign Program staff to review the participants' files to correct, if possible, any condition observed in each file to assure compliance the Program regulations.

Also, as a prospective measure, we are going to give specific instructions to our Program staff and to monitor your performance closely in order to assure adherence to the procedures established by the Office of the Commissioner of Municipal Affairs (OCAM) in the procedures guide titled in Spanish as "Guía Operacional para el Programa de Rehabilitación de Viviendas".

**Program: CHILD CARE**

**Finding Number  
2004-III-4**

**REPORTING**

**Condition**

As per OMB Circular A-133, the reporting requirements for sub recipients are as specified by the pass-through entity. In many cases, these will be the same as or similar to the following requirements for recipients.

During our audit, we did not observe the quarterly financial reports required by grantor's agency.

**Status provided by Management**

For the Program Year 2004-2005, which its approved budget was for a ten months period (October 1, 2004 to July 31, 2005) we made available to the external auditors the quarterly reports for the quarters ended on December 31, 2004, March 31, 2005, June 30, 2005, and an additional report for the month ended on July 31, 2005. But, actually, we have pending to submit the final report to the Pass-through grantor for such program year, and we will submit it in the first week of April 2006. To do so, we are reviewing and modifying our Program accounting records with the support of our financial consultants in order to assure that the accounting records present the financial position and the results of operation in sufficient detail to permit an easily audit trial of financial reports to the accounting records in future audits.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SANTA ISABEL  
STATUS OF PRIOR YEARS FINDINGS AND QUESTIONED COSTS  
June 30, 2005

**FINANCIAL STATEMENTS FINDINGS-YEAR 2003**

**Program: CDBG**

**Finding Number  
2003-II-1**

**Accounting Records**

**Condition**

The Municipality does not maintain general ledgers for most of its major federal funds.

**Status provided by Management**

For CDBG program, Partially corrective action has been taken. Actually, the Municipality post all of its Program transactions in a cash basis manual records that consist of the following records:

- e) Cash Receipt Books (a Book per each Grant Award)– To record all receipts from the Pass-through Grantor; each receipt is posted in detail under each account title, and at the end of the month each column total is posted to the General Ledger.
- f) Cash Disbursement Books (a Book per each Grant Award)– To record all cash disbursements made by the Official Payer; each cash disbursement is posted in detail under each account title, and at the end of the month each account total is posted to the General Ledger.
- g) General Ledgers (a Book per each Grant Award)– To summarize monthly cash receipt and cash disbursement transactions charged to each account.
- h) Check Register – To records all disbursements issued from the CDBG program cash bank account.

The Program accountant prepared quarterly a trial balance for each grant award using each grant award general ledger, but some trial balances were not self balanced, and therefore, we instruct him to revise past transactions in order to correct such differences.

COMMONWEALTH OF PUERTO RICO  
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STATUS OF PRIOR YEARS FINDINGS AND QUESTIONED COSTS  
June 30, 2005

**FEDERAL FUNDS FINDINGS- YEAR 2003**

**Program: CDBG  
CHILD CARE  
SECTION 8**

**Finding Number  
2003-III-1**

**Cash Management**

**Condition**

The administrative personnel is 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.

**Status provided by Management**

For CDBG program no corrective action has been taken. To correct the condition reported by the external auditors we are going to start the disbursement process when the requisitions of funds were submitted to the Office of the Commissioner of Municipal Affairs (OCAM) in order to assure that when the funds were transferred by the Pass-through Grantor we will disburse its immediately.

For Child Care and Development Block Grant, the requisition of funds system established by the Commonwealth of Puerto Rico Child Care and Development Administration (ACUDEN) has been designed to request funds quarterly. Therefore, each quarter, we complete and submit the request of funds form provided by ACUDEN, reporting the amounts of funds received to date, the total award expended to date, a forecast of expenditures for the next three months (payroll, fringe benefits, contractual services, etc.), and the total amount of cash requested based on the referenced information.

The funds requested and received from ACUDEN each quarter are disbursed during each quarter period principally to reimburse the payroll and fringe benefits paid by the General Fund and to pay the monthly portion of contractual services.

Therefore, is our opinion that the requisition of funds system established by the Pass-through Grantor, who is the non-federal entity who maintain closely monitoring to our Program operations, has been followed by us in compliance with the grant agreement clauses.

For Section 8 Housing Choice Voucher, corrective action was taken. Actually, we are disbursing the housing assistance payments in a reasonable time after receipt of the electronic fund transfer from the US Treasury Department.

COMMONWEALTH OF PUERTO RICO  
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STATUS OF PRIOR YEARS FINDINGS AND QUESTIONED COSTS  
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**Program: SECTION 8**

**Finding Number  
2003-III-2**

**Cash Management**

**Condition**

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

**Status provided by Management**

During the fiscal year ended on June 30, 2005, no bank charges were applied to the Section 8 Housing Choice Voucher Program. Also, in relation with the bank charges reported by the external auditors in the finding reference 2003-III-2, we will request to the Bank to reverse such charges.

**Program: CDBG**

**Finding Number  
2003-III-3**

**Reporting**

**Condition**

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

**Status provided by Management**

Our Municipality is administering the Section 8 Housing Choice Voucher Program with a limitation in source of funds due to the fact that the administrative fee earned did not permit us to satisfy the cost of additional employees. Also, the Municipality general fund deficit did not permit us to satisfy the cost of additional employees. But, our Federal Program Director maintain a closely supervision over the Program Coordinator in order to assure full compliance with the Program rules and regulations.

COMMONWEALTH OF PUERTO RICO  
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STATUS OF PRIOR YEARS FINDINGS AND QUESTIONED COSTS  
June 30, 2005

**FINDINGS BEFORE YEAR 2003**

**Program: FEMA  
Section 8  
Head Start**

**Finding Number  
2002-2**

**Disbursing**

**Condition**

Noncompliance related to disbursing procedures.

**Status provided by Management**

To reduce to a low level the probability that a condition as described on Finding 2002-02 occur again in the future, the Finance Director instruct the Official Payer to improve the actual procedures in order to assure that all of disbursement vouchers and its supporting documents were stamped as paid whenever a check is issued, and that all of disbursement vouchers and its supporting documents were adequately safeguarded in order to provide its timely in future audits.

**Program: CDBG  
Section 8  
Head Start  
FEMA**

**Finding Number  
2002-3, 6 and 7**

**Cash Management**

**Condition**

Reportable conditions over cash management.

**Status provided by Management**

**Finding 2002-3:**

For CDBG program no corrective action has been taken. To correct the condition reported by the external auditors we are going to start the disbursement process when the requisitions of funds were submitted to the Office of the Commissioner of Municipal Affairs (OCAM) in order to assure that when the funds were transferred by the Pass-through Grantor we will disburse its immediately.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF SANTA ISABEL  
STATUS OF PRIOR YEARS FINDINGS AND QUESTIONED COSTS  
June 30, 2005

For Section 8 Housing Choice Voucher, corrective action was taken. Actually, we are disbursing the housing assistance payments in a reasonable time after receipt of the electronic fund transfer from the US Treasury Department.

For Head Start Program, corrective action was taken. During the year 204-2005, funds were requested based on realistic cash needs and were disbursed in a reasonable lapse of time since receipt of funds from the US Treasury Department.

**Finding 2002-6:**

During the fiscal year 2004-2005, bank charges were applied to some Federal bank accounts, but to remediate such condition the Finance Director gave instructions in order to reduce to a low level the probability that disbursements were made without the cash available in the bank account.

Recently, the Municipality received from FEMA a Public Assistance program award to recover for damages to public facilities and infrastructure caused by a major disaster (flood rains) occurred in the last months of the year 2005, and we will comply with the cash management requirements applicable to this grant award.

**Finding 2002-7:**

The Finance Director gave instructions to the employee in charge of cash collections and to the Program accountant in order to assure that a collection receipt be issued promptly each time that an electronic fund transfer is received from the US Treasury Department.

**Program: FEMA**

**Finding Number  
2002-5**

**Reporting**

**Condition**

Reportable conditions over reporting.

**Status provided by Management**

Finding has not been cleared by Federal Agency. But recently, the Municipality received from FEMA a Public Assistance program award to recover for damages to public facilities and infrastructure caused by a major disaster (flood rains) occurred in the last months of the year 2005, and we will comply with the reporting requirements applicable to this grant award.

MUNICIPIO DE SANTA ISABEL  
PROGRAMAS FEDERALES  
(787) 845-4040

FACSIMILE TRANSMITTAL SHEET

<b>To:</b> RAYMOND VEGA	<b>From:</b> Janice Brugman
<b>FAX NUMBER:</b> (787) 751-5009	<b>Date:</b> June 6, 2006
<b>COMPANY:</b> OCAM	<b>TOTAL NO. OF PAGES INCLUDING COVER:</b> 9
<b>PHONE NUMBER:</b>	<b>SENDER'S REFERENCE NUMBER:</b>
<b>Re:</b>	<b>YOUR REFERENCE NUMBER:</b>

URGENT     FOR REVIEW     PLEASE COMMENT     PLEASE REPLY     PLEASE RECYCLE

**NOTES/COMMENTS:**

**Adjunto Plan de Acción Correctiva del Single Audit. 2004-2005.**

06 JUN -6 PM 3:21

DIVISION REGULAMENTACION  
E INTERVENCION

# Municipality of Santa Isabel

## Corrective Action Plan Single Audit 2004-2005

Finding Reference Number	Responsible Employee	Corrective Action Planned	Expected Implementation Date
		<p>But, the Office of the Commissioner of Municipal Affairs is considering alternatives to improve our accounting system, including the acquisition of new accounting software, and therefore, we will hope to solve our accounting system condition in a near future.</p> <p>As reflected in the audited financial statements, the Municipality's general fund deficit presents a continuous and consistent growth each year for the past three fiscal years as the consequence principally of: a) adoption of budgets with budgeted revenues that at the end of each year were less than actual revenues collected, and which did not provide funding for all of incurred obligations; b) <del>and the high percentage of budget revenues used with payroll</del> fringe benefits, and statutory obligations.</p>	
		<p>Based on this reality, the municipal administration has adopted an ambitious program to reduce the general fund expenditures and stop the continuous and consistent Municipality's general fund financial condition deterioration, and then, improve it. The Municipality's executive branch, with the approval of the legislative branch (for items a) and b)), places in force various actions including the following actions after year ended June 30, 2005:</p> <p><b>\$1,410,000 Operational Loan</b></p> <p>On July 5, 2005 the Government Development Bank for Puerto Rico (GDB) approved a special obligation bond issuance with original issue amounts of \$1,410,000 to pay general fund current liabilities due and payable at June 30, 2005. This bond issuance was authorized by the Municipality's legislative branch on July 28, 2005 through the Ordinance number 4, 2005-2006 Series.</p> <p><b>Workforce Displacement Plan</b></p>	

## Municipality of Santa Isabel

### Corrective Action Plan Single Audit 2004-2005

Finding Reference Number	Responsible Employee	Corrective Action Planned	Expected Implementation Date
		<p>newspaper a request for proposal from interested parties to privatize the domestic solid waste collection services in the Municipality's urban and rural areas. On December 27, 2005 the Municipality received three proposals from private companies interested to provide domestic solid waste collection services to the Municipality. These proposals were subject to a detailed review in order to select the best offer to protect the public interest, and the bidder selected started the domestic solid waste collection services on February 1, 2006.</p> <p><b>Debts Amortization Agreements</b></p>	
		<p>We are planning to request a special obligation bond to the Government Development Bank (GDB) in order to reimburse to the state joint resolutions cash bank account the cash seized by the Internal Revenue Services, and we are in the process to negotiate a debt amortization plan with the Puerto Rico Treasury Department in order to request it to liquidate our debts with governmental entities, and later paid it through monthly installments based on our cash flow capacity. Also, we formalized debt amortization agreements for past due current debts with governmental and private entities, within others.</p>	
2005-III-1	Mrs. Janice Brugman Federal Programs Department (CDBG, Section 8 and CC&DBG) Director	The Program accountant was instructed to revise past transactions posted in each grant award set of accounting books in order to correct the cash difference per books when compared with the adjusted cash balance per bank.	06/30/2006
2005-III-2	Mrs. Janice Brugman Federal Programs Department (CDBG, Section 8 and CC&DBG) Director	To correct the condition reported by the external auditors we are going to include a columns in our capital assets subsidiary ledger a column identifying the sources of funds used for each capital assets acquired. But, is important to comment that our subsidiary ledger was tested by the external auditors for	06/30/2006

## Municipality of Santa Isabel

### Corrective Action Plan Single Audit 2004-2005

Finding Reference Number	Responsible Employee	Corrective Action Planned	Expected Implementation Date
		<ul style="list-style-type: none"> <li>a. a chart of accounts (including real and nominal accounts) based on reporting requirements established by the pass-through grantor;</li> <li>b. a General Ledger which includes all necessary accounts to properly report financial results as required by the pass-through grantor;</li> <li>c. a General Journal Ledger to summarize the Revenue and Disbursement Registers transactions using the double entry accounting procedure;</li> </ul>	
		<ul style="list-style-type: none"> <li>d. a Revenue Register to support transactions to be posted in the General Ledger;</li> <li>e. a Disbursement Register to support transactions to be posted in the General Ledger;</li> <li>f. a Purchase Orders and Contracts Register to record purchase orders and contracts issued against the budgeted amounts for each account in order to maintain an adequate budgetary control.</li> </ul>	
2005-III-7	Mrs. Janice Brugman Federal Programs Department (CDBG, Section 8 and CC&DBG) Director	<p>For Child Care and Development Block Grant, The requisition of funds system established by the Commonwealth of Puerto Rico Child Care and Development Administration (ACUDEN) has been designed to request funds quarterly. Therefore, each quarter, we complete and submit the request of funds form provided by ACUDEN, reporting the amounts of funds received to date, the total award expended to date, a forecast of expenditures for the next three months (payroll, fringe benefits, contractual services, etc.), and the total amount of cash requested based on the referenced information.</p> <p>The funds requested and received from ACUDEN each quarter are disbursed</p>	Pending to discussion with the Pass-through Grantor

**Municipality of Santa Isabel**

**Corrective Action Plan  
Single Audit 2004-2005**

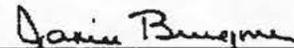
In compliance with the OMB Circular A-133, Subpart C—"Auditees", 300 "Auditee responsibilities", we prepared the corrective action plan described above on March 23, 2005 in accordance with 315(c).



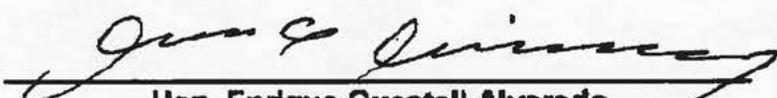
**Mrs. Irma M. Vargas Aguirre**  
Director  
Finance Department



**Mr. Carlos Melendez**  
Director  
Early and Head Start Programs



**Mrs. Janice Brugman**  
Director  
Federal Programs Department



**Hon. Enrique Questell Alvarado**  
Mayor