

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

**MUNICIPIO DE SANTA ISABEL
AUDITORÍA 2009-2010
30 DE JUNIO DE 2010**

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SANTA ISABEL
Single Audit Report
For the fiscal year ended June 30, 2010
(With Independent Auditor's Report Thereon)

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



SINGLE AUDIT REPORT
For the Fiscal Year Ended June 30, 2010
(With Independent Auditors' Report Thereon)

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SANTA ISABEL
Basic Financial Statements and
Supplemental Schedule
Single Audit Report
June 30, 2010**

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MENDOZA & RAMOS
Contadores Públicos Autorizados, C.S.P.

P.O. Box 35 • Guayama, Puerto Rico 00785

INDEPENDENT AUDITOR'S REPORT

HONORABLE MAYOR AND MUNICIPAL COUNCIL
MUNICIPALITY OF 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, 2010, which collectively comprise the Municipality's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Municipality's management. Our responsibility is to express an opinion of these financial statements based on our audit.

Except as discussed in the following paragraphs, 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. 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 provide a reasonable basis for our opinions.

The Municipality did not maintained adequate records for capital assests, acumulated depreciation and related depreciation expense and were unable to satisfy ourselves about such balances through alternate procedures. Therefore, we were not able to obtain sufficient evidence to satisfy ourselves about the capital assets of governmental activities recorded in the accompanying statement of net assets for \$31,115,655, net of accumulated depreciation of \$7,036,358, and the amount of depreciation expense stated at \$750,145 reported in the accompanying statement of activities for the year then ended. In addition, during the fiscal year ended June 30, 2010, the Municipality did not adopt the provisions of Statement No. 42, *Accounting and Financial Reporting of Impairments of Capital Assets and for Insurance Recoveries*, issued by the Governmental Accounting Standards Board, which required the Municipality to evaluate prominent events or changes in circumstances affecting capital assets to determine whether an impairment of a capital asset has occurred. Because of this departure from accounting principles generally accepted in the United States of America for capital assets, the assets and net assets reported in the accompanying statement of net assets are materially misstated for significant amounts that could not be determined at June 30, 2010. In addition, the expenses and the net result of operations reported in the accompanying statement of activities are also misstated for amounts that could not be determined for the fiscal year ended June 30, 2010.

INDEPENDENT AUDITOR'S REPORT

As shown in Note 10, the accompanying basic financial statements do not disclose the debt service maturities of the notes and balances payable to the: Puerto Rico Treasury Department, \$727,058, Municipal Revenue Collection Center, \$26,704, Puerto Rico Health Services Administration, \$59,895, Christmas Bonus of Employees, \$166,651, Retirement System Administration, \$ 281,433 and First Medical Insurance Corporation, \$ 262,207 at June 30, 2010. In our opinion, disclosure of this information is required by accounting principles generally accepted in the United States of America.

The Municipality did not recognized in the General Fund liabilities normally paid in a timely manner and in full from expendable available financial resources. Instead, these liabilities were recorded as long term liabilities in the governmental activities in the accompanying statement of net assets, based on the assertion that the Municipality Legislative branch authorized the issuance of \$2,670,000 of general obligation bond subsequent to the year ended on June 30, 2010, principally to finance debts with other governmental entities, suppliers, and contractors pending at June 30, 2010. GASB Interpretation No. 6, *Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements* state that liabilities that governments normally pay in a timely manner and in full from expendable available financial resources should be recognized when incurred, without regard to the extent to which resources are currently available to liquidate the liability. If these liabilities were accounted for properly, liabilities reported in the General Fund would be increased by \$1,270,698, and the fund balance would be decreased by \$1,270,698, as of June 30, 2010.

Because of the matters discussed in the preceding paragraphs the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the financial position of the governmental activities of the Municipality of Santa Isabel as of June 30, 2010, and the respective changes in financial position, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Also, in our opinion, because of the matters discussed in the preceding paragraphs, the General Fund financial statements referred to above do not present fairly, in conformity with accounting principles generally accepted in the United States of America, the respective financial position of the General Fund of the Municipality of Santa Isabel as of June 30, 2010.

In addition, in our opinion, the financial statements referred to previously present fairly, in all material respects, the respective financial position of the Capital Improvement Bond Fund, the Debt Service Fund, and the aggregate remaining fund information of the Municipality of Santa Isabel, as of June 30, 2010, and the respective changes in financial position, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis and budgetary comparison information on pages 5 through 18 and page 68, 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.

INDEPENDENT AUDITOR'S REPORT

In accordance with *Government Auditing Standards*, we have also issued a report dated December 29, 2011, on our consideration of the Municipality's internal control structure over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

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 not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the financial statements taken as a whole.

Mendoza & Ramos CPA's
MENDOZA & RAMOS
CONTADORES PÚBLICOS AUTORIZADOS, C.S.P.

December 29, 2011
Guayama, Puerto Rico

The stamp number 2573152
was affixed to the original of this report.



**MUNICIPALITY OF SANTA ISABEL,
COMMONWEALTH OF PUERTO RICO**
Management's Discussion and Analysis
Fiscal Year Ended June 30, 2010

As management of the Municipality of Santa Isabel (the Municipality), we offer readers the following discussion and analysis of the Municipality's financial activities reported in the accompanying basic financial statements as of and for the fiscal year ended June 30, 2010. We encourage readers to consider the information presented here in conjunction with additional information that is furnished in the accompanying financial statements, which follow this narrative.

Besides, this document includes comparative data with prior year as this information was available for the fiscal year ended on June 30, 2009, fourth year of implementation of Governmental Accounting Standards Board (GASB) Statement No. 34, "*Basic Financial Statements – and Management's Discussion and Analysis for State and Local Governments.*" This MD&A is prepared in order to comply with such pronouncement and, among other purposes, to provide the financial statements users with the following major information:

- a broader basis in focusing important issues;
- acknowledgement of an overview of the Municipality's financial activities;
- provides for an evaluation of its financial condition as of the end of fiscal year 2009-2010 compared with prior year results;
- identification of uses of funds in the financing of the Municipality's variety of activities and;
- asses management's ability to handle budgetary functions.

FINANCIAL HIGHLIGHTS

Government-Wide Highlights:

- The Municipality's total assets amounted to \$40,859,465 at June 30, 2010, of which \$24,079,297 (59%) consist of capital assets (net of accumulated depreciation and amortization of \$7,036,358), \$1,351,856 (3%) consist of cash and cash equivalents (of which \$979,731 are restricted for specific purposes), \$12,728,007 (31%) consist of cash with fiscal agent (which are restricted principally for capital projects and debt service) and \$2,700,305 (7%) consist of accounts receivable.
- The Municipality's total liabilities amounted to \$37,266,405 at June 30, 2010, of which \$24,165,783 (65%) consist of bonds and notes payable, \$9,151,885 (25%) consist of accounts payable and accrued liabilities, \$1,309,845 (3%) consist of accrued compensated absences, \$1,245,192 (3%) consist of unearned revenues, and \$1,393,700 (4%) consist of estimated landfill closure and post closure care costs.
- The Municipality's total assets exceeded its liabilities (net assets) by \$3,593,060 at June 30, 2010.
- The Municipality's total revenues amounted to \$15,317,362 for the fiscal year ended June 30, 2010, of which \$6,745,944 (44%) arose from taxes, \$8,303,089 (54%) arose from intergovernmental grants and contributions, and \$268,329 (2%) arose from charges from services, miscellaneous revenues and interest on deposits.

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Management's Discussion and Analysis
Fiscal Year Ended June 30, 2010

- The Municipality's total expenses amounted to \$15,487,100 for the fiscal year ended June 30, 2010, of which \$11,216,739 (72%) were incurred in providing direct services and benefits to citizens in relation to urban and economic development, health and sanitation, public safety, welfare and housing assistance, culture, recreation and education. In addition, the Municipality incurred in \$383,058 (2%) of its total expenses, in interests related to its long-term obligations, and \$3,887,303 (26%) in general government activities to support the Municipality's functions and programs. The Municipality's total expenses include depreciation and amortization of capital assets in the amount of \$750,145 for the fiscal year ended June 30, 2010.
- The Municipality's total net assets decreased by \$169,738 during the fiscal year ended June 30, 2010.

Governmental Funds' Highlights:

- The total fund balances of governmental funds amounted to \$6,542,978 at June 30, 2010, of which \$6,851,657 are reserved for capital projects, debt service, encumbrances and other specific purposes, while \$308,679 are presented as unreserved fund deficit.
- The fund balances of governmental funds increased by \$6,954,622 during the fiscal year ended June 30, 2010, principally due to proceeds from bonds issuance.

OVERVIEW OF THE BASIC FINANCIAL STATEMENTS

The purpose of financial reporting is to provide external users of basic financial statements with information that will help them to make decisions or draw conclusions about the Municipality. There are many external parties that use the basic financial statements of the Municipality; however, these parties do not always have the same specific objectives. In order to address the needs of as many parties as reasonably possible, the Municipality, in accordance with required financial reporting standards, presents this Management's Discussion and Analysis (MD&A) as an introduction to the accompanying basic financial statements. This narrative represents an overview and analysis of the financial activities of the Municipality for the fiscal year ended June 30, 2010. 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.

The Municipality's basic financial statements include three components: (1) government-wide financial statements (GWFS), (2) fund financial statements (FFS), and (3) notes to the basic financial statements (NBFS). This report also contains additional required information in addition to the basic financial statements themselves. These components are described below.

The basic financial statements focus on: (1) the Municipality as a whole (government-wide financial reporting) and, (2) the Municipality's major individual governmental funds. Both perspectives allow the users to address relevant questions, broaden a basis for comparison (year to year or government to government) and enhance the Municipality's accountability. The components of the basic financial statements are described below.

**MUNICIPALITY OF SANTA ISABEL,
COMMONWEALTH OF PUERTO RICO**
Management's Discussion and Analysis
Fiscal Year Ended June 30, 2010

a) Government-Wide Financial Statements

The GWFS are composed of: (1) the statements of net assets (SNA) and (2) the statement of activities (SA). These financial statements can be found immediately following this MD&A. GWFS are designed to provide readers with a broad overview of the Municipality's operations as a whole in a manner similar to private-sector businesses. 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 June 30, 2010. The GWFS are prepared using methods that are similar to those used by most private businesses.

Both of the government-wide financial statements distinguish functions of the Municipality that are principally supported by taxes and intergovernmental activities (*governmental activities*) from other functions that are intended to recover all or a significant portion of their costs through user fees and charges (*business-type activities*).

1. Statement of Net Assets

The purpose of SNA is to attempt to report all assets owned and all liabilities owed by the Municipality. The Municipality reports of all of its assets when it acquires ownership over the assets and reports all of its liabilities when they are incurred. For example, the Municipality reports buildings and infrastructure as assets, even though they are not available to pay the obligations incurred by the Municipality. On the other hand, the Municipality reports liabilities, such as claims and judgments, bonds and notes payable, obligations under capital leases, compensated absences and certain accounts payable and accrued liabilities, even though these liabilities might not be paid until several fiscal years into the future.

The difference between the Municipality's total assets and total liabilities reported in SNA is presented as *net assets*, which is similar to the total owners' equity reported by a commercial enterprise in its financial statements. Although the purpose of the Municipality is not to accumulate net assets, as this amount increases or decreases over time, such amount represents a useful indicator of whether the financial position of the Municipality is either improving or deteriorating, respectively.

2. Statement of Activities

The SA presents information showing how the Municipality's net assets changed during the fiscal year ended June 30, 2010, by presenting all of the Municipality's revenues and expenses. As previously discussed, the items reported in SA are measured in a manner similar to the approach used by a commercial enterprise in that revenues are recognized when earned or established criteria are satisfied, and expenses are recorded when incurred by the Municipality. Consequently, revenues are reported even when they may not be collected for several months after the end of the fiscal year and expenses are recorded even though they may not have used cash during the current year.

Although SA looks different from a commercial enterprise's income statement, the difference is only in format, not substance. Whereas the bottom line in a commercial enterprise represents its net income, the Municipality reports an amount described as *net change in net assets*, which is essentially the same concept.

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The focus of SA is on the *net cost* of various activities provided by the Municipality. The statement begins with a column that identifies the cost of each of the Municipality's major functions. Another column identifies the revenues that are specifically related to the classified governmental functions. The difference between the expenses and revenues related to specific functions/programs identifies the extent to which each function of the Municipality draws from general revenues or is self-financing through fees, intergovernmental aid, and other sources of resources.

This statement also presents a comparison between direct expenses and program revenues for each function of the Municipality.

GWFS and FFS present all of the Municipality's governmental activities, which are supported mostly by taxes, intergovernmental revenues (such as federal and state grants and contributions), and charge for services. All services normally associated with the Municipality fall into this category, including culture, recreation and education; general government; health and sanitation; public safety; welfare and housing assistance; and urban and economic development.

b) Fund Financial Statements

The Municipality's FFS 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, the results of operations of the Municipality's governmental funds, with an emphasis on the Municipality's major 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. All of the funds of the Municipality can be divided into two categories: governmental funds and proprietary funds.

1. Governmental funds

Governmental funds are used to account for most of the services provided by the Municipality. These funds are used to account for essentially the same functions reported as governmental activities in the GWFS. Unlike GWFS, the focus of governmental funds in the FFS is directed to specific activities of the Municipality rather than the Municipality as a whole; therefore, governmental funds in FFS report the Municipality's operations in more detail than the GWFS.

Governmental funds in FFS provide a detailed short term view of the Municipality's finances that assist in determining whether there will be adequate financial resources available to meet the current needs of the Municipality, which is, evaluating the Municipality's near-term financing requirements. For financial reporting purposes, the Municipality classifies its governmental funds within the following types: (1) general fund, (2) debt service fund, (3) special revenue funds, (4) capital projects funds and (5) permanent funds.

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Governmental funds FFS are prepared on an accounting basis that is significantly different from that used to prepare GWFS. In general, governmental funds FFS focus on near-term inflows and outflows of expendable financial resources, consequently, they measure and account for cash and other assets that can easily be converted to cash. For example, amounts reported on the balance sheet include capital assets within a very short period of time, but do not include capital assets such as land and buildings. Governmental fund liabilities generally include amounts that normally are going to be paid within a short period after the end of the fiscal year. The difference between a fund's total assets and total liabilities is reported as the fund balance or deficit, and generally indicates the amount that can be used to finance the next fiscal year's activities. Likewise, the operating statement for governmental funds reports only those revenues and expenditures that were collected in cash or paid with cash, respectively, during the current fiscal year or very shortly after the end of the fiscal year.

Because the focus of governmental funds FFS is narrower than that of the GWFS, it is useful to compare the fund information presented for governmental funds with similar information presented for governmental activities in the GWFS. By doing so, readers may better understand the long-term impact of the Municipality's near-term financial decisions. Both the governmental funds' balance sheet and the governmental funds' statement of revenues, expenditures and changes in fund balances provide a reconciliation to facilitate the comparison between governmental funds and the governmental-activities reported in the government-wide financial statements.

The Municipality has three major governmental funds. Each major fund is presented in a separate column in the balance sheet – governmental funds and the statement of revenues, expenditures and changes in fund balances – governmental funds. The three major governmental funds are: (1) general fund, (2) debt service fund, and (3) Capital improvement bond fund.

c) Notes to Basic Financial Statements

The NBFS provide additional information that is essential for a full understanding of the data provided in the GWFS and FFS. The NBFS can be found immediately following the basic financial statements.

d) Other Supplementary Information

The basic financial statements are followed by a section of other supplementary information consisting of budgetary comparison schedule – general fund.

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COMMONWEALTH OF PUERTO RICO**
Management's Discussion and Analysis
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FINANCIAL ANALYSIS OF GOVERNMENT-WIDE FINANCIAL STATEMENTS

The Municipality's overall financial position and operations at June 30, 2010 and 2009 are summarized as follows, based on the information included in the accompanying statement of net assets:

	<u>Governmental activities</u>		<u>Change</u>	
	<u>2010</u>	<u>2009</u> <u>(as restated)</u>	<u>\$</u>	<u>%</u>
Assets:				
Current assets	\$16,780,168	\$ 9,732,742	\$7,047,426	71%
Non-current assets:				
Capital assets, net	24,079,297	24,735,648	(656,351)	(3%)
Total assets	<u>40,859,465</u>	<u>34,468,390</u>	<u>6,391,075</u>	<u>19%</u>
Liabilities:				
Current liabilities, excluding long-term obligations	8,715,334	9,931,192	(1,215,858)	(12%)
Long-term obligations:				
Due within one year	4,389,694	3,062,474	1,327,220	43%
Due after one year	24,161,377	19,068,399	5,092,978	27%
Total liabilities	<u>37,266,405</u>	<u>32,062,065</u>	<u>5,204,340</u>	<u>16%</u>
Net assets (deficit):				
Invested in capital assets, net of related debt	20,149,031	21,277,638	(1,128,607)	(5%)
Restricted	3,305,307	1,635,296	1,670,011	102%
Unrestricted	(19,861,278)	(19,150,136)	(711,142)	4%
Total net assets	<u>\$ 3,593,060</u>	<u>\$ 3,762,798</u>	<u>\$ (169,738)</u>	<u>(5%)</u>

At June 30, 2010, the Municipality's current assets, amounting to \$16,780,168 are mainly composed of restricted and unrestricted cash and cash equivalents (\$1,351,856), restricted cash with fiscal agent (\$12,728,007), and restricted and unrestricted intergovernmental grants and contributions receivable (\$2,514,019).

The restricted cash represents resources legally designated for: (1) the payment of debt service, (2) the acquisition, construction and improvement of major capital assets, and (3) the operations of federally and state funded grant programs. Restricted cash also consists of unspent proceeds of bonds issued for acquisition, construction and improvement of major capital assets, and to pay operational debts.

The Municipality's non-current assets, amounting to \$24,079,297 at June 30, 2010, are substantially composed of capital assets, with a cost basis of \$31,115,655, which are reported net of accumulated depreciation and amortization of \$7,036,358.

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At June 30, 2010, the Municipality's current liabilities amounting to \$8,715,334 are mainly composed of unearned revenues (\$1,245,192) accounts payable and accrued liabilities (\$4,469,714), and intergovernmental payables (\$3,000,428). Unearned revenues principally consist of unearned revenues associated with municipal license taxes and intergovernmental grants and contributions related to state and federally funded grant programs.

The Municipality's non-current liabilities, amounting to \$28,551,071 at June 30, 2010, are mainly composed of portion due within one year of bonds and notes payable (\$900,998), and the portion due after one year of bonds and notes payable (\$22,477,832).

As noted earlier, net assets may serve over time as a useful indicator of the Municipality's financial position. The assets of the Municipality exceeded liabilities by \$3,593,060 at June 30, 2010. The most significant portion of net assets (\$20,149,031) reflects the Municipality's investment in capital assets (e.g. land, buildings, machinery, equipment, furniture, fixtures, infrastructure, etc.), net of all related debt still outstanding that was issued to acquire, construct or improve those assets. The Municipality uses these capital assets to provide services to its citizens; consequently, these assets are not available for future spending. Although the Municipality's investment in capital assets is reported net of the outstanding related debt, the resources needed to repay that debt must be provided by other sources, since capital assets cannot be used to liquidate these liabilities.

Another significant portion of net assets (\$3,305,307) at June 30, 2010, represents resources that are restricted for debt service payments and to finance the operations of federal and state funded programs.

The remaining component of total net assets consists of unrestricted net liabilities amounting to (\$19,861,278) at June 30, 2010. These unrestricted net liabilities are the consequence of previous budgets that did not provide sufficient funding for incurred long-term obligations, such as bonds and notes payable, compensated absences, etc. Historically, a significant portion of such obligations has been budgeted on a pay-as-you-go basis.

The total net assets of the Municipality decreased by \$169,738 for the fiscal year ended June 30, 2010. Such decrease is due to the excess of total expenses (\$15,487,100), including depreciation and amortization of capital assets of (\$750,145), over total revenues (\$15,317,362) for the fiscal year ended June 30, 2010.

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**MUNICIPALITY OF SANTA ISABEL,
COMMONWEALTH OF PUERTO RICO**
Management's Discussion and Analysis
Fiscal Year Ended June 30, 2010

The following is a condensed presentation of the Municipality's results of operations as reported in the statement of activities for the fiscal years ended June 30, 2010 and 2009:

	Governmental activities		Change	
	2010	2009 (as restated)	\$	%
Program revenues:				
Program-specific operating grants and contributions	\$1,360,389	\$3,164,868	\$ (1,804,479)	(57%)
Program-specific capital grants and contributions	2,655,387	2,210,219	445,168	20%
Charges for services	30,721	82,636	(51,915)	(63%)
Total program revenues	<u>4,046,497</u>	<u>5,457,723</u>	<u>(1,411,226)</u>	<u>(100%)</u>
General revenues:				
Property taxes	3,269,583	2,432,940	836,643	34%
Municipal license taxes	1,231,128	1,075,319	155,809	14%
Sales and use taxes	1,842,585	1,821,430	21,155	1%
Construction excise taxes	402,648	504,754	(102,106)	(20%)
Unrestricted grants and contributions	4,287,313	4,515,383	(228,070)	(5%)
Other general revenues (various sources)	237,608	304,310	(66,702)	(22%)
Total general revenues	<u>11,270,865</u>	<u>10,654,136</u>	<u>616,729</u>	<u>(11%)</u>
Total revenues	<u>15,317,362</u>	<u>16,111,859</u>	<u>(794,497)</u>	<u>(111%)</u>
Program expenses:				
General government	3,887,303	7,536,279	(3,648,976)	(48%)
Urban and economic development	6,562,561	2,615,340	3,947,221	151%
Health and sanitation	733,506	1,276,118	(542,612)	(43%)
Public safety	714,939	877,673	(162,734)	(19%)
Public housing and welfare	2,379,609	2,698,128	(318,519)	(12%)
Culture, recreation and education	826,124	1,332,533	(506,409)	(38%)
Interest on long-term obligations	383,058	730,896	(347,838)	(48%)
Total expenses	<u>15,487,100</u>	<u>17,066,967</u>	<u>(1,579,867)</u>	<u>(9%)</u>
Net increase (decrease) in net assets	(169,738)	(955,108)	785,370	(82%)
Net assets, at beginning of fiscal year, as restated	3,762,798	4,717,906	(955,108)	(20%)
Net assets, at end of fiscal year	<u>\$3,593,060</u>	<u>\$3,762,798</u>	<u>\$ (169,738)</u>	<u>(5%)</u>

As previously mentioned, the Municipality's total net assets decreased by \$169,738 during the current fiscal year. Approximately 44% (\$6,745,944) of the Municipality's total revenues for the current fiscal year came from property, municipal license, construction excise and sales and use taxes, while 54% (\$8,303,089) resulted from restricted and unrestricted capital and operating grants and contributions. Charges for services and other revenues, amounting to \$268,329, provided 4% of the total revenues for the current fiscal year.

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Management's Discussion and Analysis
Fiscal Year Ended June 30, 2010

The Municipality's expenses cover a wide range of services. The largest expenses of the Municipality for the fiscal year ended June 30, 2010 were related to: (1) general administrative and operating costs (\$3,887,303), which were classified as "general government" and accounted for 25% of total expenses, (2) welfare and housing assistance (\$826,124), which accounted for 5% percent of total expenses, (3) health and sanitation (\$714,939), which accounted for 5% of total expenses, (4) urban and economic development (\$6,562,561), which accounted for 42% of total expenses, (5) public safety (\$733,506), which accounted for 5% of total expenses, (6) culture, recreation and education (\$2,379,609), which accounted for 15% of total expenses, and (7) interest on long-term obligations (\$383,058), which accounted for 2% of total expenses. These expenses include depreciation of capital assets and deferred charges in the amount of \$750,145, for the fiscal year ended June 30 2010.

FINANCIAL ANALYSIS OF GOVERNMENTAL ACTIVITIES

Analysis of Financial Position of Governmental Funds

As discussed earlier, the Municipality uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. The focus of the Municipality's governmental funds is to provide information on near-term inflows, outflows, and balances of expendable resources. Such information is useful in assessing the Municipality's compliance with finance-related legal requirements. Specifically, unreserved fund balance may serve as a useful measure of the Municipality's net resources available for spending at the end of the fiscal year.

At June 30, 2010, the total assets of governmental funds amounted to \$18,125,057, which consisted principally of: (1) cash and cash equivalents of \$1,351,856 (7%), (2) cash in fiscal agent of \$12,728,007 (70%), (3) property and sales taxes, intergovernmental, accrued interests and other receivables of \$2,700,305 (15%). Such assets include cash, cash equivalents and receivables that are principally used for debt service, capital projects, encumbrances and other specific purposes.

At June 30, 2010, the total liabilities of governmental funds amounted to \$11,582,079, which consisted principally of: (1) deferred revenues of \$2,294,048 (20%), (2) accounts payable and accrued liabilities of \$4,280,542 (37%), (3) intergovernmental accounts payable of \$3,000,428 (26%) and matured bonds and interests due and payable of \$662,172 (6%).

The total fund balances of governmental funds amounted to \$6,542,978 at June 30, 2010, of which \$6,851,657 are reserved for capital projects, debt service, encumbrances and other specific purposes, while \$308,679 represent unreserved fund deficit. The fund balances of governmental funds increased by \$6,954,622 during the fiscal year ended June 30, 2010, principally due to proceed from bonds issuance (\$7,310,000) during the current year.

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**MUNICIPALITY OF SANTA ISABEL,
COMMONWEALTH OF PUERTO RICO**
Management's Discussion and Analysis
Fiscal Year Ended June 30, 2010

The following table presents the condensed financial position of governmental funds at June 30, 2010 and 2009:

	2010	2009 (as restated)
<i>Assets:</i>		
Total assets - major governmental funds	\$ 15,086,288	\$ 8,856,535
Total assets - other governmental funds	3,038,769	1,832,680
Combined total assets	18,125,057	10,689,215
<i>Liabilities:</i>		
Total liabilities - major governmental funds	9,680,553	9,722,134
Total liabilities - other governmental funds	1,901,526	1,378,725
Combined total liabilities	11,582,079	11,100,859
<i>Fund balances (deficits):</i>		
Reserved - major governmental funds	5,714,414	5,369,331
Reserved - other governmental funds	1,137,243	453,955
Unreserved - major governmental funds	(308,679)	(6,234,930)
Combined total fund balances	6,542,978	(411,644)
<i>Total liabilities and fund balances</i>	\$ 18,125,057	\$ 10,689,215

Major Governmental Funds

General fund (GF) – The GF is the principal operating fund of the Municipality. The GF's total assets amounted to \$9,039,644 at June 30, 2010. Such assets consist principally of: (1) Cash in commercial banks (\$372,125), (2) sales and use tax receivables (\$124,163), (3) short-term amounts due from other funds (\$890,194), (4) due from governmental entities (\$1,048,856), and (5) restricted cash in fiscal agent (\$6,599,505).

The GF's total liabilities amounted to \$8,681,207 at June 30, 2010. Such liabilities are composed mainly of: (1) deferred revenues (\$2,014,235), and (2) accounts payable and accrued liabilities, including amounts due to other governments (\$6,212,277).

At the end of the current fiscal year, reserved fund balance for encumbrances and other specified purposes reached \$667,116, unreserved fund deficit of the GF amounted to \$308,679, while total fund balance reached \$358,437.

Capital improvement bond fund (CIBF)- The CIBF's total assets amounted to \$3,352,234 at June 30, 2010, which consist of restricted cash with fiscal agent (\$3,352,234). The CIBF's total liabilities amounted to \$337,174 at June 30, 2010, which are composed mainly of accounts payable and accrued liabilities (\$325,490). At the end of the current fiscal year, the CIBF had total reserved fund balances amounted to \$3,015,060.

**MUNICIPALITY OF SANTA ISABEL,
COMMONWEALTH OF PUERTO RICO**
Management's Discussion and Analysis
Fiscal Year Ended June 30, 2010

Debt service fund (DSF)- The DSF's total assets amounted to \$2,694,410 at June 30, 2010, which consist mainly of restricted cash in fiscal agent (\$2,637,088). The DSF's total liabilities amounted to \$662,172 at June 30, 2010, which are mainly composed of: (1) matured bonds due and payable (\$473,000), and (2) matured interest due and payable (\$189,172). At the end of the current fiscal year, DSF's total and reserved fund balance reached \$2,032,238.

Other governmental funds (OGF)- The OGF's total assets amounted to \$3,038,769 at June 30, 2010, which consist mainly of restricted cash and cash equivalents (\$979,731), restricted cash in fiscal agent (\$139,180), due from other governmental funds (\$454,695), and receivables from intergovernmental grants and contributions (\$1,465,163). The OGF's total liabilities amounted to \$1,901,526 at June 30, 2010, which are mainly composed of deferred revenues (\$279,813), accounts payable and accrued liabilities (\$743,203) and short-term amounts due to other funds (\$878,510). At the end of the current fiscal year, OGF's total reserved fund balance reached \$1,137,243.

Analysis of Operating Results of Governmental Funds

Major Governmental Funds

General fund – The total fund deficit of the GF decreased by \$6,593,367 during current fiscal year, principally due to proceed from bonds issuance to pay operational debts. Total revenues, expenditures and other financing sources (net) amounted to \$9,652,073, \$10,192,721, and \$7,134,015, respectively, for the fiscal year ended June 30, 2010.

Approximately 52% (\$5,048,832) of the GF's total revenues for the current fiscal year came from property, municipal license, construction excise and sales and use taxes, while 46% (\$4,408,124) resulted from intergovernmental grants and contributions. Interest revenues, charges for services and miscellaneous revenues, amounting to \$195,117, provided 2% of the total revenues for the current fiscal year.

The largest expenses of the GF for the fiscal year ended June 30, 2010 were related to: (1) general administrative and operating costs (\$4,114,551), which were classified as "general government" and accounted for 40% of total expenses, (2) welfare and housing assistance (\$373,515), which accounted for 4% percent of total expenses, (3) health and sanitation (\$643,252), which accounted for 6% of total expenses, (4) urban and economic development (\$4,228,684), which accounted for 42% of total expenses, (5) public safety (\$553,277), which accounted for 5% of total expenses, and (6) culture, recreation and education (\$279,442), which accounted for 3% of total expenses.

Capital improvement bond fund (CIBF)- The total fund balance of the CIBF decreased by \$1,172,930 during current fiscal year. Total expenditures amounted to \$1,172,930 for the fiscal year ended June 30, 2010.

CIBF's total expenditures for the current fiscal year came from culture, recreation and education (\$1,160,693), and urban and economic development (\$12,237).

**MUNICIPALITY OF SANTA ISABEL,
COMMONWEALTH OF PUERTO RICO**
Management's Discussion and Analysis
Fiscal Year Ended June 30, 2010

Debt service fund (DSF) – The total fund balance of the DSF increased by \$850,897 during current fiscal year. Total revenues, expenditures and other financing sources (net) amounted to \$1,697,705, \$1,007,058 and \$160,250, respectively, for the fiscal year ended June 30, 2010.

Approximately 75% (\$1,277,492) of DSF's total revenues for the current fiscal year came from restricted property taxes, while 25% (\$419,620) came from restricted sales and use taxes. DSF's total expenditures for the current fiscal year came from principal and interests on bonds payable (\$1,007,058).

Other governmental funds (OGF) – The total fund balance of the OGF increased by \$683,288 during current fiscal year. Total revenues, expenditures and other financing uses (net) amounted to \$4,088,395, \$3,420,842 and \$15,735, respectively, for the fiscal year ended June 30, 2010. Approximately 98% (\$4,015,776) of OGF's total revenues for the current fiscal year came from intergovernmental grants.

The largest expenses of the OGF for the fiscal year ended June 30, 2010 were related to: (1) urban and economic development (\$2,158,648), which accounted for 63% of total expenses, (2) welfare and housing assistance (\$444,494), which accounted for 13% percent of total expenses, and (3) culture, recreation and education (\$720,042), which accounted for 21% of total expenses.

BUDGETARY HIGHLIGHTS

a) General Fund

The original and the final budget of the general fund for the fiscal year ended June 30, 2010 amounted to \$11,075,700. Over the course of the fiscal year, the Municipality revised the GF's budget in order to include increases and decreases in revenues that were identified during the course of the fiscal year based on current developments that positively affected the Municipality's finances. The laws and regulations of the Commonwealth mandate a balanced budget.

The total actual revenues (budgetary basis) of the general fund for the fiscal year ended June 30, 2010 were \$9,581,817, which is 13% (\$1,493,883) lower than the budgeted revenues. In addition, the total actual expenditures (budgetary basis) of the general fund for the fiscal year ended June 30, 2010 were \$9,663,119, which is 11% (\$1,199,256), lower than the budgeted expenditures.

The most significant fluctuations in actual revenues occurred in construction excise taxes which had actual revenues that were \$2,047,827 lower than budgeted, and in property taxes and intergovernmental grants and contributions, which had actual revenues that were \$192,065 and \$221,324 more than budgeted, respectively.

Also, the most significant fluctuations in actual expenditures and encumbrances occurred in general government, which had actual expenditures and encumbrances that were \$644,189 lower than budgeted, and public housing and welfare, and culture, recreation and education, which had actual expenditures and encumbrances that were \$179,746 and \$250,539 lower than budgeted, respectively.

**MUNICIPALITY OF SANTA ISABEL,
COMMONWEALTH OF PUERTO RICO**
Management's Discussion and Analysis
Fiscal Year Ended June 30, 2010

CAPITAL ASSETS AND DEBT ADMINISTRATION

a) Capital Assets

The Municipality has invested \$31,115,655 in capital assets used in governmental activities, which have an accumulated depreciation and amortization of \$7,036,358 at June 30, 2010. The net capital assets of governmental activities increased during the current fiscal year due to the current fiscal year's capital additions (\$93,794), which were partially offset by the depreciation and amortization expense (\$750,145), and capital assets disposal (\$33,026) for the same period.

b) Debt Administration

The Municipality finances a significant portion of its construction activities through bond and note issuances, and through 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.

At June 30, 2010, the Municipality's total bonded debt amounted to \$21,687,500, consisting of bonds payable. Such debt is backed by the full faith and credit of the Municipality. The following is a summary of the debt activity for the fiscal year ended June 30, 2010:

- Bonds payable increased by 45% (\$6,686,500) by the net effect of total principal payments on bonds (\$623,500) and bond issuance (\$7,310,000) made during the current fiscal year.
- The Municipality has also certain outstanding notes payable due to Puerto Rico Treasury Department (\$1,399,599). During the year, notes payable to the Treasury Department decreased by 12% by the total principal payments on notes (\$198,471) made during the current fiscal year.
- The Municipality has also certain outstanding notes payable due to CRIM (\$1,018,789). Such notes payable decreased by \$52,225 during the current fiscal year mainly due to the principal payments made during the same period.
- Furthermore, the Municipality has estimated the landfill closure and post closure care costs in approximately \$1,393,700.

c) Authorization to issue General Obligation Bonds

The Municipality Legislative branch authorized the issuance of \$2,670,000 of general obligation bond subsequent to the year ended on June 30, 2010 principally to finance debts with other governmental entities, suppliers and contractors pending at June 30, 2010. These liabilities were recorded as long term liabilities in the governmental activities in the accompanying statement of net assets.

**MUNICIPALITY OF SANTA ISABEL,
COMMONWEALTH OF PUERTO RICO**
Management's Discussion and Analysis
Fiscal Year Ended June 30, 2010

REQUEST FOR INFORMATION

This financial report is designed to provide a general overview of the Municipality's finances for all of the Municipality's citizens, taxpayers, customers, investors and creditors. This financial report seeks to demonstrate the Municipality's accountability for the money it receives. Questions concerning any of the information provided in this report or requests for additional information should be addressed to the Municipality of Santa Isabel, Department of Finance.

Commonwealth of Puerto Rico
Municipality of Santa Isabel
Statement of Net Assets
June 30, 2010

Assets

Current assets:

Cash in commercial banks	\$	372,125
Accounts receivable, net of allowance for doubtful accounts:		
Property taxes		22,031
Intergovernmental		2,514,019
Sales tax		159,454
Interest		4,551
Miscellaneous		250
Restricted assets :		
Cash with commercial banks		979,731
Cash with fiscal agent		12,728,007
Total current assets		16,780,168

Noncurrent assets:

Capital assets, net of accumulated depreciation and amortization of \$7,036,358		24,079,297
Total noncurrent assets		24,079,297
Total assets	\$	40,859,465

Current Liabilities (due within one year):

Accounts payable	\$	4,280,542
Intergovernmental payables		3,000,428
Accrued interest payable on long-term debt		189,172
Deferred revenues		1,245,192
Current portion of long-term obligations:		
Bonds payable		628,000
Other debts		3,761,694
Total current liabilities		13,105,028

Noncurrent liabilities (due in more than one year):

Total liabilities	\$	24,161,377
		37,266,405

Net assets (liabilities):

Invested in capital assets, net of related debt	\$	20,149,031
Restricted for:		
Capital projects		625,460
Debt service		2,505,238
Other specified purposes		174,609
Unrestricted net assets		(19,861,278)
Total net assets	\$	3,593,060

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, 2010

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	\$ 3,887,303	\$ -	\$ -	\$ -	\$ (3,887,303)
Urban and economic development	6,562,561	4,000	312,677	2,615,763	(3,630,121)
Public safety	733,506	6,438	24,471	39,624	(662,973)
Health and sanitation	714,939	20,283	36,541	-	(658,115)
Culture, recreation and education	2,379,609	-	-	-	(2,379,609)
Welfare and housing assistance	826,124	-	986,700	-	160,576
Interest on long-term obligation	383,058	-	-	-	(383,058)
Total governmental activities	<u>\$ 15,487,100</u>	<u>\$ 30,721</u>	<u>\$ 1,360,389</u>	<u>\$ 2,655,387</u>	<u>\$ (11,440,603)</u>

General Revenues:

Taxes:

Property taxes	3,269,583
Municipal license taxes	1,231,128
Sales taxes	402,648
Construction excise taxes	1,842,585
Total taxes	<u>6,745,944</u>
Grants and contributions, not restricted to specific programs	4,287,313
Interests on deposits	79,855
Miscellaneous	157,753
Total general revenues	<u>11,270,365</u>
Net changes in net assets	(169,738)
Net assets at beginning of the year, as restated	3,762,798
Net assets at the end of the year	<u>\$ 3,593,060</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, 2010

	MAJOR FUNDS				Total Governmental Funds
	General Fund	Capital Improvement Bonds Fund	Debt Service	Other Nonmajor Fund	
ASSETS					
Cash in commercial banks	\$ 372,125	\$ -	\$ -	\$ -	\$ 372,125
Account receivable, net of doubtful accounts:					
Property taxes	-	-	22,031	-	22,031
Sales tax	124,163	-	35,291	-	159,454
Interest	4,551	-	-	-	4,551
Other	250	-	-	-	250
Due from other funds	890,194	-	-	454,695	1,344,889
Due from governmental entities	1,048,856	-	-	1,465,163	2,514,019
Restricted assets:					
Cash in commercial bank	-	-	-	979,731	979,731
Cash in fiscal agent	6,599,505	3,352,234	2,637,088	139,180	12,728,007
Investments	-	-	-	-	-
Total assets	<u>\$ 9,039,644</u>	<u>\$ 3,352,234</u>	<u>\$ 2,694,410</u>	<u>\$ 3,038,769</u>	<u>\$ 18,125,057</u>
LIABILITIES					
Accounts payable	3,211,849	325,490	-	743,203	4,280,542
Intergovernmental	3,000,428	-	-	-	3,000,428
Due to other funds	454,695	11,684	-	878,510	1,344,889
Deferred revenue	2,014,235	-	-	279,813	2,294,048
Matured bonds due and payable	-	-	473,000	-	473,000
Matured interests due and payable	-	-	189,172	-	189,172
Total liabilities	<u>8,681,207</u>	<u>337,174</u>	<u>662,172</u>	<u>1,901,526</u>	<u>11,582,079</u>
FUND BALANCE					
Reserved for:					
Encumbrances	134,315	-	-	-	134,315
Debt service	-	-	2,032,238	-	2,032,238
Capital projects	-	3,015,060	-	962,634	3,977,694
Other specified purposes	532,801	-	-	174,609	707,410
Unreserved, reported in:					
General fund	(308,679)	-	-	-	(308,679)
Total fund balances	<u>358,437</u>	<u>3,015,060</u>	<u>2,032,238</u>	<u>1,137,243</u>	<u>6,542,978</u>
TOTAL LIABILITIES AND FUND BALANCE	<u>\$ 9,039,644</u>	<u>\$ 3,352,234</u>	<u>\$ 2,694,410</u>	<u>\$ 3,038,769</u>	<u>\$ 18,125,057</u>

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 the Balance Sheet - Governmental Funds
 to the Statement of Net Assets
 June 30, 2010

Aggregate fund balance reported in the balance sheet - governmental funds	\$ 6,542,978
Governmental activities' amounts reported in the statement of net assets and the balance sheet - governmental funds are different because:	
Capital assets used in governmental activities are not financial resources, therefore, are not reported in the governmental funds	24,079,297
Deferred (unavailable) revenues in the governmental funds that are recorded as revenues in the statement of activities	1,048,856
The following liabilities are not due (mature) in the current period, therefore, are not reported in the governmental funds:	
Accrued employees' christmas bonus	(166,651)
Compensated absences	(1,309,845)
Bonds and notes payable	(21,214,500)
Debt to intergovernmental agencies	(3,731,168)
Debt to suppliers	(262,207)
Landfill closure and postclosure care costs	<u>(1,393,700)</u>
Net assets as reported in the accompanying statement of net assets	<u>\$ 3,593,060</u>

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 the Balance Sheet - Governmental Funds
 to the Statement of Net Assets
 June 30, 2010

Aggregate fund balance reported in the balance sheet - governmental funds	\$ 6,542,978
Governmental activities' amounts reported in the statement of net assets and the balance sheet - governmental funds are different because:	
Capital assets used in governmental activities are not financial resources, therefore, are not reported in the governmental funds	24,079,297
Deferred (unavailable) revenues in the governmental funds that are recorded as revenues in the statement of activities	1,048,856
The following liabilities are not due (mature) in the current period, therefore, are not reported in the governmental funds:	
Accrued employees' christmas bonus	(166,651)
Compensated absences	(1,309,845)
Bonds and notes payable	(21,214,500)
Debt to intergovernmental agencies	(3,731,168)
Debt to suppliers	(262,207)
Landfill closure and postclosure care costs	(1,393,700)
Net assets as reported in the accompanying statement of net assets	<u>\$ 3,593,060</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, 2010

	MAJOR FUNDS				Total Governmental Funds
	General Fund	Capital Improvement Bonds Fund	Debt Service	Other Non-major Funds	
REVENUES					
Taxes:					
Property taxes	\$ 1,992,091	\$ -	\$ 1,277,492	\$ -	\$ 3,269,583
Municipal license	1,231,128	-	-	-	1,231,128
Construction excise taxes	402,648	-	-	-	402,648
Sales tax	1,422,965	-	419,620	-	1,842,585
Charges of service	15,804	-	-	14,917	30,721
Intergovernmental grants and contributions:					
Federal government	-	-	-	2,167,071	2,167,071
State government	4,408,124	-	-	1,848,705	6,256,829
Investment earnings	79,262	-	593	-	79,855
Miscellaneous	100,051	-	-	57,702	157,753
Total Revenues	<u>\$ 9,652,073</u>	<u>\$ -</u>	<u>\$ 1,697,705</u>	<u>\$ 4,088,395</u>	<u>\$ 15,438,173</u>
EXPENDITURES					
Current:					
General government	4,114,551	-	-	-	4,114,551
Urban and economic development	4,228,684	12,237	-	2,158,648	6,399,569
Public safety	553,277	-	-	97,658	650,935
Health and Sanitation	643,252	-	-	-	643,252
Culture, recreation and education	279,442	1,160,693	-	720,042	2,160,177
Welfare and housing assistance	373,515	-	-	444,494	818,009
Debt service:					
Principal	-	-	624,000	-	624,000
Interest	-	-	383,058	-	383,058
Total Expenditures	<u>10,192,721</u>	<u>1,172,930</u>	<u>1,007,058</u>	<u>3,420,842</u>	<u>15,793,551</u>
Excess (Deficiency) of Revenues over expenditures	<u>(540,648)</u>	<u>(1,172,930)</u>	<u>690,647</u>	<u>667,553</u>	<u>(355,378)</u>
OTHER FINANCING SOURCES (USES)					
Transfer in from other funds	-	-	160,250	15,735	175,985
Transfer out to other funds	(175,985)	-	-	-	(175,985)
Special Items	-	-	-	-	-
Proceeds from bond issuance	7,310,000	-	-	-	7,310,000
Total Other Financing Sources (uses)	<u>7,134,015</u>	<u>-</u>	<u>160,250</u>	<u>15,735</u>	<u>7,310,000</u>
NET CHANGE IN FUND BALANCES (DEFICITS)	6,593,367	(1,172,930)	850,897	683,288	6,954,622
FUND BALANCE (DEFICIT) AT BEGINNING OF YEAR, AS RESTATED	<u>(6,234,930)</u>	<u>4,187,990</u>	<u>1,181,341</u>	<u>453,955</u>	<u>(411,644)</u>
FUND BALANCE AT END OF YEAR	<u>\$ 358,437</u>	<u>\$ 3,015,060</u>	<u>\$ 2,032,238</u>	<u>\$ 1,137,243</u>	<u>\$ 6,542,978</u>

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 30,2010

Net change in fund balances- total governmental funds \$ 6,954,622

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 PREPA Contribution in Liue of Taxes Revenue Deferred in GFFS	235
Net Change in State Treasury Department Christmas Bonus Reimbursement Deferred in GFFS	(121,046)

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

Net Change in Compensated Absences Liability	(11,863)
Net Change in Christmas Bonus	(506)
Landfill Closure and Post closure care costs	(66,367)
Net Change in PREPA Contribution in Liue of Taxes Liability	121,046
Other intergubernamental debts	250,696
CRIM Final Settlement - Fiscal Year 2009-2010	(26,704)

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 the amount by which capital outlays exceed depreciation expenses. (656,351)

Repayment of principal of long-term obligation is an expenditures in the governmental funds, but the repayment reduces long-term liabilities in the statement of net assets 696,500

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 (7,310,000)

Net changes in net assets reported in the accompanying statements of activities \$ (169,738)

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, 2010

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) 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, 2010, in conformity with accounting principles generally accepted in the United States of America, as prescribed by the Governmental Accounting Standards Board (GASB).

According to the financial reporting model established by GASB Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments* (GASB No. 34), the minimum required financial statement 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).

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, 2010, 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.

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 –

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Accounting and Financial Reporting for Nonexchange 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.

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.

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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, 2010 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.

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,

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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.

- **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, 2010, 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

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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

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.

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- **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.

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, sales taxes and construction excise taxes are reported as general revenues. All other nontax 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 manner similar to private

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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).

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 and nonmajor 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 provided 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 major fund, as defined below, used by the Municipality to account for the accumulation of resources for, and the payment of, principal

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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 nonmajor 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.

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 nonmajor 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 nonmajor 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 nonoperating

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revenues (net of allowances), except for other financing sources. Total expenditures for these purposes mean all expenditures, including operating and nonoperating 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 capital improvement bond fund, and (3) debt service fund.

The Capital Improvement Bond Fund is a major capital projects fund used to account for proceeds of general obligation, public improvement or special obligation bonds. These proceeds are used for the acquisition, construction or improvement of major capital facilities and other assets.

The Debt Service are used to account for the accumulation of recourses for and the payment of, general long-term debt principal, interest, and related cost.

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 nonexchange transactions are recorded using the criteria set forth by GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions* (GASB No. 33), which the Municipality adopted on July 1, 2003. GASB No. 33 established accounting and reporting standards for nonexchange transactions involving cash and financial or capital resources (for example, most taxes, grants and private donations). In a nonexchange 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 nonexchange transactions into the following four

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classes in the accompanying basic financial statements: (a) derived tax revenues, (b) imposed nonexchange revenues, (c) government mandated nonexchange transactions, and (d) voluntary nonexchange 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 nonexchange 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 nonexchange 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 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 nonexchange transactions (such as donations and 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 nonexchange transactions discussed above.

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

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Events that are neither exchange nor nonexchange 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, 2010, 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, 2010. 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 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 nonexchange transactions are recorded in a similar manner to the GWFS, using the previously discussed criteria set forth by GASB No. 33 for nonexchange 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.

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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) is recorded as expenditure 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).
- 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.
- Executory 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.

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Under the 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 31, respectively. The Commissioner preliminarily 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.

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 it 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

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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.

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, 2010. Further details of the Municipality's budgetary control at the legal level may be obtained from the

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Budgetary Liquidation Report for the fiscal year ended June 30, 2010. 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.

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 noninterest 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.

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h) Unrestricted and Restricted Accounts and Notes Receivable

In the accompanying GWFS, receivables consist of all revenues earned but not collected at June 30, 2010. 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, 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

Inventories consist of materials, supplies, food and medicine inventories held for consumption. Generally, inventories are recorded as expenditures when purchased (purchase method).

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

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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.

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) *Review of Carrying Value of Capital Assets for Impairment*

The Municipality reviews the carrying value of capital assets for impairment whenever a significant and unexpected decline in service utility of a capital asset occurs.

l) *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.

m) *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, 2010 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

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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.

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.

n) 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.

o) 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

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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.

p) 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, 2010. In the past three years, the Municipality has not settled claims that exceeded insurance coverage.

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q) *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.
- *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.
- *Other Specified Purposes* – Represent resources set aside for use in federal and state grant programs accounted for in the special revenue funds.

r) *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.

s) *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

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of the basic financial statements, and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

t) *Future Adoption of Accounting Pronouncements*

The GASB has issued the following standards that have effective dates after June 30, 2010:

- GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions* (GASB No. 54). This Statement establishes fund balance classifications that comprise a hierarchy based primarily on the extent to which a government is bound to observe constraints imposed upon the use of the resources reported in governmental funds. This Statement is effective for periods beginning after June 15, 2010.
- GASB Statement No. 57, *Fund OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans* (GASB No. 57). The objective of this Statement is to address issues related to the use of the alternative measurement method and the frequency and timing of measurements by employers that participate in agent multiple-employer other postemployment benefit (OPEB) plans (that is, agent employers). The provisions of Statement No. 57 related to the use and reporting of the alternative measurement method are effective immediately. The provisions related to the frequency and timing of measurements are effective for actuarial valuations first used to report funded status information in OPEB plan financial statements for periods beginning after June 15, 2011.
- GASB Statement No. 59, *Financial Instruments Omnibus* (GASB No. 59). The objective of this Statement is to update and improve existing standards regarding financial reporting and disclosure requirements of certain financial instruments and external investment pools for which significant issues have been identified in practice. This Statement is effective for periods beginning after June 15, 2010.
- GASB Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements* (GASB No. 60). The objective of this Statement is to improve financial reporting by addressing issues related to service concession arrangements (SCAs), which are a type of public-private or public-public partnership. This Statement is effective for periods beginning after December 15, 2011.
- GASB Statement No. 61, *The Financial Reporting Entity: Omnibus—an amendment of GASB Statements No. 14 and No. 34* (GASB No. 61). The objective of this Statement is to improve financial reporting for a governmental financial reporting entity. The requirements of Statement No. 14, *The Financial Reporting Entity*, and the related financial reporting requirements of Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, were amended to better meet user needs and to address reporting entity issues that have arisen since the issuance of those Statements. This Statement is effective for periods beginning after June 15, 2012.

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- GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and IACPA Pronouncements*. The objective of this Statement is to incorporate into the GASB's authoritative literature certain accounting and financial reporting guidance that is included in the following pronouncements issued on or before November 30, 1989, which does not conflict with or contradict GASB pronouncements; 1) Financial Accounting Standard Board (FASB) Statements and interpretations, 2) Accounting Principles Board Opinions, 3) Accounting Research Bulletins of the American Institute of Certified Public Accountants' (AICPA) Committee on Accounting Procedure. This Statement is effective for periods beginning after December 15, 2011.

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

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 \$250,000 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, 2010. 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, 2010 consists of the following:

	General fund	Capital improvement bond fund	Debt service fund	Nonmajor funds	Totals
Unrestricted (category 1):					
Cash in commercial banks	\$ 372,125	-	-	-	\$ 372,125
Restricted (category 1):					
Cash in commercial banks	-	-	-	979,731	979,731
Restricted (category 3):					
Cash in GDB or CRIM, as fiscal agents	6,599,505	3,352,234	2,637,088	139,180	12,728,007
Total deposits	<u>\$ 6,971,630</u>	<u>3,352,234</u>	<u>2,637,088</u>	<u>1,118,911</u>	<u>\$ 14,079,863</u>

The Municipality's bank balances in commercial banks amounting to \$1,351,856 at June 30, 2010 were fully collateralized (Category 1). The bank balance of deposits in GDB and CRIM, which is uninsured and uncollateralized (Category 3), amounted to \$12,728,007 at June 30, 2010.

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, 2010, 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 \$3 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.

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

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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 \$965,379 at June 30, 2010, which represents municipal licenses collected in advance for the taxable year 2010-2011.

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, 2010 was 8.53% (of which taxpayers pay 8.33% 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, 2010 was 10.53% (of which 10.33% 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

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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.

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.

5. SALES TAX

On July 4, 2006, the Governor of Puerto Rico signed into law the Taxpayer Justice Act (Act No.117, H.B. 2193). The new law imposes a municipal sales tax at a rate of 1.5% (effective July 1, 2006) and the Commonwealth sales tax at the rate of 5.5%, with an effective date of November 15, 2006. Conversely, the Commonwealth of Puerto Rico eliminated the excise tax of 6.6% on some imports (taxes on cigarettes, liquor, and cars are still in effect) and implemented the sales and use tax ("sales tax") system. Accordingly with this law the municipal sales tax is administered at the local level, and the Commonwealth sales tax is administered through the Puerto Rico Treasury Department. Consequently, separate registration and filing forms are required of retailers.

In fiscal year 2006-2007, the Municipal Legislature of the Municipality of Santa Isabel approved an Ordinance establishing a citizenship contribution of 1.0% over all business or personal transactions related to sale of goods and/or services made on the Municipalities boundaries. The resources collected due to this tax assessment will be used in local activities like improvements in health services, improvements in the control and management of solid waste disposal and recycling programs, public improvements, improvements of public safety, and maintenance of all public facilities of the Municipality.

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7. SALES TAX (CONTINUED)

Any person/corporation is required to register with each municipality in which it conducts commercial transactions and in the Puerto Rican Treasury to obtain a Retailer's Registration Certificate, exemption certificates, and tax returns forms. The retailers are required to file and send monthly sales tax returns by the 20th day following the month in which the tax was collected.

Also, on July 29, 2007, the Governor of Puerto Rico signed into Law an amendment of Act No. 117, H.B. 2193 known as Act No. 80. The most significant amendments were: first, to uniform the tax rate at 7% of which the municipalities will collect 1% and the Puerto Rico Treasury Department the other 6%, .05% of the 6% belongs to the municipality and it is distributed through three separate funds: Municipal Development Fund, Municipal Redemption Fund and Municipal Improvements Fund; secondly the establishment of a Local Commercial Rule and the elimination of source and nexus rules to impose the sale and use tax.

These funds are administered by the Government Development Bank for Puerto Rico. Finally, the Law restricts the use of the funds by the municipalities to certain specific activities.

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6. DUE FROM TO GOVERNMENTAL ENTITIES

Intergovernmental receivables and payables recorded in the accompanying GWFS and GFFS are as follows:

	General Fund	Other governmental funds	Total governmental funds	Statement of net assets
<i>Intergovernmental receivables:</i>				
Grants and contributions:				
Puerto Rico Power Authority (PREPA) - 2009-2010 contribution in lieu of tax	\$ 971,452	-	971,452	\$ 971,452
Puerto Rico Office of the Commissioner of Municipal Affairs- Community Development Block Grants Program	-	801,578	801,578	801,578
Puerto Rico Department of Labor – Act. No. 52	-	165,773	165,773	165,773
Puerto Rico Treasury Department – Act. No. 9 of March 9, 2009	-	108,934	108,934	108,934
Puerto Rico Treasury Department – Act. No. 9 of March 9, 2009	-	115,183	115,183	115,183
Puerto Rico Department of Labor – Act. No. 82	-	78,779	78,779	78,779
Puerto Rico Treasury Department – Christmas bonus	77,404	-	77,404	77,404
Puerto Rico Administration for Integral Care and Development of Children	-	43,274	43,274	43,274
Others	-	151,642	151,642	151,642
Total intergovernmental receivables	<u>\$ 1,048,856</u>	<u>1,465,163</u>	<u>2,514,019</u>	<u>\$ 2,514,019</u>
<i>Intergovernmental payables:</i>				
Puerto Rico Treasury Department	\$ 700,000	-	700,167	\$ 700,000
Employees Retirement System of the Government of the Commonwealth of Puerto Rico	996,778	-	996,778	996,778
Puerto Rico Department of Labor	480,700	-	480,700	480,700
Puerto Rico Aqueduct and Sewer Authority	665,250	-	665,250	665,250
Commonwealth of Puerto Rico Employees Association	157,700	-	157,700	157,700
Total intergovernmental payables	<u>\$ 3,000,428</u>	<u>-</u>	<u>3,000,428</u>	<u>\$ 3,000,428</u>

Intergovernmental receivables and payables represent the pending settlements of the aforementioned intergovernmental transactions.

The amount due from Puerto Rico Department of Treasury – Christmas bonus (\$77,404) and (\$971,452) 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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7. 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, 2010 consisted of the following:

Operating transfers-in:				
Operating transfers-out:	Debt service fund	Non major funds	Total	
Major funds:				
General fund	\$ 160,250	\$ 15,735	\$	175,985
Total	\$ 160,250	\$ 15,735	\$	175,985

Due/advances to:	General fund	Capital improvement bonds fund	Nonmajor governmental funds	Total	
Major funds:					
General fund	\$ -	11,684	878,510	\$	890,194
Nonmajor governmental funds	454,695	-	-	\$	454,695
Total	\$ 454,695	11,684	878,510	\$	1,344,889

At June 30, 2010 all amounts due to among funds are considered collectible by the Municipality's management.

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8. CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2010, was as follows:

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

<u>COST BASIS:</u>	Balance at June 30, 2009	Additions/ increases	Disposals/ decreases	Balance at June 30, 2010
Cost basis of capital assets, not subject to depreciation and amortization:				
Land	\$ 1,433,191	-	-	\$ 1,433,191
Construction in progress	8,859,387	-	-5,200,000	3,659,387
Total cost basis of capital assets, not subject to depreciation and amortization	<u>10,292,578</u>	<u>-</u>	<u>-5,200,000</u>	<u>5,092,578</u>
Cost basis of capital assets, subject to depreciation and amortization:				
Buildings, structures and building improvements	12,195,303	5,200,000	-	17,395,303
Infrastructure	4,434,069	-	-	4,434,069
Land Improvements	62,800	-	-	62,800
Licensed vehicles	2,420,436	-	-	2,420,436
Machinery and equipment	1,649,701	93,794	-33,026	1,710,469
to depreciation and amortization	<u>20,762,309</u>	<u>5,293,794</u>	<u>-33,026</u>	<u>26,023,077</u>
Total cost basis of capital assets	<u>\$ 31,054,887</u>	<u>5,293,794.00</u>	<u>-5,233,026</u>	<u>\$ 31,115,655</u>
	Balance at June 30, 2009	Depreciation and Amortization Expense	Reclassifications	Balance at June 30, 2010
<u>ACCUMULATED DEPRECIATION AND AMORTIZATION:</u>				
Buildings, structures and building improvements	\$ 2,599,150	265,861	-	\$ 2,865,011
Infrastructure	1,477,264	175,425	-	1,652,689
Land Improvements	5,840	1,130	-	6,970
Licensed vehicles	1,603,895	167,749	-	1,771,644
Machinery and equipment	633,090	139,980	-33,026	740,044
Total accumulated depreciation and amortization	<u>6,319,239</u>	<u>750,145</u>	<u>-33,026</u>	<u>7,036,358</u>
CAPITAL ASSETS, NET	<u>\$ 24,735,648</u>			<u>\$ 24,079,297</u>

The depreciation expense is detailed as follow:

General government	56,875
Public safety	82,571
Welfare and housing assistance	8,115
Culture recreation and education	219,432
Health and sanitation	5,320
Urban and economic development	377,832
Total depreciation and amortization expense	<u>\$ 750,145</u>

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9. 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 publicly available 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 to become 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 nor 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.

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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.

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.

Required contributions for the fiscal year and two preceding years were as follows:

Type of Contribution	Contributions to Retirement Plan					
	June 30, 2010		June 30, 2009		June 30, 2008	
	Law 447	Reforma 2000	Law 447	Reforma 2000	Law 447	Reforma 2000
Required	\$ 118,075	\$82,474	\$ 29,265	\$27,395	No available	No available
Actual	\$ 118,075	\$82,474	\$29,265	\$27,395	No available	No available

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10. 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, 2010, the Municipality is in compliance with the debt limitation requirements. The general long-term debt activity for the year ended June 30, 2010 was as follows:

	Balance at June 30, 2009, as restated	Borrowings or Additions	Payments or Deductions	Balance at June 30, 2010	Due Within One Year
Bonds and bond anticipation notes payables	\$15,001,000	\$7,310,000	\$ 623,500	\$21,687,500	\$ 628,000
Notes payable to:					
Puerto Rico Treasury Department					
Financing agreement for the excess of property tax advances over collections	6,316	-	6,316	-	-
Financing agreement to settle two legal demands	864,696	-	192,155	672,541	192,155
Income Tax Withheld	727,058	-	-	727,058	727,058
CRIM:					
Advances over collections through fiscal year 2000	507,097	-	9,997	497,100	10,625
Act No. 146 -Financing of delinquent property tax accounts sold	481,550	-	20,937	460,613	20,937
LDMS Reimbursement	55,663	-	21,291	34,372	22,577
Final Settlement – Fiscal Year 2009-2010	-	26,704	-	26,704	26,704
Puerto Rico Health Insurance Administration (ASES)	59,895	-	-	59,895	59,895
Compensated absences	1,297,982	941,498	929,635	1,309,845	950,000
Estimated landfill closure and post closure care costs	1,327,333	66,367	-	1,393,700	70,000
Puerto Rico Power Authority - fiscal year power utility expense	1,092,498	971,452	1,092,498	971,452	971,452
Christmas bonus	166,145	166,651	166,145	166,651	166,651
First Medical Insurance	262,207	-	-	262,207	262,207
Puerto Rico Retirement System Administration	281,433	-	-	281,433	281,433
Total	\$ 22,130,873	\$ 9,482,672	\$ 3,062,474	\$ 28,551,071	\$ 4,389,694

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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, 2010 is composed of the following debts:

<u>General and Special Obligations:</u>	<u>Outstanding Amount</u>
\$1,850,000 rent bond series of 2003 payable in annual installments ranging from \$30,000 to \$140,000 through July 2027, interest ranging 2.43% to 6.50%	\$ 1,580,000
\$730,000 rent bond series of 2003 payable in annual installments ranging from \$10,000 to \$55,000 through July 2027, interest ranging 2.43% to 6.50%	625,000
\$33,000 rent bond series of 1994 payable in annual installments ranging from \$1,000 to \$2,000 through January 2018, interest at 4.5%	16,000
\$205,000 rent bond series of 1997 payable in annual installments ranging from \$5,000 to \$20,000 through July 2022, interest ranging 4.87% to 6.56%	145,000
\$215,000 rent bond series of 1994 payable in annual installments ranging from \$5,000 to \$15,000 through January 2018, interest at 4.5%	101,000
\$235,000 rent bond series of 2000 payable in annual installments ranging from \$10,000 to \$30,000 through July 2011, interest ranging 2.7% to 7.81%	55,000
\$324,000 rent bond series of 1987 payable in annual installments ranging from \$7,000 to \$23,000 through January 2011, interest at 5.0%	23,000
\$361,000 rent bond series of 2003 payable in annual installments ranging from \$9,000 to \$25,000 through July 2019, interest at 5.0%	135,000
\$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%	175,500
\$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%	80,000
\$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%	430,000

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\$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%	625,000
\$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%	155,000
\$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%	155,000
\$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%	10,000
\$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%	256,000
\$1,410,000 general obligation bond series of 2006 payable in annual installments ranging of \$40,000 to \$115,000 through July 2025, interest ranging 5.32 to 5.5%	1,235,000
\$2,690,000 general obligation bond series of 2007 payable in annual installments ranging of \$40,000 to \$225,000 through July 2031, interest at 5.5%	2,560,000
\$210,000 general obligation bond series of 2007 payable in annual installments ranging of \$25,000 to \$35,000 through July 2015, interest at 5.5%	130,000
\$745,000 general obligation bond series of 2008 payable in annual installments ranging of \$20,000 to \$70,000 through July 2027, interest ranging 2.43% to 7.0%	705,000
\$5,356,000,000 general obligation bond series of 2008 payable in annual installments ranging of \$85,000 to \$456,000 through July 2032, interest ranging 2.43% to 7.50%	5,181,000
\$810,000 general obligation bond series of 2009 payable in annual installments ranging of \$5,000 to \$70,000 through July 2034, interest ranging 4.75% to 6.50%	810,000

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\$6,500,000 general obligation bond series of 2010 payable in annual installments ranging of \$60,000 to \$915,000 through July 2034, interest ranging 6.00% to 7.00%

6,500,000

Total bonds

\$ 21,687,500

These bonds are payable from the special ad valorem property tax of 1.50% and from the 0.4% of sales and use taxes collected by the Treasury Department on behalf of the Municipality, which are restricted for debt service and transferred to 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.

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

Year ended June 30,	Principal	Interest	Total
2011	\$ 538,000	\$ 601,172	\$ 1,139,172
2012	557,000	1,364,253	1,921,253
2013	555,000	1,353,984	1,908,984
2014	593,000	1,317,218	1,910,218
2015	586,000	1,514,207	2,100,207
2016-2020	3,452,500	5,694,493	9,146,993
2021-2025	4,255,000	4,581,510	8,836,510
2026-2030	5,470,000	2,954,965	8,424,965
2031-2035	5,681,000	950,975	6,631,975
Totals	<u>\$ 21,687,500</u>	<u>20,332,776</u>	<u>\$ 42,020,276</u>

b) Notes Payable to Puerto Rico Treasury Department

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, 2010, the outstanding principal balance of this note amounted to \$610,810. The principal and discount amortization maturities are as follows:

Year ending June 30,	Principal amortization	Discount amortization	Total
2011	\$ 164,328	27,827	\$ 192,155
2012	171,578	20,577	192,155
2013	178,828	13,327	192,155
2014	96,076	-	96,076
Total	<u>\$ 610,810</u>	<u>61,731</u>	<u>\$ 672,541</u>

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

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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 \$497,100, at June 30, 2010. The principal and interest maturities are as follows:

Year ending June 30,	Principal	Interest	Total
2011	\$ 10,625	\$ 30,596	\$ 41,221
2012	11,292	29,928	41,220
2013	12,003	29,218	41,221
2014	12,756	28,465	41,221
2015	13,558	27,663	41,221
2016-2020	81,691	124,416	206,107
2021-2025	110,787	95,318	206,105
2026-2030	150,250	55,856	206,106
2031-2035	94,138	8,913	103,051
Total	<u>\$ 497,100</u>	<u>430,373</u>	<u>\$ 927,473</u>

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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. The financing agreement in the form of a line of credit bearing interests at 6.50% during the first 5 years, and variable interests 125 points over LIBOR rate during the next 25 years. At June 30, 2010, the outstanding principal balances amounted to \$460,613. The principal and interest maturities are as follows:

<u>Year ending June 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2011	\$ 20,937	\$ 28,653	\$ 49,590
2012	20,937	27,348	48,285
2013	20,937	26,046	46,983
2014	20,937	24,744	45,681
2015	20,937	23,442	44,379
2016-2020	104,685	97,670	202,355
2021-2025	104,685	65,114	169,799
2026-2030	104,685	32,558	137,243
2031-2035	41,873	3,906	45,779
Total	<u>\$ 460,613</u>	<u>329,481</u>	<u>\$ 790,094</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, 2010, the balance of this note amounted to \$34,372. The principal and interest maturities are as follows.

<u>Year ending June 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2011	\$ 22,577	1,715	\$ 24,292
2012	11,795	351	12,146
Total	<u>\$ 34,372</u>	<u>2,066</u>	<u>\$ 36,438</u>

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d) Puerto Rico Power Authority (PREPA)

The Municipality indebtedness to PREPA on the payment of the power utility for current fiscal year that amount to \$971,452. The outstanding balance will be paid from the PREPA annual contribution in lieu of taxes during next fiscal year. Therefore, an account receivable of \$971,452 to PREPA was accrued in the GWFS and general fund at June 30, 2010. The receivable in the general fund was charged against deferred revenue because it was not a current available financial resource at June 30, 2010.

e) Compensated Absences

At June 30, 2010, the liability for compensated absences is composed as follows:

	<u>Due within</u> <u>One year</u>	<u>Due after</u> <u>one year</u>	<u>Total</u>
Vacations and sick leave	<u>\$ 950,000</u>	<u>\$ 359,845</u>	<u>\$1,309,845</u>
Total	<u>\$950,000</u>	<u>\$ 359,845</u>	<u>\$1,309,845</u>

11. 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 \$1,393,700 reported as landfill closure and postclosure care liability at June 30, 2010, represents the cumulative amount reported to date based on the percentage used of the estimated capacity of the landfill. These amounts are based on what it would cost to perform all closure and postclosure care in 2004. The closing date of the landfill is the year 2014. Actual cost may be higher due to inflation, changes in technology, or changes in regulations.

12. 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 not reported liabilities in the general fund for awarded unfavorable judgment because there is not liabilities with a fixed or expected due date, which will require future available financial resources for its payment.

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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 \$134,315 in the general fund at June 30, 2010. 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.

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June 30, 2010

13. RESTATEMENTS

During the current fiscal year, the Municipality revised its fund financial statements and its government-wide financial statements, which resulted in the reclassification of debt balance previously reported as long term debt to fund liabilities, correction of balance of long term debt balance reported in the prior year government wide financial statements, and correction of various accounting errors and omissions reported in the prior year governmental funds, principally in interfund account balances and intergovernmental receivables account balances.

a) Governmental Fund Financial Statements

The following schedule presents a summary of the prior-period adjustments recorded in the accompanying balance sheet – governmental funds, and reconciles the fund balances, as previously reported by the Municipality at June 30, 2009, to the beginning fund balances in the accompanying basic financial statements, as restated:

	<u>Major governmental funds</u>				Total Governmental Funds
	General fund	Debt service fund	Capital improvement bonds fund	Other governmental funds	
Assets:					
As previously reported in the audited financial statements at June 30, 2009	\$ 2,503,425	1,946,987	4,340,372	1,130,565	\$ 9,921,349
Add/(deduct): prior-period adjustments	65,751	-	-	702,115	767,866
Total assets at June 30, 2009, as restated	<u>\$ 2,569,176</u>	<u>1,946,987</u>	<u>4,340,372</u>	<u>1,832,680</u>	<u>\$ 10,689,215</u>
Liabilities:					
As previously reported in the audited financial statements at June 30, 2009	\$ 2,210,413	553,672	-	1,334,631	\$ 4,098,716
Add/(deduct): prior-period adjustments	6,593,693	211,974	152,382	44,094	7,002,143
Total liabilities at June 30, 2009, as restated	<u>\$ 8,804,106</u>	<u>765,646</u>	<u>152,382</u>	<u>1,378,725</u>	<u>\$ 11,100,859</u>
Fund balance:					
As previously reported in the audited financial statements at June 30, 2009	\$ 293,012	1,393,315	4,340,372	(204,066)	\$ 5,822,633
Add/(deduct): prior-period adjustments	(6,527,942)	(211,974)	(152,382)	658,021	(6,234,277)
Total fund balance at June 30, 2009, as restated	<u>\$(6,234,930)</u>	<u>1,181,341</u>	<u>4,187,990</u>	<u>453,955</u>	<u>\$ (411,644)</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SANTA ISABEL
Notes to Basic Financial Statements
June 30, 2010

b) Government-Wide Financial Statements

The following schedule reconciles the total net asset balance at June 30, 2009, as previously reported by the Municipality, to the beginning net assets, as restated in the accompanying GWFS:

	Net assets – governmental activities	Total net assets
As previously reported in the audited financial statements at June 30, 2009	\$ 2,925,730	\$ 2,925,730
Add/(deduct): prior-period adjustments	837,068	837,068
Total net assets at June 30, 2009, as restated	\$ 3,762,798	\$ 3,762,798

14. SUBSEQUENTS EVENTS

On December 20, 2010 the Municipality's Legislative branch authorized the issuance of \$2,670,000 of general obligation bond principally to finance debts with other governmental entities and suppliers. The interest rate on the bond is prime rate variable plus 1.50 percent and maturity date is July 1, 2036.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SANTA ISABEL
Budgetary Comparison Schedule- General Fund
(See Notes to Budgetary Comparison Schedule)
June 30, 2010

	<u>Budgeted amounts</u>		<u>Actual amounts (budgetary basis)</u>	<u>Variance with final budget – over (under)</u>
	<u>Original</u>	<u>Final</u>		
Revenues:				
Property taxes	\$ 1,800,026	1,800,026	1,992,091	\$ 192,065
Municipal license taxes	1,168,220	1,168,220	1,233,824	65,604
Sales and use taxes	1,396,700	1,396,700	1,421,182	24,482
Construction excise taxes	2,495,000	2,495,000	447,173	(2,047,827)
Intergovernmental grants and contributions	4,065,754	4,065,754	4,287,078	221,324
Interest on deposits	40,000	40,000	83,364	43,364
Charges for services	20,000	20,000	15,804	(4,196)
Miscellaneous	90,000	90,000	101,301	11,301
Total revenues	<u>11,075,700</u>	<u>11,075,700</u>	<u>9,581,817</u>	<u>(1,493,883)</u>
Expenditures and encumbrances:				
General government	4,097,514	4,148,624	3,504,435	644,189
Urban and economic development	4,312,524	4,357,186	4,301,872	55,314
Health and sanitation	576,930	582,929	553,277	29,652
Public safety	691,300	683,068	643,252	39,816
Public housing and welfare	452,196	459,320	279,574	179,746
Culture, recreation and education	731,911	631,248	380,709	250,539
Total expenditures	<u>10,862,375</u>	<u>10,862,375</u>	<u>9,663,119</u>	<u>1,199,256</u>
Revenues over (under) expenditures and encumbrances	<u>213,325</u>	<u>213,325</u>	<u>(81,302)</u>	<u>(294,627)</u>
Other financing sources (uses):				
Transfer to other governmental funds	<u>(213,325)</u>	<u>(213,325)</u>	<u>(160,250)</u>	<u>53,075</u>
Total other financing sources (uses)	<u>(213,325)</u>	<u>(213,325)</u>	<u>(160,250)</u>	<u>53,075</u>
Net increase (decrease) in fund balance (deficit)	<u>\$ -</u>	<u>-</u>	<u>(241,552)</u>	<u>\$ (241,552)</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SANTA ISABEL
Budgetary Comparison Schedule- General Fund
(See Notes to Budgetary Comparison Schedule)
June 30, 2010

Reconciliation of differences:

Sources/inflows of financial resources:

Actual amounts (budgetary basis) "available for appropriations" from the budgetary comparison schedule	\$ 9,581,817
Differences - budgetary basis to GAAP:	
Differences in bases of accounting:	
GAAP adjustments to revenues	70,256
Total revenues reported on the statement of revenues, expenditures and changes in fund balances	<u>\$ 9,652,073</u>

Uses/outflows of financial resources:

Actual amounts (budgetary basis) "total charges to appropriations" from the budgetary comparison schedule (including other financing uses)	\$ 9,823,369
Timing differences:	
Current year encumbrances recorded as expenditures for budgetary purposes	(134,315)
Prior year encumbrances recorded as expenditures for GAAP purposes	455,155
Entity differences:	
Non-budgeted transfers to other funds	15,735
Non-budgeted expenditures	208,762
Total expenditures and other financing sources reported on the statement of revenues, expenditures and changes in fund balances	<u>\$ 10,368,706</u>

See accompanying notes to financial statements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF SANTA ISABEL
Notes to Budgetary Comparison Schedule- General Fund
June 30, 2010

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, 2010 representing the original budget. There were no supplemental appropriations for the year ended June 30, 2010.

MUNICIPALITY OF SANTA ISABEL, PUERTO RICO

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
YEAR ENDED JUNE 30, 2010

Federal Grantor/Pass-Through Grantor/Program Title	Federal CFDA Number (Note 3)	Pass-Through Grantor's Number (Note 4)	Expenditures (Note 1)
<u>U.S. Department of Agriculture</u>			
_____ Program:			
Passed through the P.R. Department of Education:			
Child and Adult Care Food Program	10.558	N/AV	\$ 32,022
Total U.S. Department of Agriculture			<u>32,022</u>
<u>U.S. Department of Housing and Urban Development</u>			
_____ Program:			
Direct Program:			
Section 8 Housing Choice Voucher	14.871	N/A	372,141
_____ Program:			
Passed through the P.R. Office of Commissioner of Municipal Affairs:			
Community Development Block Grant - State's Program	14.228	N/AV	1,037,393
_____ Program:			
Passed through the P.R. Department of Family:			
Homeless Prevention and Rapid Re-Housing Program (ARRA Funded)	14.262	N/AV	11,804
Total U.S. Department of Housing and Urban Development			<u>1,421,338</u>
<u>U.S. Department of Energy</u>			
_____ Program:			
Direct Program:			
Energy Efficiency and Conservation Block Grant (ARRA Funded)	81.128	N/AV	8,500
Total U.S. Department of Energy			<u>8,500</u>
<u>U.S. Department of Health and Human Services</u>			
_____ Program:			
Passed through the P.R. Administration for Care and Integral Development of Childhood (ACUDEN)			
Child Care and Development Block Grant	93.575	N/AV	607,410
Child Care and Development Block Grant (ARRA Funded)	93.575	N/AV	4,712
Total U.S. Department of Health and Human Services			<u>612,122</u>

MUNICIPALITY OF SANTA ISABEL, PUERTO RICO

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
YEAR ENDED JUNE 30, 2010

Federal Grantor/Pass-Through Grantor/Program Title	Federal CFDA Number (Note 3)	Pass-Through Grantor's Number (Note 4)	Expenditures (Note 1)
<u>U.S. Department of Homeland Security</u>			
Program:			
Passed through the P.R. Governor Authorized Representative (GAR):			
Disaster Grants - Public Assistance	97.036	N/AV	58,313
Passed through the Governor Office – Public Security Affairs Office:			
National Incident Management System (NIMS)	97.107	N/AV	39,624
Total U.S. Department of Homeland Security			<u>97,937</u>
Total federal awards expenditures			<u><u>\$ 2,171,919</u></u>

The accompanying notes are an integral part of this schedule.

MUNICIPALITY OF SANTA ISABEL, PUERTO RICO

NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
YEAR ENDED JUNE 30, 2010

NOTE 1: BASIS OF PRESENTATION

The accompanying schedule of expenditures of federal awards includes the federal grant activity of the Municipality of Santa Isabel, Commonwealth of Puerto Rico (the Municipality) for the year ended June 30, 2010. The Municipality's reporting entity is disclosed in Note 1 to the Municipality's basic financial statements as of and for the fiscal year ended June 30, 2010.

The accompanying schedule of expenditures of federal awards is presented on the modified accrual basis of accounting.

The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying Schedule of Expenditures of Federal Awards is prepared from Municipality's accounting records and is not intended to present financial position or the results of operations. The financial transactions are recorded by the Municipality in accordance with the terms and conditions of the grants, which are consistent with accounting principles generally accepted in the United States of America. Expenditures are recognized in the accounting period in which the liability is incurred, if measurable or when actually paid, whichever occurs first.

NOTE 3: FEDERAL CFDA NUMBER

The CFDA numbers included in this Schedule are determined based on the program name, review of grant contract information and the Office of Management and Budget's Catalogue of Federal Domestic Assistance.

NOTE 4: PASS THROUGH GRANTOR'S NUMBER

State or local government redistribution of federal awards to the Municipality, treated as if 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 identifying number assigned by the pass through entity for federal awards received as a sub-recipient. Numbers identified as N/AV are not available.

NOTE 5: MAJOR PROGRAMS

Major programs are identified in the Summary of Auditor's Results Section of the Schedule of Findings and Questioned Costs.

END OF NOTES



MENDOZA & RAMOS
Contadores Públicos Autorizados, C.S.P.

P.O. Box 35 • Guayama, Puerto Rico 00785

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

**To the Honorable Mayor and
Members of the Municipal Legislature
MUNICIPALITY OF SANTA ISABEL, PUERTO RICO**

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the Municipality of Santa Isabel, Puerto Rico (the "Municipality") as of and for the fiscal year ended June 30, 2010, which collectively comprise Municipality of Santa Isabel's basic financial statements and have issued our report thereon dated December 29, 2011. We did not express an opinion on governmental activities financial statement because the Municipality did not maintain adequate records regarding capital assets, accumulated depreciation and related depreciation expense reported in the governmental activities. Also, the report's opinion on Fund Financial Statements was adverse on General Fund because the Municipality did not recognize in this fund liabilities normally paid in a timely manner and in full from expendable available financial resources. Moreover, the report's opinion on Capital Improvement Bond Fund, Debt Service Fund and the aggregate remaining fund information was unqualified. Except as discussed in the preceding sentences, we conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

INDEPENDENT AUDITOR'S REPORT

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects Municipality's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the Municipality's financial statements that is more than inconsequential will not be prevented or detected by the Municipality's internal control. We consider the deficiencies described in the accompanying schedule of finding and questioned costs to be significant deficiencies in internal control over financial reporting. Significant deficiencies are described in the accompanying schedule of findings and questioned costs as finding number 10-01, 10-02, 10-03, 10-04 and 10-05.

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

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, of the significant deficiencies described above, we consider 10-01, 10-02 and 10-03 to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Municipality's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants 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* and which are described in the accompanying schedule of findings and questioned costs as findings 10-01, 10-02, 10-03, 10-04 and 10-05.

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

This report is intended solely for the information and use of the management, Municipal Legislature, Office of the Commissioner of Municipal Affairs, federal awarding agencies, state funding agencies, and pass-through entities, and other regulatory agencies, and is not intended to be and should not be used by anyone other than these specified parties.

Mendoza & Ramos CPAs
MENDOZA & RAMOS
CERTIFIED PUBLIC ACCOUNTANTS, C.S.P.

Guayama, Puerto Rico
December 29, 2011

Stamp number 2573153 was
affixed to the original of this report.





MENDOZA & RAMOS
Contadores Públicos Autorizados, C.S.P.

P.O. Box 35 • Guayama, Puerto Rico 00785

**INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH REQUIREMENTS
APPLICABLE TO EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER
COMPLIANCE IN ACCORDANCE WITH THE OMB CIRCULAR A-133**

**To the Honorable Mayor and
Members of the Municipal Legislature
MUNICIPALITY OF SANTA ISABEL, PUERTO RICO**

Compliance

We have audited the compliance of the Municipality of Santa Isabel, Puerto Rico (the "Municipality") with the types of compliance requirements described in the *U. S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2010. The Municipality's major federal programs are identified in the summary of auditor's results section of the accompanying Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the Municipality's management. Our responsibility is to express an opinion on the Municipality's compliance based on our audit.

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

INDEPENDENT AUDITOR'S REPORT

As described in the accompanying Schedule of Findings and Questioned Costs, the Municipality did not comply with the requirements that are applicable to its major programs, as follows:

Reference Number	Compliance Requirement	Major Program
10-06	Fiscal Requirements	Community Development Block Grant / State's Program
10-07	Reporting	Community Development Block Grant / State's Program
10-08	Equipment And Real Property	Community Development Block Grant / State's Program
10-09	Cash Management	Community Development Block Grant / State's Program
10-10	Davis-Bacon Act	Community Development Block Grant / State's Program
10-11	Special Test – Project Documentation	Community Development Block Grant / State's Program
10-12	Fiscal Requirements	Section 8 Housing Choice Vouchers
10-13	Activities Allowed	Section 8 Housing Choice Vouchers
10-14	Cash Management	Section 8 Housing Choice Vouchers
10-15	Eligibility	Section 8 Housing Choice Vouchers
10-16	Special Test–HAP and Negative Rent Payments	Section 8 Housing Choice Vouchers
10-17	Special Test–Waiting List	Section 8 Housing Choice Vouchers
10-18	Special Test – Depository Agreement	Section 8 Housing Choice Vouchers
10-19	Fiscal Requirements	Child Care and Development Block Grant
10-20	Program Income	Child Care and Development Block Grant
10-21	Equipment And Real Property	Child Care and Development Block Grant

Compliance with such requirements is necessary, in our opinion, for the Municipality to comply with the requirements applicable to such programs.

In our opinion, except for the noncompliance described above, the Municipality complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2010.

Internal Control Over Compliance

The management of the Municipality is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered the Municipality's internal control over compliance with the requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of Municipality's internal control over compliance. Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in the entity's internal control that might be significant deficiencies or material weaknesses as defined below. However, as discussed below, we identified certain deficiencies in internal control over compliance that we consider to be significant deficiencies and a material weaknesses.

INDEPENDENT AUDITOR'S REPORT

A control deficiency in an entity's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects Municipality's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of federal program that is more than inconsequential will not be prevented or detected by the Municipality's internal control. We consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs as findings 10-06, 10-08, 10-09, 10-10, 10-11, 10-12, 10-13, 10-14, 10-15, 10-17, 10-19, 10-20 and 10-21 to be significant deficiencies.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by Municipality's internal control. Of the significant deficiencies in internal control over compliance described in the accompanying schedule of finding and questioned costs, we consider items 10-06, 10-08, 10-09, 10-10, 10-11, 10-12, 10-13, 10-14, 10-15, 10-17, 10-19, 10-20 and 10-21 to be material weaknesses.

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

This report is intended solely for the information and use of the Municipal Legislature, management, Office of the Commissioner of Municipal Affairs, federal awarding agencies, state funding agencies, and pass-through entities, and other regulatory agencies, and is not intended to be and should not be used by anyone other than these specified parties.

Mendoza & Ramos CPA's
MENDOZA & RAMOS
CERTIFIED PUBLIC ACCOUNTANTS, C.S.P.

Guayama, Puerto Rico
December 29, 2011

Stamp number 2573154 was
affixed to the original of this report.



MUNICIPALITY OF SANTA ISABEL, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

Financial Statements

Type of auditors' report issued:

- Unqualified Opinion for Capital improvement bond fund, Debt Service Fund, and the aggregate remaining fund information
- Qualified Opinion for government-wide financial statement
- Adverse Opinion for general fund
- Disclaimer of Opinion on Governmental Activities

Internal control over financial reporting:

- Material weakness (es) identified? Yes No
- Significant deficiencies identified that are not considered to be material weakness (es)? Yes None Reported

Noncompliance material to financial statements noted?

- Yes No

Federal Awards

Internal control over major programs:

- Material weakness (es) identified? Yes No
- Significant deficiencies identified that are not considered to be material weakness (es)? Yes None Reported

Type of auditors' report issued on compliance for Major Programs:

- Unqualified Opinion
- Qualified Opinion
- Adverse Opinion
- Disclaimer

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

- Yes No

The Municipality's major programs were:

CFDA Number	Name of Federal Program
14.228	Community Development Block Grant
14.871	Section 8 Housing Choice Vouchers
93.575	Child Care and Development Block Grant

Dollar threshold used to distinguish between Type A and Type B Programs:

\$300,000

Auditee qualified as low-risk auditee?

- Yes No

MUNICIPALITY OF SANTA ISABEL, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

FINDING	10-01
CATEGORY	INTERNAL CONTROL \ COMPLIANCE
TOPIC SENTENCE	FIXED \ CAPITAL ASSETS AND EXPENDITURES – SUFSIDIARY LEDGER.
CONDITION	The Municipality has not maintained complete and adequate records in order to obtain sufficient, competent evidential matter with respect to the Capital Assets reported in governmental activities and, accordingly, the amount by which this departure would affect the assets, net assets, and expenses of the governmental activities is not determinable.
CRITERIA	Chapter IX, Article 9.002 of State Act Number 81 of August 30, 1991 states that the municipality should maintain updated property accounting records. Also the GASB Statements No. 34 <i>Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments</i> require that all capital assets, including infrastructure, must be presented in the Statements of Net Assets and that these assets must be depreciated during its useful life. Furthermore provisions of GASB Statement No. 42, <i>Accounting and Financial Reporting of Impairments of Capital Assets and for Insurance Recoveries</i> , requires the Municipality to evaluate prominent events or changes in circumstances affecting capital assets to determine whether an impairment of a capital asset has occurred.
CAUSE	Competent and sufficient evidential matter related to the capital assets was not available to support the value, completeness and ownership of these assets.
EFFECT	The Municipality’s Government Wide Financial Statements do not present fairly, the financial position of the governmental activities, and the change in financial position of the Municipality.
RECOMMENDATION	We recommend that the Municipality should continue the compilation of documents to support the value, completeness and ownership of its capital assets, to comply with the requirements of the GASB Statement No. 34 and GASB No. 42.
QUESTIONED COSTS	NONE
MANAGEMENT RESPONSE AND CORRECTIVE ACTION PLAN	Currently the Municipality’s Finance Department staffs continue updating the capital assets subsidiary ledger in order to comply

MUNICIPALITY OF SANTA ISABEL, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

FINDING

10-01 (Continued)

with GASB No. 34 capital assets requirements for the fiscal year ended on June 30, 2012.

Implementation Date: June 30, 2012

Responsible Person: Mrs. Irma M. Vargas
Finance Department Director

MUNICIPALITY OF SANTA ISABEL, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

FINDING	10-02 (Continued)
CATEGORY	INTERNAL CONTROLS \ COMPLIANCE
TOPIC SENTENCE	ACCOUNTING SYSTEM
CONDITION	The accounting system and manuals used by the Municipality to account and register the financial transactions during the fiscal year does not provide for the summarization of transactions that permit the preparation of Municipality's financial statements in conformity with the General Accepted Accounting Principles of the United States of America (GAAP).
CRITERIA	According to Article 8.010 (a) and (b) of Law Num. 81 for the Municipalities of Puerto Rico, the computerized system and the procedures of accounting and property will be designed to allow the Municipality to carry out its functions, at the same time as they serve to maintain an uniform and coordinated accounting, which should provide a complete picture of the financial operations of the Municipality and the necessary financial information that assist the Municipality Legislature, the Governor, and the Secretary of the Puerto Rico Treasury Department in the performance of its respective responsibilities. Municipalities accounting will be based on funds, Generally Accepted Accounting Principles and the requirements established by the Governmental Accounting Standard Board. Also the pronouncements of the National Committee on Governmental Accounting and the "Blue Book" will be used to design municipalities' accounting systems and fiscal procedures.
CAUSE	Municipality's accounting system and financial reports are subject to State's agencies requirements which does not allow nor provide the Municipality with the necessary tools, capable of recapturing the financial information and provide financial statements.
EFFECT	The lack of an adequate accounting system which can capture all the financial information and in order to generate Municipality's financial statements for each fiscal year affects the Municipality ability to measure: the financial and nonfinancial performance of programs and activities, adequately safeguard significant assets and properly record various transactions, and hinder the Municipality from having reliable financial information to operate in an economical, efficient, and effective manner.

MUNICIPALITY OF SANTA ISABEL, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

FINDING

10-02 (CONTINUED)

Sound decisions on the current results and future direction of vital programs and policies are made more difficult without timely, reliable and useful financial performance information.

RECOMMENDATION

The Municipality should establish and implement the necessary measures that allow the summarization of the financial transactions in order to prepare the financial statements in conformity with GAAP.

QUESTIONED COSTS

None

MANAGEMENT RESPONSE AND
CORRECTIVE ACTION PLAN

The Municipality maintains two set of accounting records; a manual system and a uniform computerized accounting system provided in the past by the Office of the Commissioner of Municipal Affairs (OCAM) to all of the municipalities of Puerto Rico (as required by Law No. 81). The manual system is the primary financial records for financial statements preparation purposes at the end of each fiscal year due to the fact that the computerized system real accounts balances carried forward from prior years were affected by accounting errors in the first years of the system operation.

Some of the manual accounting records maintained by the Municipality consist of the following records, that provide information based on cash and budgetary basis: a) Cash Receipt Books – To record all receipts issued by the Official and Auxiliary Cash Collectors; each receipt is posted under each account of fund column title, and at the end of the month each column total is posted to the General Ledger; b) Cash Disbursement Books – To record all cash disbursements made by the Official Payer; each cash disbursement is charged to an account or to a fund, and at the end of the month each account or fund total is posted to the General Ledger; and c) Purchase Orders and Contracts Registers – To record purchase orders and contracts issued against the budgeted amounts for each account or fund.

We are considering alternatives to for the acquisition of new accounting software, and therefore, we will hope to solve our accounting system condition in a near future.

Implementation Date: June 30, 2013

Responsible Person: Mrs. Irma M. Vargas
Finance Department Director

MUNICIPALITY OF SANTA ISABEL, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

FINDING	10-03
CATEGORY	INTERNAL CONTROL/COMPLIANCE
TOPIC SENTENCE	LIABILITY RECOGNITION
CONDITION	The Municipality did not recognized in the General Fund liabilities by \$1,270,698 that are normally paid in a timely manner, and in full, from expendable available financial resources. Instead, these liabilities were recorded as long term liabilities in the governmental activities in the accompanying statement of net assets.
CRITERIA	GASB Interpretation No. 6, <i>Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements</i> state that liabilities that governments normally pay in a timely manner and in full from expendable available financial resources should be recognized when incurred, without regard to the extent to which resources are currently available to liquidate the liability.
CAUSE	These liabilities were recorded as long term liabilities in the governmental activities in the accompanying statement of net assets based on the management assertion that these liabilities will be liquidated with the proceed of two general long term bonds issuances authorized subsequent to the year then ended.
EFFECT	The General Fund do not present fairly, the financial position and the change in financial position thereof, for the year then ended.
RECOMMENDATION	Liabilities that the Municipality normally pays in a timely manner and in full from expendable available financial resources should be recognized when incurred in the governmental funds.
QUESTIONED COSTS	None

MANAGEMENT RESPONSE AND
CORRECTIVE ACTION PLAN

As discussed in Note 13 in the accompanying Basic Financial Statements, the Municipality Legislative branch authorized the issuance of \$2,670,000 of general obligation bond after year ended on June 30, 2010 principally to finance debts of the General Fund with other governmental entities, services providers, suppliers and contractors pending at June 30, 2010.

Implementation Date: December 2011

Responsible Person: Mrs. Irma M. Vargas
Finance Department Director

MUNICIPALITY OF SANTA ISABEL, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

FINDING	10-04
CATEGORY	INTERNAL CONTROL \ COMPLIANCE
TOPIC SENTENCE	INADEQUATE EXPENDITURES PROCEDURES AND CONTROLS
CONDITIONS	<p>Municipality's expenditures procedures and controls were inadequate. Among 40 payment vouchers examined we found the following deficiencies:</p> <ul style="list-style-type: none">▪ Twenty-nine checks were not provided for examination.▪ Three payment vouchers and related supporting documentation were not provided for examination.▪ Twenty-five payment vouchers and supporting documents were not cancelled once the payment was made.▪ In three cases the purchase orders regarding goods and services were issued after the goods and services were received.▪ Three payment vouchers examined did not include evidence regarding the quotation process or the evidence included was incomplete.▪ In one of the payment vouchers examined, the invoice was not included as part of the supporting documents.▪ In one of the payment vouchers examined, the purchase order was not included as part of the supporting documents.
CRITERIA	<p>According to Article 8:005 of Law Num. 81 for the Municipalities of Puerto Rico the Mayor, the functionaries and employees in which this one delegates and any authorized representative of the same or the municipality, will be responsible for the legality, exactitude, property, necessity and correction of all the expenses that are authorized for the payment of any concept. Also, the Chapter IV of the Regulation for Municipal Administration states the procedures and controls that should be observed by the Municipality regarding the expenditure cycle.</p>
CAUSES	<p>The Municipality has not properly established the procedures and internal controls to be followed regarding the request, order, payment and other related procedures regarding the expenditures cycle.</p>

MUNICIPALITY OF SANTA ISABEL, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

FINDING **10-04 (CONTINUED)**

EFFECT Absence of such procedures and controls could lead to approval and disbursement of improper payments and other errors, and prevent them from being detected.

RECOMMENDATION The Municipality should establish proper internal controls and procedures regarding the expenditures cycle and assure compliance with those procedures and controls through adequate supervision.

QUESTIONED COSTS None

MANAGEMENT RESPONSE AND
CORRECTIVE ACTION PLAN

We will improve our purchases and expenditures procedures in order to correct the Conditions reported by the External Auditors, providing technical training to the Finance Department Staff and increasing supervision on such procedures.

Implementation Date: December 2011

Responsible Person: Mrs. Irma M. Vargas
Finance Department Director

MUNICIPALITY OF SANTA ISABEL, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

FINDING	10-05
CATEGORY	INTERNAL CONTROL \ COMPLIANCE
TOPIC SENTENCE	INTERNAL CONTROLS DEFICIENCIES REGARDING REVENUES\COLLECTIONS CYCLE
CONDITION	<p>Municipality's collections procedures and controls were inadequate. Among 40 collections receipts examined we found the following deficiencies:</p> <ul style="list-style-type: none">• Since February 2010, the internal controls over the cash collections were not adequately followed. This situation prevents us from tracing the collection to the bank statement in 12 out of 40 cases.• In 6 out of 40 cases the evidence of documents related to collections was not available for our review.
CRITERIA	<p>According to Article 8.010 (d) of Law Num. 81 for the Municipalities of Puerto Rico, the procedures for the collection and deposit of municipal funds should have sufficient and adequate controls in order to prevent irregularities or to allow the detection and establishment of responsibilities, if such irregularities are committed. Also, the Chapter III of the Regulation for Municipal Administration states the procedures and controls that should be observed by the Municipality regarding the revenue and collection cycle.</p>
CAUSE	<p>The Municipality is not properly following the established procedures and internal controls regarding the revenues and collections cycle.</p>
EFFECT	<p>Absence of such procedures and controls could lead to errors and irregularities during the collection process and prevent them from being detected timely.</p>
RECOMMENDATION	<p>The Municipality should establish proper internal controls and procedures regarding the revenue and collections cycle and assure compliance with those procedures and controls through adequate supervision.</p>
QUESTIONED COSTS	NONE

MUNICIPALITY OF SANTA ISABEL, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

FINDING **10-05 (CONTINUED)**

MANAGEMENT RESPONSE AND
CORRECTIVE ACTION PLAN

We will improve our collections procedures in order to correct the Conditions reported by the External Auditors, providing technical training to the Finance Department Staff and increasing supervision on such procedures.

Implementation Date: December 2011

Responsible Person: Mrs. Irma M. Vargas
Finance Department Director

MUNICIPALITY OF SANTA ISABEL, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

FINDING	10-06
FEDERAL PROGRAM	COMMUNITY DEVELOPMENT BLOCK GRANT/STATE'S PROGRAM (CDBG) (CFDA NO. 14.228) DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT PASS THROUGH STATE-OFFICE OF COMMISSIONER OF MUNICIPAL AFFAIRS
CATEGORY	INTERNAL CONTROL / COMPLIANCE
NONCOMPLIANCE	FISCAL REQUIREMENTS
TOPIC SENTENCE	INADEQUATE FISCAL CONTROL AND LACK OF ACCOUNTING RECORDS
CONDITION	Municipality's Community Development Block Grant Program does not maintain accurate and complete accounting records. Proper accounting policies regarding revenue recognition, expenditures, assets, liabilities and fund balance are not being followed. Month-end and year-end closing procedures were not performed according to Program's federal regulations. These situations cause that general ledger accounts were not in balance as of June 30, 2010.
CRITERIA	As stated in 24 CFR 982.158(a) the PHA must maintain complete and accurate accounts and other records for the program in accordance with HUD requirements, in a manner that permits a speedy and effective audit. In addition, 24 CFR 92.20(b) establishes that the financial management systems of other grantees and subgrantees must meet the following standards: (1) 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 or subgrant; (2) grantees and subgrantees 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 subgrant awards and authorizations, obligations, unobligated balances, assets, liabilities, outlays or expenditures, and income; (3) Effective control and accountability must be maintained for all grant and subgrant cash, real and personal property, and other assets.
CAUSE	The Municipality's and Program's management have not established the procedures and adequate internal controls to ensure the adequate recording of all related financial information.

MUNICIPALITY OF SANTA ISABEL, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

FINDING	10-06 (CONTINUED)
EFFECT	These conditions inhibit the Municipality from having current accurate and reliable financial reports and information necessary for management to take efficient and effective actions, including corrective actions plans. Also, Municipality's failure to have accurate and complete accounting records could result in the qualification of the general purposes financial statements audit opinion.
RECOMMENDATION	The Municipality should establish a plan and implement the corresponding internal controls to ensure that all Program's transactions and activities are properly recorded and fairly presented in accordance with program requirements.
QUESTIONED COSTS	None

MANAGEMENT RESPONSE AND
CORRECTIVE ACTION PLAN

All of the CDBG Program accounting transactions has been posted in the Fund 70 of the Uniform Computerized Accounting System (SUCM, by its acronyms in Spanish) provided by the Office of the Commissioner of Municipal Affairs (OCAM) to all of the municipalities of Puerto Rico (as required by Law No. 81), but due to the fact that the SUCM real accounts balances carried forward from prior years were affected by accounting errors in the first years of the system operation, the real accounts balances could be affected by such errors. We believe that for operational and budgetary purposes, the financial information provided by the SUCM provides current accurate and reliable financial reports and information necessary for management to take efficient and effective actions. But, in order to maintain accounting records exclusively for the CDBG Program transactions, we will improve our set of manual accounting records.

Implementation Date: December 2011

Responsible Person: Mrs. Janice Brugman
Federal Programs Director

MUNICIPALITY OF SANTA ISABEL, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

FINDING **10-07**

FEDERAL PROGRAM COMMUNITY DEVELOPMENT BLOCK GRANT/STATE'S PROGRAM (CDBG) (CFDA NO. 14.228) DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT PASS THROUGH STATE-OFFICE OF COMMISSIONER OF MUNICIPAL AFFAIRS

CATEGORY COMPLIANCE

NONCOMPLIANCE REPORTING

TOPIC SENTENCE **NON COMPLIANCE WITH REPORTING REQUIREMENTS**

CONDITION

Amounts reported during the fiscal year to the Lead Agency (OCAM) were incorrect. Reported amounts as of June 30, 2010 could not be traced to any accounting record or financial reports since they were not maintained. For such reason, in order to determine Programs' expenditures during the fiscal year a check register was examined. Based on such evaluation we noted that the amounts reported to the Lead Agency (OCAM) were (under)/overstated as follows:

Program Fiscal Year	Expenditures		
	Per Quarterly Report	Per Audit	Difference
Adm FD 2000	\$ 2,010.91	\$ 2,010.91	\$ 0.00
Adm FD 2001	11,230.41	41,414.24	30,183.83
Adm FC 2001	-	3,760.53	3,760.53
03-FC-60-006	5,328.04	13,878.04	8,550.00
Adm AB 2003	1,915.86	2,275.17	359.31
Adm AB 2005	24,888.04	24,138.68	(749.36)
06-FC-60-008	59,817.60	55,092.60	(4,725.00)
Adm FC 2006	589.92	-	(589.92)
06-AB-60-001	132,856.77	111,417.84	(21,438.93)
Adm AB 2006	11,431.14	140.30	(11,290.84)
07-FC-60-002	4,120.15	3,968.18	(151.97)
Adm FC 2007	7,891.51	4,891.51	(3,000.00)
07-AB-60-002	32,782.71	33,048.53	265.82
Adm AB 2007	(2,197.55)	518.52	2,716.07
08-FC-60-003	641.28	798.03	156.75
Adm FC 2008	30,141.65	27,019.45	(3,122.20)
08-AB-60-002	63.14	198.59	135.45
Adm AB 2008	14,917.30	13,497.98	(1,419.32)
09-FC-003	18,459.46	18,181.76	(277.70)
Adm FC 2009	3,000.00	-	(3,000.00)
09-AB-003	52,361.99	52,346.61	(15.38)
	<u>\$ 412,250.33</u>	<u>\$ 408,597.47</u>	<u>\$ (3,652.86)</u>

MUNICIPALITY OF SANTA ISABEL, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

FINDING	16-07 (CONTINUED)
CRITERIA	As specified in 24 CFR 85.20(b)(1), 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.
CAUSE	Lack of adequate accounting records and fiscal control.
EFFECT	The continuing occurrence of this situation inhibits the Lead Agency (OCAM) and other Federal award agencies from monitoring the programs financial performance. In addition, the Program could be sanctioned by the federal awarding agency due to the inaccurate filing of financial reports.
RECOMMENDATION	The Municipality should establish a plan and implement the corresponding internal controls to ensure that all Program's transactions and activities are properly recorded and fairly presented in accordance with program requirements and that all financial transactions' supporting documents are properly safeguarded. In addition, should establish and maintain a subsidiary ledger to accurately account for inter fund transactions.
QUESTIONED COSTS	None
MANAGEMENT RESPONSE AND CORRECTIVE ACTION PLAN	All of the CDBG Program accounting transactions has been posted in the Fund 70 of the Uniform Computerized Accounting System (SUCM, by its acronyms in Spanish) provided by the Office of the Commissioner of Municipal Affairs (OCAM) to all of the municipalities of Puerto Rico (as required by Law No. 81), but due to the fact that the SUCM real accounts balances carried forward from prior years were affected by accounting errors in the first years of the system operation, the real accounts balances could be affected by such errors. We believe that for operational and budgetary purposes, the financial information provided by the SUCM provides current accurate and reliable financial reports and information necessary for management to take efficient and effective actions. But, in order to maintain accounting records exclusively for the CDBG Program transactions, we will improve our set of manual accounting records. Implementation Date: December 2011 Responsible Person: Mrs. Janice Brugman Federal Programs Director

MUNICIPALITY OF SANTA ISABEL, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

FINDING	10-08
FEDERAL PROGRAM	COMMUNITY DEVELOPMENT BLOCK GRANT/STATE'S PROGRAM (CDBG) (CFDA NO. 14.228) DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT PASS THROUGH STATE-OFFICE OF COMMISSIONER OF MUNICIPAL AFFAIRS
CATEGORY	INTERNAL CONTROL / COMPLIANCE
NONCOMPLIANCE	EQUIPMENT AND REAL PROPERTY MANAGEMENT
TOPIC SENTENCE	LACK OF CONTROLS OVER PROPERTY AND EQUIPMENT ITEMS ACQUIRED WITH FEDERAL FUNDS.
CONDITION	<p>The Municipality and the Community Development Block Grant (CDBG) are not maintaining internal controls over property and equipment items acquired with Federal Funds. In testing property and equipment we noted the following:</p> <ul style="list-style-type: none">- The Municipality could not provide us with adequate property records which include a description of the property, serial number or other identification number, the source of the property, who holds title, the acquisition date, cost of the property, percentage of Federal participation in the cost of the property, location, use and condition of the property, and any ultimate disposition data including the date of disposal.- The CDBG Program did not count with a general ledger or a property subsidiary ledger where all property and equipment transactions are registered. For such reason, we could not ascertain that all capital outlays and property dispositions were recorded. In addition, related annual depreciation is not being calculated and accounted for.- We could not ascertain that all the property and equipment acquired it is being used by the Program's personnel and for Program's purposes.

MUNICIPALITY OF SANTA ISABEL, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

FINDING	10-08 (CONTINUED)
CRITERIA	<p>24 CFR 85.32(d) establishes that procedures for managing equipment will, as a minimum, meet the following requirements:</p> <p>(1) Property records must be maintained that include a description of the property, a serial number or other identification number, the source of property, who holds title, the acquisition date, and cost of the property, percentage of Federal participation in the cost of the property, the location, use and condition of the property, and any ultimate disposition data including the date of disposal and sale price of the property. (2) A physical inventory of the property must be taken and the results reconciled with the property records at least once every two years. (3) A control system must be developed to ensure adequate safeguards to prevent loss, damage, or theft of the property. Any loss, damage, or theft shall be investigated. (4) Adequate maintenance procedures must be developed to keep the property in good condition.</p> <p>24 CFR 85.20 (b)(3), establishes that effective control and accountability must be maintained for all grant and subgrant cash, real and personal property, and other assets. Grantees and subgrantees must adequately safeguard all such property and must assure that it is used solely for authorized purposes.</p> <p>Chapter VII, Section 3, 14, 15(2) and 22(2) of Municipality's Basic Standards, establish that the Municipality's Finance Director is responsible for the custody, conservation and use of municipal property against theft, damage or inadequate use. The Finance Director, also, will be responsible for the accounting of all property transactions and records maintenance. All property acquired must be numbered and properly identified. A property record detailing unit number, name, description, cost, acquisition date, brand, serial number, and property location must be completed for each property acquired. An annual physical inventory must be taken and the results reconciled with the property records.</p>

MUNICIPALITY OF SANTA ISABEL, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

FINDING	10-08 (CONTINUED)
CAUSE	The Municipality has inadequate internal control procedures that guarantee adequate records, registering and safeguarding of property.
EFFECT	<p>Due to the lack of internal controls and updated property accounting records, we could not validate the accuracy and completeness of the annual physical inventory report and any other related report. For such reason, we were unable to adequately perform our tests of real property and equipment management in order to ascertain compliance with applicable federal laws and regulations.</p> <p>The Municipality is exposed to the risk of possible unauthorized use and disposition of equipment due to the lack of internal controls and property records. In addition, sanctions could be imposed by the State CDBG Program or the federal awarding agency.</p>
RECOMMENDATION	The Property Division must require each office, department and federal program that acquires property and equipment to submit a report including a full description of the assets, location, use, responsible person, cost, and any other pertinent data. In addition, the CDBG Program and the Accounting Department should establish a property control account and a subsidiary ledger to provide for the reconciliation of property. A physical inventory of the Municipality's property should be performed as soon as possible for all departments and all differences should be investigated, adjusted and reconciled with the property records maintained by the Municipality's federal program offices.
QUESTIONED COSTS	None
MANAGEMENT RESPONSE AND CORRECTIVE ACTION PLAN	<p>Actually, the Municipality's Finance Department staffs continue updating the capital assets subsidiary ledger in order to comply with the GASB No. 34 capital assets requirements for the fiscal year ended on June 30, 2012. Therefore, we will request to the Property Division staff to take into account the Federal regulations requirements.</p> <p>Implementation Date: June 30, 2012</p> <p>Responsible Person: Mrs. Janice Brugman Federal Programs Director</p>

MUNICIPALITY OF SANTA ISABEL, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

FINDING	10-09
FEDERAL PROGRAM	COMMUNITY DEVELOPMENT BLOCK GRANT/STATE'S PROGRAM (CDBG) (CFDA NO. 14.228) DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT PASS THROUGH STATE-OFFICE OF COMMISSIONER OF MUNICIPAL AFFAIRS
CATEGORY	INTERNAL CONTROL / COMPLIANCE
NONCOMPLIANCE	CASH MANAGEMENT
TOPIC SENTENCE	NON-COMPLIANCE WITH CASH MANAGEMENT REQUIREMENTS
CONDITION	<p>In testing compliance with the Cash Management requirements, we examined the monthly cash balances of the Community Development Block Grants Programs and evaluated the procedures implemented to minimize the time elapsed between the transfer of federal funds and the payment of funds for program purposes.</p> <p>Based on our tests, we noted that the Community Development Block Grants Program has not established effective cash management procedures. Program had a monthly average cash balance of \$138,050 during the fiscal year ended June 30, 2010.</p> <p>In addition to the above test, we selected six drawdowns for examination and noted that the time elapsed between the drawdown date and the disbursement date was between 5 and 221 days.</p>
CRITERIA	<p>OMB Circular A-102 and the Treasury Regulations at 31 CFR 205, state that drawdown of federal funds should be made only for immediate needs. In addition, when grant award funds are advanced to the Community Development Block Grants Program, the Municipality must follow procedures to minimize the time elapsing between the receipt and the disbursement of such funds.</p> <p>When advances are made by letter of credit or electronic transfer of funds, the Municipality must make drawdowns as close as possible to the time of making disbursements. Disbursements of funds received should be made within three (3) days of the date of deposit of funds for grant advances greater than \$5,000.</p>

MUNICIPALITY OF SANTA ISABEL, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

FINDING	10-09 (CONTINUED)
	<p>31 CFR 205.6 established that the zero balance accounting is a method of transferring federal funds to the Municipality based on the actual amount of funds that are paid out by the Municipality. The funding technique must be auditable for internal control purposes. Auditable means, the sources of data and information for a calculation are readily available, fully documented, and verifiable, such that the calculation can be replicated and proven to comply with all pertinent standards.</p>
CAUSE	<p>These conditions occurred because the Municipality does not have adequate internal controls and procedures designed to appropriately ascertain compliance with these federal requirements.</p>
EFFECT	<p>The continued occurrence of this situation will result in future instances of noncompliance with federal regulations related to cash management. In addition, the Municipality will not be able to reconcile the disbursements with their corresponding checks for accounting purposes in a timely manner.</p>
RECOMMENDATION	<p>We recommend the Community Development Block Grants Program to establish the necessary internal controls and procedures to ascertain that the drawdown of federal funds is only made for immediate program needs. In addition, the Municipality must establish and implement adequate procedures to forecast the transfer of funds from the grantor to the program.</p>
QUESTIONED COSTS	None
MANAGEMENT RESPONSE AND CORRECTIVE ACTION PLAN	<p>We will instruct our Program Accountant to follow the established procedures to drawdown and disburse Program funds in order to demonstrate compliance with the cash management regulations.</p> <p>Implementation Date: December 2011</p> <p>Responsible Person: Mrs. Janice Brugman Federal Programs Director</p>

MUNICIPALITY OF SANTA ISABEL, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

FINDING	10-10
FEDERAL PROGRAM	COMMUNITY DEVELOPMENT BLOCK GRANT/ STATE'S PROGRAM (CDBG) (CFDA NO. 14.228) DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT PASS THROUGH STATE-OFFICE OF COMMISSIONER OF MUNICIPAL AFFAIRS
CATEGORY	INTERNAL CONTROL / COMPLIANCE
NONCOMPLIANCE	DAVIS-BACON ACT
TOPIC SENTENCE	NONCOMPLIANCE WITH THE DAVIS-BACON ACT
CONDITION	Municipality did not comply adequately with Davis-Bacon Act applicable regulations. The Municipality did not required to all contractors or subcontractors, for each week in which any contracted work was performed, a copy of the payroll and a statement of compliance. Also, the Municipality did not document adequately the verification about that all laborers employed by the contractors were paid according to the wages established by law.
CRITERIA	As stated in 29 CFR 5.5 (a)(3)(ii)(A), the contractor shall submit weekly for each week in which any contract work is performed a copy of all payrolls to the Municipality. The payrolls submitted shall set out accurately and completely all of the information required to be maintained. The prime contractor is responsible for the submission of copies of payrolls by all subcontractors. Each payroll submitted shall be accompanied by a "Statement of Compliance", signed by the contractor or subcontractor or his or her agent who pays or supervise the payment of the persons employed under the contract and certifying all the information required under 5.5 (a)(3)(ii)(B) (1) to (3).
CAUSE	The Municipality did not require all contractors the documentation to ascertain compliance with such requirements.
EFFECT	The Municipality may have procured services from an organization that is not complying with the applicable Department of Labor regulations and could result in cost disallowances by the federal awarding agency.
RECOMMENDATION	The Municipality should require to all contractors whose contracts are funded with CDBG award that complies with this requirement and should verify its compliance trough the designated municipal officer.

MUNICIPALITY OF SANTA ISABEL, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

FINDING **10-10 (CONTINUED)**

QUESTIONED COSTS None

MANAGEMENT RESPONSE AND
CORRECTIVE ACTION PLAN

The Program staff with the duties of a labor standards officer has been properly advised of the need to obtain and monitor the contractors certificated payrolls related to the projects, and verify its for compliance.

Implementation Date: December 2011

Responsible Person: Mrs. Janice Brugman
Federal Programs Director

MUNICIPALITY OF SANTA ISABEL, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

FINDING	10-11
FEDERAL PROGRAM	COMMUNITY DEVELOPMENT BLOCK GRANT/ STATE'S PROGRAM (CDBG) (CFDA NO. 14.228) DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT PASS THROUGH STATE-OFFICE OF COMMISSIONER OF MUNICIPAL AFFAIRS
CATEGORY	INTERNAL CONTROL / COMPLIANCE
NONCOMPLIANCE	SPECIAL TEST
TOPIC SENTENCE	DEFICIENCIES REGARDING THE HOUSEKEEPERS PROJECTS DOCUMENTATION
CONDITION	<p>In testing compliance with the housekeeper's project requirements, we examined six participants and six housekeeper's files from the two projects active during the fiscal year 2009-10 and we noted the following conditions:</p> <ul style="list-style-type: none">• Participant's files:<ul style="list-style-type: none">✓ No official number is being assigned to the participant's files.✓ In three cases the participant's file did not include evidence of family income nor was the evidence available for our review.✓ One participant's file did not include evidence of family expenses nor was the evidence available for our review.✓ One participant's file did not include the certificate stating the health condition of the participant.✓ The six participant's files did not include copy of the form or communication of eligibility determination to the participant.• Housekeeper's files:<ul style="list-style-type: none">✓ The employment application was not found in file for the six files reviewed.✓ In two cases the file did not include a housekeeper's health certificate valid for the contracted period.

MUNICIPALITY OF SANTA ISABEL, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

FINDING	10-11 (CONTINUED) <ul style="list-style-type: none">• Visits and follow-up:<ul style="list-style-type: none">✓ We observe that the Municipality personnel are not performing the follow-up visits as required by the project operational guide. For the six cases reviewed, there was only one visit documented in file for the entire contracted period. Also, we observe the evaluation form is not being signed by the housekeeper and only in two cases the form was signed by the participant.
CRITERIA	The Housekeeper's Project Operational Guide establishes the controls and procedures to be followed by Municipality personnel during the eligibility determination and the housekeeper's recruitment. Also, states the related documentation that should be included in file. In addition, the guide requires that the Service Coordinator perform at least one monthly follow-up visit for each case, being present the housekeeper and the participant; and one follow-up visit without the housekeeper present.
CAUSE	These conditions occurred because of the lack of adequate internal controls and procedures designed to obtain the required documentation during eligibility determination and recruitment processes. Also, the Municipality personnel did not have adequate controls and supervision to assure compliance with the required follow-up visits and evaluations.
EFFECT	The continued occurrence of this situation will result in future instances of noncompliance with the aforementioned requirements.
RECOMMENDATION	The Program personnel should assure the consistent implementation of internal controls and procedures in order to obtain all the required documentation from the participants and housekeepers during the eligibility determination and recruitment processes, respectively. Also, adequate supervision and controls should be implemented to assure that the required follow-up and evaluation visits are performed.
QUESTIONED COSTS	None

MUNICIPALITY OF SANTA ISABEL, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

FINDING

10-11 (CONTINUED)

MANAGEMENT RESPONSE AND
CORRECTIVE ACTION PLAN

We are going to instruct the Program staff with the responsibilities to maintain the participants' files in compliance the Program regulations, to follow all the procedures and to use all forms specified in the procedures guide.

Implementation Date: December 2011

Responsible Person: Mrs. Janice Brugman
Federal Programs Director

MUNICIPALITY OF SANTA ISABEL, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

FINDING	10-12
FEDERAL PROGRAM	SECTION 8 HOUSING CHOICE VOUCHERS (CFDA NO. 14.871) U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
CATEGORY	INTERNAL CONTROL / COMPLIANCE
NONCOMPLIANCE	FISCAL REQUIREMENTS
TOPIC SENTENCE	INADEQUATE FISCAL CONTROL AND LACK OF ACCOUNTING RECORDS
CONDITION	Municipality's Section 8 Housing Choice Vouchers Program does not maintain accurate and complete accounting records. Proper accounting policies regarding revenue recognition, expenditures, assets, liabilities and fund balance were not adequately followed. Month-end and year-end closing procedures were incomplete and they were not performed according to Program's federal regulations. These situations cause that general ledger accounts were not in balance as of June 30, 2010.
CRITERIA	As stated in 24 CFR 982.158(a) the PHA must maintain complete and accurate accounts and other records for the program in accordance with HUD requirements, in a manner that permits a speedy and effective audit. In addition, 24 CFR 92.20(b) establishes that the financial management systems of other grantees and subgrantees must meet the following standards: (1) 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 or subgrant; (2) grantees and subgrantees 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 subgrant awards and authorizations, obligations, unobligated balances, assets, liabilities, outlays or expenditures, and income; (3) Effective control and accountability must be maintained for all grant and subgrant cash, real and personal property, and other assets.
CAUSE	The Municipality's and Program's management have not established the procedures and adequate internal controls to ensure the adequate recording of all related financial information.

MUNICIPALITY OF SANTA ISABEL, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

FINDING	10-12 (CONTINUED)
EFFECT	These conditions inhibit the Municipality from having current accurate and reliable financial reports and information necessary for management to take efficient and effective actions, including corrective actions plans. Also, Municipality's failure to have accurate and complete accounting records could result in the qualification of the general purposes financial statements audit opinion.
RECOMMENDATION	The Municipality should establish a plan and implement the corresponding internal controls to ensure that all Program's transactions and activities are properly recorded and fairly presented in accordance with program requirements.
QUESTIONED COSTS	None
MANAGEMENT RESPONSE AND CORRECTIVE ACTION PLAN	<p>All of the Section 8 Housing Choice Voucher Program accounting transactions has been posted in the Fund 03 of the Uniform Computerized Accounting System (SUCM, by its acronyms in Spanish) provided by the Office of the Commissioner of Municipal Affairs (OCAM) to all of the municipalities of Puerto Rico (as required by Law No. 81), but due to the fact that the SUCM real accounts balances carried forward from prior years were affected by accounting errors in the first years of the system operation, the real accounts balances could be affected by such errors. We believe that for operational and budgetary purposes, the financial information provided by the SUCM provides current accurate and reliable financial reports and information necessary for management to take efficient and effective actions. But, in order to maintain accounting records exclusively for the Section 8 Housing Choice Voucher Program transactions, we will improve our set of manual accounting records.</p> <p>Implementation Date: March 2012</p> <p>Responsible Person: Mrs. Janice Brugman Federal Programs Department Director</p>

MUNICIPALITY OF SANTA ISABEL, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

FINDING	10-13
FEDERAL PROGRAM	SECTION 8 HOUSING CHOICE VOUCHERS (CFDA NO. 14.871) U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
CATEGORY	INTERNAL CONTROL / COMPLIANCE
NONCOMPLIANCE	ACTIVITIES ALLOWED
TOPIC SENTENCE	INADEQUATE SEGREGATION OF DUTIES
CONDITION	<p>As part of our evaluation of the Program's internal controls, we observe the following conditions:</p> <ul style="list-style-type: none">✓ The Section 8 Housing Choice Voucher Program has only two employees assigned to perform the program related tasks and procedures: the Program Director and the Program Inspector. The Program Director performs the principal program tasks and procedures without proper supervision and mitigating controls. Those tasks and procedures includes the following:<ul style="list-style-type: none">• Maintain and update the waiting list.• Obtain documentation from applicants and participants, and perform the initial eligibility determination and the annual reexamination processes, including the submission of the form 50058 to HUD. This includes the determination of the HAP Payment and Total Tenant Payment.• Prepare the participants and owners contracts and obtain the required signatures.• Prepare the purchase orders and disbursement vouchers and register them in the Municipality's Uniform Accounting System.• Register and update the supplier's master information in the Municipality's Uniform Accounting System.• Maintain custody of participant's files and other program documentation.• In some occasions, perform the HQS inspections.

MUNICIPALITY OF SANTA ISABEL, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

FINDING

10-13 (CONTINUED)

CRITERIA

The A-102 Common Rule and OMB Circular A-110 (2 CFR part 215) require that non-Federal entities receiving Federal awards establish and maintain internal control designed to reasonably ensure compliance with Federal laws, regulations, and program compliance requirements.

An adequate segregation of duties between performance, review, and recordkeeping of a task, is one of the control activities that the entity should establish in order to assure that Federal Awards are expended only for allowable activities, and that the costs of goods and services charged to Federal awards are allowable and in accordance with the applicable cost principles.

The 24 CFR sections 982.151 and 982.152 establish that PHAs may use program funds only for HAPs to participating owners, and for administrative fees.

According to Article 8.010 (d) of Law Num. 81 for the Municipalities of Puerto Rico, the procedures to incur in expenses and pay for them, and to collect and deposit municipal funds should have sufficient and adequate controls in order to prevent irregularities, or to allow the detection and establishment of responsibilities, if such irregularities are committed. Also, the Chapter III and IV of the Regulation for Municipal Administration states the procedures and controls that should be observed by the Municipality regarding the revenue and expenditure cycle, respectively.

CAUSE

The Municipality and Program personnel have not established adequate segregation of duties between performance, review, and recordkeeping of the principal program's tasks, or other mitigating controls, in order to ensure compliance with Federal laws, regulations, and program compliance requirements.

EFFECT

Absence of such controls could lead to the approval and payment of expenditures for activities that are not allowed or are not in accordance with the applicable cost principles. Also, the absence of proper supervision and mitigating controls could prevent the detection of errors and irregularities from being detected.

MUNICIPALITY OF SANTA ISABEL, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

FINDING	10-13 (CONTINUED)
RECOMMENDATION	The Municipality and program personnel should establish adequate internal controls and segregation of duties between program's tasks and procedures, or adequate mitigating controls, in order to ensure compliance with Federal laws, regulations, and program compliance requirements.
QUESTIONED COSTS	None
MANAGEMENT RESPONSE AND CORRECTIVE ACTION PLAN	We will realize an overall analysis of the Program operations in order to design appropriate control and procedures, including a redistribution of Program staff tasks in order to maintain an adequate segregation of duties. Implementation Date: March 2012 Responsible Person: Mrs. Janice Brugman Federal Programs Director

MUNICIPALITY OF SANTA ISABEL, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

FINDING	10-14
FEDERAL PROGRAM	SECTION 8 HOUSING CHOICE VOUCHERS (CFDA NO. 14.871) U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
CATEGORY	INTERNAL CONTROL / COMPLIANCE
NONCOMPLIANCE	CASH MANAGEMENT
TOPIC SENTENCE	NON-COMPLIANCE WITH CASH MANAGEMENT REQUIREMENTS
CONDITION	<p>In testing compliance with the Cash Management requirements, we examined the monthly cash balances of the Section 8 Housing Choice Voucher Program and evaluated the procedures implemented to minimize the time elapsed between the transfer of federal funds and the payment of funds for program purposes.</p> <p>During the fiscal year 2009-10, the Municipality received approximately \$375,000 from Section 8 Housing Choice Vouchers grant funds. In order to determine compliance with the applicable cash management requirements, we selected for testing four out of twelve transfers of funds received during the fiscal year amounting \$148,960 (40%). Even though the time elapsed between the receipt and the disbursement of such funds was from 1 to 3 days, we observe that the Program's maintain an account bank balance of approximately \$79,000 as of June 30, 2010.</p> <p>In addition, internal controls regarding the receipt of income are not adequately followed. Collections receipts were not issued to account for the receipt of monthly housing assistance and administrative fees funds electronically transferred to the Municipality.</p>
CRITERIA	<p>As stated in 24 CFR 85.20(b)(7); 85.21(c) and 31 CFR 205.33, Subpart B, grantees must minimize the time between the drawdown of Federal funds from the Federal government and their disbursement for Federal program purposes.</p> <p>Also, the Chapter III Section 4(2)(h) of the Regulation for Municipal Administration establishes that a pre numbered receipt (OCAM CR01 Model) should be issue by the Municipality's Collector to account for all funds received.</p>

MUNICIPALITY OF SANTA ISABEL, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

FINDING	10-14 (CONTINUED)
	24 CFR 85.20(b)(3) establishes that effective control and accountability must be maintained for all grant cash and other assets.
CAUSE	The aforementioned condition is mainly due to the lack of adequate controls that guarantee the adequate and promptly disbursement of federal funds transactions.
EFFECT	If the recipient fails to expend those Federal assistance funds within a reasonable period, the Municipality could be subject to penalties from the Federal Government and be adversely affected in the benefits they are entitled to receive in the future.
RECOMMENDATION	The Program should implement adequate internal control procedures which allow the promptly use of federal funds received. Administrative funds should be budgeted, distributed and managed in a manner that provide for the promptly use of funds.
QUESTIONED COSTS	None.
MANAGEMENT RESPONSE AND CORRECTIVE ACTION PLAN	<p>Program Staff was instructed to improve disbursement procedures to minimize the time elapsed between the receipt and the disbursement of Section 8 program funds in order to disburse funds in the next three to five days after receipt of funds; and to request to the Official Collector a receipt issuance for each monthly housing assistance and administrative fees electronic fund transfer received by the Program.</p> <p>Implementation Date: December 2011</p> <p>Responsible Person: Mrs. Janice Brugman Federal Programs Department Director</p>

MUNICIPALITY OF SANTA ISABEL, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

FINDING	10-15
FEDERAL PROGRAM	SECTION 8 HOUSING CHOICE VOUCHERS (CFDA NO. 14.871) U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
CATEGORY	INTERNAL CONTROL / COMPLIANCE
NONCOMPLIANCE	ELIGIBILITY
TOPIC SENTENCE	INADEQUATE CONTROLS OVER ELIGIBILITY DOCUMENTATION
CONDITION	<p>During the fiscal year 2009-10, Municipality's Section 8 Housing Choice Voucher Program counts with approximately 64 participants. In order to evaluate participants' income eligibility, total tenants payments and housing assistance payments ("HAP") we select for testing 10 participants files or 16% of Programs' total participants. Of those files, 6 correspond to new admissions during the fiscal year and 4 to reexaminations. Based on our examination of the project files, we noted the following conditions:</p> <ul style="list-style-type: none">✓ For two out of four participant families subject to reexamination during the fiscal year, the EIV Report corresponding to the reviewed reexamination was not available for our review and was not included in the participant's file.✓ Three out of four participant's files corresponding to reexaminations during the fiscal year did not include evidence of the utility bills for the reexamination reviewed.✓ In seven cases, the application form was not available for our review and was not included in the participant's file.✓ In two cases, we observe differences among the demographic information presented in the form 50058 and the family member's documents in file.✓ For one case the voucher was not found in file.✓ For one participant family, the social security copy for one of its members was not available for our examination and was not included in the participant's file.

MUNICIPALITY OF SANTA ISABEL, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

FINDING

10-15 (CONTINUED)

- ✓ For one participant family, the certificate of no penal record for one of its members was not available for our examination and was not included in the participant's file.
- ✓ For one participant family, the CRIM certification for one of its members was not available for our examination and was not included in the participant's file.
- ✓ For three (3) participant families, the social security numbers of all family members were not included in the participant's file and were not available for our examination.
- ✓ One file did not include the family picture.

Also, as part of additional procedures designed to corroborate the accuracy of the HAP and negative rent payments, 130 cancelled checks solicited to Municipality personnel were not available for our review.

CRITERIA

24 CFR 982.201(b) states that an applicant may eligible to obtain Section 8 Housing Choice Voucher benefits if he or she: (1) is income eligible, (2) is part of a family group in accordance with the definition of family prescribed by HUD, (3) furnishes the social security numbers for all family members age six or older, and (4) is a head of household or part of an elderly or disabled family.

CAUSE

These conditions occurred because of the lack of adequate internal controls and procedures designed to obtain the required documentation during the initial examination and annual reexaminations. Program's personnel is not following, gathering and obtaining all the required documents that support amounts indicated on form 50058. In addition, HUD forms 50058 are not double checked once they are electronically generated by a mechanism system in order to determine any mistake made at the moment when the information was entered into the system.

EFFECT

The continued occurrence of this situation will result in future instances of noncompliance with the aforementioned federal requirements.

MUNICIPALITY OF SANTA ISABEL, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

FINDING

10-15 (CONTINUED)

RECOMMENDATION

The Program personnel should assure the consistent implementation of internal controls during the initial examination and annual reexaminations in order to obtain all the required documentation from the participants. The Program should also revise its internal control procedures to obtain, and include in the participant files, all the necessary information that support amounts indicated on HUD 50058 forms.

QUESTIONED COSTS

None

MANAGEMENT RESPONSE AND
CORRECTIVE ACTION PLAN

A new Staff was engaged to manage the programmatic operations of Section 8 Housing Choice Voucher Program. This Staff have been properly trained in order to assure compliance with Program Regulations.

Implementation Date: March 2012

Responsible Person: Mrs. Janice Brugman
Federal Programs Director

MUNICIPALITY OF SANTA ISABEL, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

FINDING	10-16
FEDERAL PROGRAM	SECTION 8 HOUSING CHOICE VOUCHERS (CFDA NO. 14.871) U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
CATEGORY	COMPLIANCE
NONCOMPLIANCE	SPECIAL TESTS AND PROVISIONS
TOPIC SENTENCE	DEFICIENCIES REGARDING HOUSING ASSISTANCE PAYMENTS AND NEGATIVE RENT PAYMENTS
CONDITION	<p>During the fiscal year 2009-10, Municipality's Section 8 Housing Choice Voucher Program counts with approximately 64 participants. In order to evaluate participants' income eligibility, total tenants payments and housing assistance payments ("HAP") we select for testing 10 participants files or 16% of Programs' total participants. Of those files, 6 correspond to new admissions during the fiscal year and 4 to reexaminations. Based on our recalculation of the HAP and tenant payments we noted the following conditions:</p> <ul style="list-style-type: none">✓ In two out of ten cases, we observe that the HAP payment calculation was performed using the payment standard corresponding to the subsidy standard size on the housing voucher instead of the payment standard that correspond to actual housing unit size, as follows:<ul style="list-style-type: none">• For one case, the subsidy standard size was 3 bedrooms but the actual housing unit size, as stated in the inspection form, was 2 bedrooms. The program personnel used the payment standard for a 3 bedroom unit for the HAP payment calculation. Per this calculation, the family received a negative rent of \$52 when the family should pay the owner \$38.• For other case, the subsidy standard size was 4 bedrooms but the actual housing unit size, as stated in the inspection form, was 3 bedrooms. The program personnel used the payment standard for a 4 bedroom unit for the HAP payment calculation. Per this calculation, the family received a negative rent of \$68 when the family should receive a negative rent of \$22.

MUNICIPALITY OF SANTA ISABEL, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

FINDING

10-16 (CONTINUED)

- ✓ For one case, we observe inconsistencies in the negative rent payments to the tenant. During our test we could not trace the amount of negative rent paid to the tenant for June 2010 to the amount presented in the form 50058 and the tenant rent contract. Per those documents, the tenant will receive a negative rent of \$48 from February 2010 to January 2011, but as per check register, during the period from February to June 2010, negative rent payments to the tenant were as follows: one for \$48, two for \$47, one for \$67 and one for \$29. We verified the participant file and there was no documentation about these variations in the negative rent payments.

CRITERIA

24 CFR 982.402(c) states that the payment standard for a family shall be the lower of: (1) The payment standard amount for the family unit size; or (2) The payment standard amount for the unit size of the unit rented by the family.

Chapter I of the Program Administrative Plan states that a family may lease a unit with fewer bedrooms than the subsidy standard size on the housing voucher, as long as the smaller unit meets the applicable Housing Quality Standards (HQS) space requirements at 24 CFR 982.402 [d]. However, the calculation of the housing subsidy will be based on the actual unit size selected as will the allowances for any tenant-paid utilities.

CAUSE

The Program personnel are not following the policies and procedures established by the federal regulation when determining the HAP and TTP amounts.

EFFECT

Housing assistance payment (HAP) amount could be incorrectly determined by considering an amount not properly supported or incorrectly determined. The Program might be making payments in excess or below the corresponding HAP amount that may expose the Municipality to cost disallowance and adversely affect the Municipality's ability to be awarded with future grants.

RECOMMENDATION

At the moment of determining HAP and TTP amounts, Program personnel should adhere to the policies and procedures established by federal regulation and by HUD approved Program's Administrative Plan.

MUNICIPALITY OF SANTA ISABEL, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

FINDING

10-16 (CONTINUED)

QUESTIONED COSTS

No questioned costs were determined since likely questioned costs do not exceed \$10,000.

MANAGEMENT RESPONSE AND
CORRECTIVE ACTION PLAN

A new Staff was engaged to manage the programmatic operations of Section 8 Housing Choice Voucher Program. This Staff have been properly trained in order to assure compliance with Program Regulations.

Implementation Date: March 2012

Responsible Person: Mrs. Janice Brugman
Federal Programs Director

MUNICIPALITY OF SANTA ISABEL, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

FINDING	10-17
FEDERAL PROGRAM	SECTION 8 HOUSING CHOICE VOUCHERS (CFDA NO. 14.871) U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
CATEGORY	INTERNAL CONTROL / COMPLIANCE
NONCOMPLIANCE	SPECIAL TESTS AND PROVISIONS
TOPIC SENTENCE	WAITING LIST DEFICIENCIES
CONDITIONS	<p>In testing compliance with applicable federal regulations regarding the waiting list administration, we selected for testing ten applicants names that reach the top of the waiting list in order to verify if were admitted to the program or provided the opportunity to be admitted to the program in accordance with the PHA's applicant selection policies. Five out of ten applicants were not admitted to the program. The application files with the follow-up notices or other documentation stating the exclusion reasons for those five cases were not available for our review.</p>
CRITERIA	<p>As stated in 24 CFR 982.204(c); the PHA administrative plan must state PHA policy on when applicant names may be removed from the waiting list. The policy may provide that the PHA will remove names of applicants who do not respond to PHA requests for information or updates.</p> <p>As stated in 24 CFR 982.204(a); except for special admissions, PHA must select participants from the waiting list in accordance with admission policies in the PHA administrative plan.</p> <p>Chapter D of the Program Administrative Plan states the process the Program personnel should follow when updating the waiting list and the documentation that should be maintained in file. Among other requirements, it establish that for each application which there has been no response and no return notice, the program will send a second notice by certified mail providing a final deadline. When the final deadline passes with no response, the family's application will be closed and maintained with the record of certified delivery for a period of three years.</p>

MUNICIPALITY OF SANTA ISABEL, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

FINDING	10-17 (CONTINUED)
CAUSE	The program personnel is not maintaining adequate control over the applications files and related documentation regarding the waiting list update process.
EFFECT	The continued occurrence of this situation will result in future instances of noncompliance with the aforementioned federal requirements.
RECOMMENDATION	The Program personnel should maintain controls to assure adequate documentacion is maintained about the waiting list update process in order to prove that applicants are admitted to the program or provided the opportunity to be admitted to the program in accordance with the PHA's applicant selection policies.
QUESTIONED COSTS	None.
MANAGEMENT RESPONSE AND CORRECTIVE ACTION PLAN	<p>A new Staff was engaged to manage the programmatic operations of Section 8 Housing Choice Voucher Program. This Staff have been properly trained in order to assure compliance with Program Regulations.</p> <p>Implementation Date: March 2012</p> <p>Responsible Person: Mrs. Janice Brugman Federal Programs Director</p>

MUNICIPALITY OF SANTA ISABEL, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

FINDING	10-18
FEDERAL PROGRAM	SECTION 8 HOUSING CHOICE VOUCHERS (CFDA NO. 14.871) DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
CATEGORY	COMPLIANCE
NONCOMPLIANCE	SPECIAL TESTS AND PROVISIONS
TOPIC SENTENCE	NONCOMPLIANCE WITH THE DEPOSITORY AGREEMENT REQUIREMENT
CONDITIONS	We were not able to find evidence indicating that the Municipality enters into a depository agreement, in the form required by HUD, with the financial institution in where Program's funds are deposited.
CRITERIA	As stated in 24 CFR 982.156 PHAs are required to enter into depository agreements with the financial institutions in the form required by HUD. The agreements serve as safeguards for Federal funds and provide third-party rights to HUD.
CAUSE	The Program's personnel did not have knowledge about this requirement.
EFFECT	The Program's funds did not count with the safeguards established in the depository agreement. Also, HUD did not have the required rights over the Program's bank accounts.
RECOMMENDATION	The Program should enter into a depository agreement with the financial institution selected as depository of Program's funds, as required by the federal regulation.
QUESTIONED COSTS	None.
MANAGEMENT RESPONSE AND CORRECTIVE ACTION PLAN	We are in the process to enter into a depository agreement, in the form required by HUD, with the financial institution in where Program's funds are deposited. Implementation Date: January 2012 Responsible Person: Mrs. Janice Brugman Federal Programs Director

MUNICIPALITY OF SANTA ISABEL, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

FINDING NUMBER	10-19
FEDERAL PROGRAM	CHILD CARE AND DEVELOPMENT BLOCK GRANT (CFDA NO. 93.575) PASS THROUGH COMMONWEALTH OF PUERTO RICO- ADMINISTRATION FOR CARE AND INTEGRAL DEVELOPMENT OF CHILDHOOD (ACUDEN)
CATEGORY	INTERNAL CONTROLS OVER COMPLIANCE
NONCOMPLIANCE	FISCAL REQUIREMENTS
TOPIC SENTENCE	INADEQUATE FISCAL CONTROL AND LACK OF ADEQUATE ACCOUNTING RECORDS
CONDITION	<p>Municipality's Child Care and Development Block Grant Program (the Program) does not maintain an adequate fiscal control and accounting records over the management, use and registering of funds granted by the Lead Agency (ACUDEN). Among the deficiencies founds were the following:</p> <ul style="list-style-type: none">- The Program could not provide us with an adequate general ledger or any related subsidiary ledger which detail assets, liabilities, encumbrances, receipts and expenditures of the Program for the fiscal year 2009-2010. We were not able to ascertain that all financial and accounting transactions were recorded.- The lack of proper accounting records does not make possible for the preparation of annual financial statements.- There are no control accounts to accurately account for the inter fund receivable and payables balances. Monthly Program's expenditures financed by the Municipality's general fund are not being registered, monitored nor accounted for by the Program. In addition, inter fund transactions regarding the reimbursement of money between funds were not supported by an analysis.- Program's financial and accounting records does not provided for the proper segregation and accountability of direct service, quality and administrative costs.- A budgetary control is not maintained.

MUNICIPALITY OF SANTA ISABEL, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

FINDING NUMBER **10-19 (CONTINUED)**

CRITERIA

Provision 17(6), (11), (14) and (16) of the Delegation of Funds Contracts subscribed with the Lead Agency (ACUDEN) require the Program to maintain accounting subsidiaries, financial and accounting records, supporting documents, among others, that provide for the proper accountability, implementation of internal controls and monitoring from the Lead Agency and federal authorities. The Program will adopt written administrative and accounting procedures that provide for the trustworthiness of the financial information, and must maintain an adequate fiscal control that provide for the preparation of monthly and annual financial reports, budget control and bank account reconciliations.

45 CFR 98.67(c) establishes that fiscal control and accounting procedures shall be sufficient to permit: (1) preparation of reports; and (2) the tracing of funds to a level of expenditure adequate to establish that such funds have not been used in violation of the provisions of this part.

As stated in 45 CFR 92.20(a) fiscal control and accounting procedures of the State, as well as its subgrantees, must be sufficient to (1) permit preparation of reports required by this part and the statutes authorizing the grant, and (2) permit the tracing of funds to a level of expenditures adequate to establish that such funds have not been used in violation of the restrictions and prohibitions of applicable statutes; (b) The financial management systems of other grantees and subgrantees must meet the following standards: (1) 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 or subgrant; (2) grantees and subgrantees 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 subgrant awards and authorizations, obligations, unobligated balances, assets, liabilities, outlays or expenditures, and income; (3) Effective control and accountability must be maintained for all grant and subgrant cash, real and personal property, and other assets. Grantees and subgrantees must adequately safeguard all such property and must assure that it is used solely for authorized purposes; (4) Actual expenditures or outlays must be compared with budgeted amounts for each grant or subgrant.

MUNICIPALITY OF SANTA ISABEL, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

FINDING NUMBER **10-19 (CONTINUED)**

CAUSE The Municipality's and Program's management have not established the procedures and adequate internal controls to ensure the adequate recording, safeguarding and custody of all related financial information.

EFFECT These conditions inhibit the Municipality from having current accurate and reliable financial reports and information necessary for management to take efficient and effective actions, including corrective actions plans. On the other hand, the awarding agency it is inhibits from monitoring the programs financial performance. Also, Municipality's failure to have accurate and complete accounting records could result in the qualification of the general purposes financial statements audit opinion.

RECOMMENDATION The Municipality should establish a plan and implement the corresponding internal controls to ensure that all Program's transactions and activities are properly recorded and fairly presented in accordance with program requirements and that all financial transactions' supporting documents are properly safeguarded. In addition, should establish and maintain a subsidiary ledger to accurately account for inter fund transactions.

QUESTIONED COSTS None

MANAGEMENT RESPONSE AND
CORRECTIVE ACTION PLAN

To correct the condition reported by the external auditors we will modify existing records in order to assure that the accounting records presented the financial position and the results of operation in sufficient detail to permit an easily audit trial and preparation on time of required financial reports.

Implementation Date: June 30, 2012

Responsible Person: Mrs. Ruby J. Giraldo Meléndez
Program Accountant

MUNICIPALITY OF SANTA ISABEL, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

FINDING NUMBER	10-20
FEDERAL PROGRAM	CHILD CARE AND DEVELOPMENT BLOCK GRANT (CFDA NO. 93.575) PASS THROUGH COMMONWEALTH OF PUERTO RICO- ADMINISTRATION FOR CARE AND INTEGRAL DEVELOPMENT OF CHILDHOOD (ACUDEN)
CATEGORY	INTERNAL CONTROL OVER COMPLIANCE
NONCOMPLIANCE	PROGRAM INCOME
TOPIC SENTENCE	LACK OF INTERNAL CONTROLS OVER PROGRAM INCOME
CONDITION	<p>In testing internal controls over program income compliance requirement, we determined that the Program lack of internal controls over the billing, receipt, accounting, registering, deposit and unobligated balance at the end of each program year regarding parent's contribution for child care services and enrollment fees.</p> <p>The Program does not have an adequate general ledger, nor subsidiary ledger control accounts to accurately account for receivable balances, daily receipts, expenditures, encumbrances and unobligated balance at the end of each program year. In addition, there are no internal controls in order to ascertain that all parents which are required to pay for child care services or annual enrollment fees are being paying. Also, no controls exists to corroborate that all fees that are being collected are promptly deposited, registered, reported and used according to applicable Program's regulations.</p>
CRITERIA	<p>Provisions 10 and 17(6), (8) and (11) of the Delegation of Funds Contracts subscribed with the Lead Agency (ACUDEN) require that the Program it is committed to comply with the norms and procedures to make use of program income as required by the Federal law. In addition, the Program will maintain accounting subsidiaries, financial and accounting records, supporting documents, among others, that provide for the proper accountability, implementation of internal controls and monitoring from the Lead Agency and federal authorities. The Program will adopt written administrative and accounting procedures that provide for the trustworthiness of the financial information, and must maintain an adequate fiscal control that provide for the adequate accountability of other sources of income.</p>

MUNICIPALITY OF SANTA ISABEL, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

FINDING NUMBER 10-20 (CONTINUED)

As stated in 45 CFR 92.20(b), the financial management systems of other grantees and subgrantees must meet the following standards: (1) 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 or subgrant; (2) Grantees and subgrantees 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 subgrant awards and authorizations, obligations, unobligated balances, assets, liabilities, outlays or expenditures, and income; (3) Effective control and accountability must be maintained for all grant and subgrant cash, real and personal property, and other assets.

CAUSE

The Municipality's and Program's management have not established the adequate internal controls procedures to ensure proper recording, safeguarding and reporting of all related program income financial transactions.

EFFECT

These conditions inhibit the Municipality from having current accurate and reliable financial information regarding program income. Furthermore, this condition represents a significant risk of loss of funds. Also, by not having an accounts receivable aging report, proper actions could not be taken against those parents which owed a considerable amount of money and services could be provided to children whose parents do not pay.

RECOMMENDATION

The Municipality should establish and maintain a general and subsidiary ledger to accurately account for program income. Management should implement the corresponding internal controls to ensure that all program income transactions and activities are properly recorded and fairly reported in accordance with program requirements.

QUESTIONED COSTS

None

MANAGEMENT RESPONSE AND
CORRECTIVE ACTION PLAN

To correct the condition reported by the external auditors we will modify existing accounting records in order to assure that the accounting records presented the financial position and the results of operation in sufficient detail to permit an easily audit trial and preparation on time of required financial reports.

Implementation Date: June 30, 2012

Responsible Person: Mrs. Ruby J. Giraldo Meléndez
Program Accountant

MUNICIPALITY OF SANTA ISABEL, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

MUNICIPALITY OF SANTA ISABEL, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

FINDING NUMBER	10-21
FEDERAL PROGRAM	CHILD CARE AND DEVELOPMENT BLOCK GRANT (CFDA NO. 93.575) PASS THROUGH COMMONWEALTH OF PUERTO RICO- ADMINISTRATION FOR CARE AND INTEGRAL DEVELOPMENT OF CHILDHOOD (ACUDEN)
CATEGORY	COMPLIANCE
NONCOMPLIANCE	EQUIPMENT AND REAL PROPERTY MANAGEMENT
TOPIC SENTENCE	LACK OF CONTROLS OVER PROPERTY AND EQUIPMENT ITEMS ACQUIRED WITH FEDERAL FUNDS
CONDITION	<p>The Municipality and the Child Care and Development Block Grant Program (the Program) did not maintained adequate internal controls over property and equipment items acquired with Federal Funds. In testing property and equipment we noted the following:</p> <ul style="list-style-type: none">- The Municipality could not provides us with adequate property records which include a description of the property, serial number or other identification number, the source of the property, who holds title, the acquisition date, cost of the property, percentage of Federal participation in the cost of the property, location, use and condition of the property, and any ultimate disposition data including the date of disposal.- The Child Care Program did not maintain a general ledger or a property subsidiary ledger where all property and equipment transactions are registered. We were not able to assure that all capitalizable expenditures and property dispositions are recorded. In addition, related annual depreciation is not being calculated and accounted for.- We were not able to ascertain that all property and equipment acquired was properly identified through a numbered plate or any other identification form. In a visit to the child care centers we observed that most of the property it is not numbered nor identified.- We were not able to ascertain that all the property and equipment acquired it is being used by the Program's personnel and for Program's purposes.

MUNICIPALITY OF SANTA ISABEL, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

FINDING NUMBER **10-21 (CONTINUED)**

- An updated property and educative material inventory report is not being maintain for each Child Care Center as required by the Delegation of Funds Contract subscribed with the Lead Agency (ACUDEN).

- The results of the last property physical inventory were not reconciled with a property subsidiary ledger or any other accounting record.

CRITERIA

Provisions 7 (1) (g) of the Delegation of Funds Contract subscribed with the Lead Agency (ACUDEN) require that an adequate and update property and educational material inventory register should be maintained.

45 CFR 92.32(d) establishes that procedures for managing equipment will, as a minimum, meet the following requirements: (1) Property records must be maintained that include a description of the property, a serial number or other identification number, the source of property, who holds title, the acquisition date, and cost of the property, percentage of Federal participation in the cost of the property, the location, use and condition of the property, and any ultimate disposition data including the date of disposal and sale price of the property. (2) A physical inventory of the property must be taken and the results reconciled with the property records at least once every two years. (3) A control system must be developed to ensure adequate safeguards to prevent loss, damage, or theft of the property. Any loss, damage, or theft shall be investigated. (4) Adequate maintenance procedures must be developed to keep the property in good condition.

45 CFR 92.20 (b)(3), establishes that effective control and accountability must be maintained for all grant and subgrant cash, real and personal property, and other assets. Grantees and subgrantees must adequately safeguard all such property and must assure that it is used solely for authorized purposes.

MUNICIPALITY OF SANTA ISABEL, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

FINDING NUMBER	10-21 (CONTINUED)
	<p>Chapter VII, Section 3, 14, 15(2) and 22(2) of Municipality's Basic Standards, establish that the Municipality's Finance Director is responsible for the custody, conservation and use of municipal property against theft, damage or inadequate use. The Finance Director, also, will be responsible for the accounting of all property transactions and records maintenance. All property acquired must be numbered and properly identified. A property record detailing unit number, name, description, cost, acquisition date, brand, serial number, and property location must be completed for each property acquired. An annual physical inventory must be taken and the results reconciled with the property records.</p>
CAUSE	<p>The Municipality has inadequate internal control procedures that provides for adequate records, registering and safeguarding of property.</p>
EFFECT	<p>Due to the lack of internal controls and updated property accounting records, it was not possible to validate the accuracy and completeness of the Annual Physical Inventory Report and any other related report. For such reason, we were unable to adequately perform our tests of real property and equipment management in order to ascertain compliance with applicable federal laws and regulations.</p> <p>The Municipality is exposed to the risk of possible unauthorized use and disposition of equipment due to the lack of internal controls and property records. In addition, sanctions could be imposed by the Lead Agency or the federal awarding agency.</p>
RECOMMENDATION	<p>The Property Division must require each office, department and federal program that acquires property and equipment to submit a report including a full description of the assets, location, use, responsible person, cost, and any other pertinent data. In addition, the Program and the Accounting Department should establish a property control account and a subsidiary ledger to provide for the reconciliation of property. A physical inventory of the Municipality's property should be performed as soon as possible for all departments and all differences should be investigated, adjusted and reconciled with the property records maintained by the Municipality's federal program offices.</p>
QUESTIONED COSTS	None

MUNICIPALITY OF SANTA ISABEL, PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

FINDING NUMBER **10-21 (CONTINUED)**

MANAGEMENT RESPONSE AND
CORRECTIVE ACTION PLAN

The delegation of funds contracts provisions have established that the Grantee holds the title of each property and equipment items acquired with funds awarded. Also, the Grantee provided us a property and equipment subsidiary form and required us to include in it all of the property and equipment acquired with the funds delegated, and to conduct an annual physical inventory and submit the property and equipment subsidiary form properly completed. The Program staffs have been properly advised of the need to follow the property and equipment standards established in the delegation of funds contracts provisions.

Implementation Date: December 2011

Responsible Person: Mrs. Ruby J. Giraldo Meléndez
Program Accountant

END OF SCHEDULE

MUNICIPALITY OF SANTA ISABEL, PUERTO RICO

SCHEDULE OF PRIOR AUDIT'S FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

(1) Audit Findings that have been Fully Corrected:

Finding Number	CFDA	Questioned Cost	Comments
None			

(2) Audit Findings not corrected or Partially Corrected:

Finding Number	CFDA	Questioned Cost	Comments
09-01 Fixed\Capital Assets and Expenditures Subsidiary Ledger	N/A	None	Situation still prevails
09-02 Accounting System	N/A	None	Situation still prevails
09-03 Liability Recognition	N/A	None	Situation still prevails
09-04 Reporting	14.228	None	Situation still prevails
09-05 Equipment and Real Property Management	14.228	None	Situation still prevails
09-06 Fiscal Requirements	14.228	None	Situation still prevails
09-07 Cash Management	14.871	None	Situation still prevails
09-08 Fiscal Requirements	14.871	None	Situation still prevails
09-09 Fiscal Requirements	93.575	None	Situation still prevails
09-10 Program Income	93.575	None	Situation still prevails
09-11 Equipment and Real Property Management	93.575	None	Situation still prevails
08-01 Property, Plant and Equipment	N/A	None	Situation still prevails
08-02 Accounting System	N/A	None	Situation still prevails
08-04 Equipment and Real Property Management	14.228	None	Situation still prevails
08-06 Cash Management	14.871	None	Situation still prevails
08-08 Reporting – Internal Control	93.575	None	Situation still prevails
08-09 Program Income	93.575	None	Situation still prevails
08-10 Equipment and Real Property Management	93.575	None	Situation still prevails
07-06 Equipment and Real Property Management	14.228	None	Situation still prevails
06-06 Equipment and Real Property Management	14.228	None	Situation still prevails

(3) Corrective action taken is significantly different from corrective action previously reported:

NONE

(4) Audit findings is no longer valid:

Finding Number	CFDA	Questioned Cost	Comments
09-12 Allowable Costs/Costs Principles	93.600	None	No longer valid
09-13 Reporting	93.600	None	No longer valid
09-14 Reporting	93.600	None	No longer valid
09-15 Matching, Level of Effort, earmarking	93.600	None	No longer valid
07-20 Reporting	93.600	None	No longer valid
06-03 Reporting	93.600	None	No longer valid

END OF SCHEDULE