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AREA DE ARCHIVO DIGITAL

MUNICIPIO DE CULEBRA

AUDITORIA 2003-2004

30 DE JUNIO DE 2004

DE LA COMISIONADO
MUNICIPAL

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**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA**

**BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED
JUNE 30, 2004**

ORTIZ, RODRIGUEZ, RIVERA & CO.

CERTIFIED PUBLIC ACCOUNTANTS • VALUE ADDED SERVICES

Suite 152, PO Box 70250, San Juan, P.R. 00936-7250 • Phone (787) 756-8524, Fax (787) 274-0562

PART I - FINANCIAL SECTION

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BASIC FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

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INDEPENDENT AUDITORS' REPORT

To the Honorable Mayor and
Municipal Legislature
Municipality of Culebra
Culebra, 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 Culebra, as of and for the year ended June 30, 2004, 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 opinions on these financial statements based on our audit.

Except for 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

As discussed in Note 10 to the financial statements, management has not recorded certain general infrastructure assets in governmental activities and, accordingly, has not recorded depreciation expense on those assets. Accounting principles generally accepted in the United States of America require that those general infrastructure assets be capitalized and depreciated, which would increase the assets, net assets, and expenses of the governmental activities. The amount by which this departure would affect the assets, net assets, and expenses of the governmental activities is not reasonably determinable.

As discussed in Note 20 to the financial statements, management has not recorded a provision for liability of closure and postclosure care costs of the landfill. Accounting

principles generally accepted in the United States of America require that a provision for liability of closure and postclosure care costs be recorded to comply with applicable state and federal regulations. The amount by which this departure would affect the liabilities, net assets, and expenses of the governmental activities is not reasonably determinable.

In our opinion, because of the effects of the matters discussed in the preceding paragraphs, the financial statements referred to above do not present fairly, in conformity with accounting principles generally accepted in the United States of America, the financial position of the governmental activities of the Municipality of Culebra as of June 30, 2004, and the changes in financial position thereof for the year then ended.

In addition, in our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of each major fund and the aggregate remaining fund information of the Municipality of Culebra as of June 30, 2004, and the respective changes in financial position, thereof and the respective budgetary comparison for the general and debt service funds, for the fiscal year then ended in conformity with accounting principles generally accepted in the United States of America.

As described in Note 2 to the basic financial statements, the Municipality of Culebra has implemented a new financial reporting model, as required by the provisions of the Governmental Accounting Standards Board ("GASB") Statement No. 34, Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments, as of June 30, 2004.

In accordance with *Government Auditing Standards*, we have also issued our report dated January 5, 2005 on our consideration of the Municipality's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grants, agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis on pages 4 through 10 is not a required part of the basic financial statements, but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquires of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Municipality's basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U. S. Office of Management and Budget Circular A-133, *Audits of States*,

Local Governments, and Non-Profit Organizations, and is also not a required part of the basic financial statements of the Municipality. The schedule of expenditures of federal awards has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Ortiz, Rodriguez, Rivera & Co

San Juan, Puerto Rico
January 5, 2005

The stamp 2000974 was affixed
to the original of this report.



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

Management of the *Municipality of Culebra* of the Commonwealth of Puerto Rico (the "**Municipality**") provides this *Management's Discussion and Analysis* of the Municipality's basic financial statements as an overview and analysis of the financial activities of the Municipality for the fiscal year ended **June 30, 2004**. We encourage readers to consider the information presented here in conjunction with the additional information that we have furnished in the accompanying basic financial statements.

FINANCIAL HIGHLIGHTS

- The Municipality's in the Governmental Activities has reported assets and net assets amounting to **\$11,621,869** and **\$4,092,745** respectively, in the accompanying statement of net assets, of which the most significant assets are capital assets amounting to **\$8,412,866 (72 percent of total Municipality's assets)**.
- The Municipality in the same activities has reported total liabilities amounting to **\$7,529,124** in the accompanying statement of net assets, of which the most significant liabilities are bonds, notes and other long-term debt amounting to **\$4,493,716 (60 percent of total liabilities)**.
- The Municipality has reported total revenues amounting to **\$5,736,138** in the accompanying Statement of Revenues, Expenditures and Changes in Fund Balances-Governmental Funds, for the Fiscal Year Ended **June 30, 2004**. The most significant revenues amounting in this statement are property taxes and municipal licenses taxes and, licenses and permits were to **\$313,665 (5 percent of total revenues)** and **\$328,196 (6 percent of total revenues)**, respectively.
- The Municipality has reported a *(deficiency)* of revenues over expenditures amounting to **(\$683,640)** in the accompanying statement of revenues, expenditures and changes in fund balances.
- The Municipality's governmental funds reported combined ending fund balances of **\$335,596** which represent the fund balances of the general fund, capital projects funds and debt service fund combined (**all known as the Municipality's major funds**).
- The Municipality has reported unreserved fund balance for the general fund amounting to **(\$1,033,530)**.

- The Municipality has reported excess of revenues and other financing sources over expenditures and other financing uses amounting to **(\$1,346,027)** in the governmental funds. Such amount, **(\$1,346,027)** correspond to General Fund, debt service and capital projects fund. As a significant fact, the Municipality's outlays for capital projects during the year amounted **\$1,294,110** while to the available funds provine of the fund balance available at beginning of the fiscal year. Such outlays over financing sources are reducing the expected income for the incongruence on the State economy were the principal reasons of the deficiency in the governmental funds.

OVERVIEW OF THE BASIC FINANCIAL STATEMENTS

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

Government-Wide Financial Statements

The *government-wide financial statements* are designed to provide readers with a broad overview of the Municipality's operations and finance as a whole in a manner similar to private-sector business. These statements provide short-term and long-term information about the Municipality's financial position, which assist the Municipality's management to determine the economic condition at the end of the fiscal year. These financial statements are prepared using the flow of economic resources measurement focus and the accrual basis of accounting. This basically means that these financial statements follow methods that are similar to those used by most businesses. They take into account all revenues and expenses connected with the fiscal year ended **June 30, 2004** even if cash involved have not been received or paid. The government-wide financial statements include: **(1)** the statements of net assets and **(2)** the statement of activities.

Statement of Net Assets

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

Statement of Activities

The statement of activities presents information showing how the Municipality's net assets changed during the fiscal year ended **June 30, 2004**. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will not result in cash flows until future fiscal periods (**such as uncollected taxes and earned but unused vacation leave**). This statement also presents a comparison between direct expenses and program revenues for each function of the Municipality.

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

Fund Financial Statements

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

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

The fund financial statements focus on: **(1)** individual parts of the Municipality's government and **(2)** reporting the Municipality's operations in more detail than the government-wide financial statements. For financial reporting purposes, the Municipality classifies its funds within the following fund categories: **(1)** general fund, **(2)** debt service fund, **(3)** special revenue funds and **(4)** capital projects funds (collectively known as the "governmental funds").

Governmental funds are used to account for all of the services provided by the Municipality. Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on near-term inflows and outflows of spendable resources. They also focus on the balances of spendable resources available at the end of the fiscal year (**June 30, 2004**). This approach is known as using the flow of current financial resources measurement focus and the modified accrual basis of accounting. These statements provide a detailed short-term view of the Municipality's finances that assists in determining whether there will be adequate financial resources available to meet the current needs of the Municipality, that is, evaluating the Municipality's near-term financing requirements.

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

For financial reporting purposes the Municipality has six major funds: (1) the General Fund, (2) Housing and Urban Development Program, (3) Puerto Rico Department of Labor Law 52, (4) Debt Service Fund, (5) Capital Projects Fund and (6) Other Governmental Funds.

Notes to the Basic Financial Statements

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

Required Supplementary Information

The basic financial statements are followed by a section of required supplementary information consisting of: (1) a combining financial statements referred in connection to nonmajor governmental funds is presented, and (2) a budgetary comparison between actual operating results with the original budget and the final amended budget for the general fund.

Government-wide Financial Statements Summary

As noted earlier, net assets may serve over time as a useful indicator of the Municipality's financial position. In the case of the Municipality, assets exceeded liabilities by \$4,092,745 at June 30, 2004.

As previously discussed, by far the largest portion of the Municipality's net assets reflect its investment in capital assets (e.g., land, buildings, machinery, equipment and all other property), less any related debt used to acquire those assets that is still outstanding. The Municipality uses these capital assets to provide services to citizens; consequently, these assets are *not* available for future spending. The following is a condensed presentation of the Municipality's financial position and results of operations, as reported in the government-wide financial statements:

Condensed Statement of Net Assets:

	<u>June 30, 2004</u>
Current assets	\$ 3,209,003
Capital assets	8,412,866
Total assets	<u>\$11,621,869</u>
Current liabilities	3,161,550
Non-current liabilities	4,367,574
Total liabilities	<u>\$ 7,529,124</u>
Net assets/(liabilities):	
Invested in capital assets, net of related debt	8,282,866
Restricted	1,221,882
Unrestricted	<u>(5,412,003)</u>
Total net assets	<u>\$ 4,092,745</u>

An additional portion of the Municipality's net assets (3 percent) represents resources that are subject to restrictions on how they may be used. At the end of the current fiscal year, the Municipality has reported positive balances in two categories of net assets.

Condensed Statement of Activities:

June 30, 2004

Revenues:

Program revenues:

Charges for services	\$ 235,454
Operating grants and contributions	598,813
Capital grants and contributions	546,304

General revenues:

Property taxes	313,665
Municipal license taxes	120,981
Grants and contributions	2,970,848
Interest, fines and penalties	3,586
Miscellaneous	<u>946,487</u>

Total Revenues

\$ 5,736,138

Expenses:

General government	\$ 4,958,281
Public safety	294,816
Public works	715,913
Culture	70,994
Recreation	166,108
Health and welfare	808,737
Depreciation expense	253,588
Interest on long-term debt	<u>162,001</u>

Total expenses

\$ 7,430,438

Change in net assets (1,694,300)

Net assets – at beginning of year

5,787,045

Net assets – at end of year

\$ 4,092,745

Fund Financial Statements Summary

As discussed earlier, the Municipality uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

Governmental Funds - The focus of the Municipality's *governmental funds* is to provide information on near-term inflows, outflows, and balance of *spendable resources*. Such information is useful in assessing the Municipality's financing requirements. In particular, *unreserved fund balance* may serve as a useful measure of a government's

net resources available for spending at the end of fiscal year. The following is a condensed presentation of the Municipality's balance sheet and results of operations of governmental funds:

Condensed Balance Sheet – Governmental funds:

June 30, 2004

Total Assets – Major Funds	\$ 1,580,151
Total Assets – Nonmajor Funds	2,552,298
Total assets	<u>\$ 4,132,449</u>
Total Liabilities – Major Funds	\$ 1,244,555
Total Liabilities – Nonmajor Funds	2,552,298
Total liabilities	<u>\$ 3,796,853</u>
Fund Balances – Major Funds	\$ 335,596
Fund Balances – Nonmajor Funds	<u>-----0-----</u>
Total Fund Balance	<u>\$ 335,596</u>

Condensed Statement of Operations – Governmental funds:

Total Revenues – Major Funds	\$ 4,389,960
Total Revenues – Nonmajor Funds	1,346,178
Total revenues	<u>\$ 5,736,138</u>
Total expenditures – Major Funds	\$ 5,735,987
Total expenditures – Nonmajor Funds	1,346,178
Total expenditures	<u>\$ 7,082,165</u>
Other financing sources (uses) Major	-0-
Other financing sources (uses) Nonmajor	-0-
Revenues Over Expenses – Major	(1,346,027)
Revenues Over Expenses – Nonmajor	<u>-----0-----</u>
Total Fund Balance	<u>\$ (1,346,027)</u>

Financial Contact

The Municipality's financial statements are designed to present users (**citizens, taxpayers, customers, investors and creditors**) with a general overview of the Municipality's finances and to demonstrate the Municipality's accountability. If you have questions about the report or need additional financial information, contact the Municipality's Chief Financial Officer on the 2nd floor of the **Culebra City Hall, Culebra, Puerto Rico**.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA
STATEMENT OF NET ASSETS
JUNE 30, 2004**

<u>Assets</u>	<u>Governmental Activities</u>
Cash (Note 2)	\$ 1,855,114
Cash with fiscal agent (Note 2)	363,110
Accounts receivable - municipal licence tax (Note 7)	4,992
Due from other agencies (Note 8)	985,787
Capital assets, net (Note 10)	8,412,866
	<hr/>
Total assets	\$ 11,621,869
	<hr/>
<u>Liabilities and Net Assets</u>	
Liabilities	
Account payable and accrued liabilities	\$ 190,010
Book overdraft	640,335
Due to other agencies (Note 11)	236,209
Deferred revenues (Note 12):	
Municipal license tax	66,758
State government	1,616,650
Federal government	123,445
Accrued interest	162,001
Noncurrent liabilities (Note 14):	
Due within one year	126,142
Due in more than one year	4,367,574
Total liabilities	<hr/> 7,529,124
Net Assets	
Investment in capital assets, net of related debt	8,282,866
Restricted for:	
Debt service	133,914
Capital projects	1,087,968
Unrestricted	(5,412,003)
	<hr/>
Total net assets	\$ 4,092,745
	<hr/>

The accompanying notes are an integral part of these basic financial statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA
STATEMENT OF ACTIVITIES
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

<u>Functions/Programs</u>	<u>Expenses</u>	<u>Program Revenues</u>			<u>Net (Expense) Revenue and Changes in Net Assets Primary Government Governmental Activities</u>
		<u>Charges for Services</u>	<u>Operating Grants and Contributions</u>	<u>Capital Grants and Contributions</u>	
General government	\$ 4,958,281	\$ 235,454	\$ -	\$ -	\$ (4,722,827)
Public safety	294,816				(294,816)
Public works	715,913			546,304	(169,609)
Culture	70,994				(70,994)
Recreation	166,108				(166,108)
Health and welfare	808,737		598,813		(209,924)
Depreciation	253,588				(253,588)
Interest on long-term debt	162,001				(162,001)
Total	\$ 7,430,438	\$ 235,454	\$ 598,813	\$ 546,304	(6,049,867)
General revenues:					
Property taxes					313,665
Municipal license tax					120,981
Grants and contributions not restricted to specific programs					2,970,848
Interest, fines and penalties					3,586
Miscellaneous					946,487
Total general revenues					<u>4,355,567</u>
Change in net assets					(1,694,300)
Net assets at beginning of year					<u>5,787,045</u>
Net assets at end of year					<u>\$ 4,092,745</u>

The accompanying notes are an integral part of these basic financial statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA
BALANCE SHEET-GOVERNMENTAL FUNDS
JUNE 30, 2004**

<u>Assets</u>	<u>General</u>	<u>Housing and Urban Development Programs</u>	<u>Special Communities Fund</u>	<u>Puerto Rico Department of Labor Law 52</u>	<u>Debt Service</u>	<u>Capital Project</u>	<u>Other Governmental Funds</u>	<u>Total Governmental Funds</u>
Cash and cash equivalents (Note 2)	\$ -	\$ 11,046	\$ 1,616,650	\$ 6,780	\$ -	\$ 115,253	\$ 105,385	\$ 1,855,114
Cash with fiscal agent (Note 2)					133,914	171,821	57,375	363,110
Accounts receivable:								
Municipal license taxes (Note 7)	4,992							4,992
Due from other agencies (Note 8)		254,005		358,038		230,725	143,019	985,787
Due from other funds (Note 9)	353,277					570,169		923,446
Total assets	\$ 358,269	\$ 265,051	\$ 1,616,650	\$ 364,818	\$ 133,914	\$ 1,087,968	\$ 305,779	\$ 4,132,449

The accompanying notes are an integral part of these basic financial statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA
BALANCE SHEET-GOVERNMENTAL FUNDS
JUNE 30, 2004**

<u>Liabilities and Fund Balance</u>	<u>General</u>	<u>Housing and Urban Development Programs</u>	<u>Special Communities Fund</u>	<u>Puerto Rico Department of Labor Law 52</u>	<u>Debt Service</u>	<u>Capital Project</u>	<u>Other Governmental Funds</u>	<u>Total Governmental Funds</u>
Liabilities								
Account payable and accrued liabilities	\$ 169,624	\$ 1,773	\$ -	\$ -	\$ -	\$ -	\$ 18,613	\$ 190,010
Book overdraft	640,335							640,335
Due to other funds (Note 9)	131,629	263,278		364,818			163,721	923,446
Due to other agencies (Note 11)	236,209							236,209
Deferred revenues: (Note 12)								
Municipal license tax	66,758							66,758
State government			1,616,650					1,616,650
Federal government							123,445	123,445
Total liabilities	<u>1,244,555</u>	<u>265,051</u>	<u>1,616,650</u>	<u>364,818</u>	<u>-</u>	<u>-</u>	<u>305,779</u>	<u>3,796,853</u>
Fund Balances (Deficit)								
Reserved for:								
Encumbrances	147,244							147,244
Debt service					133,914			133,914
Capital projects						1,087,968		1,087,968
Unreserved fund balance (deficit)	<u>(1,033,530)</u>							<u>(1,033,530)</u>
Total fund balance (deficit)	<u>(886,286)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>133,914</u>	<u>1,087,968</u>	<u>-</u>	<u>335,596</u>
Total liabilities and fund balance (deficit)	<u>\$ 358,269</u>	<u>\$ 265,051</u>	<u>\$ 1,616,650</u>	<u>\$ 364,818</u>	<u>\$ 133,914</u>	<u>\$ 1,087,968</u>	<u>\$ 305,779</u>	<u>\$ 4,132,449</u>

The accompanying notes are an integral part of these basic financial statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA
RECONCILIATION OF THE GOVERNMENTAL FUNDS
BALANCE SHEET TO STATEMENT OF NET ASSETS
JUNE 30, 2004**

Total fund balances - governmental funds \$ 335,596

Amounts reported for governmental activities in the statement of net assets are different because:

- Capital assets, net used in governmental activities are not current financial resources and therefore are not reported in the governmental funds balance sheet 8,412,866

- Some liabilities, including bonds payable, are not due and payable in the current period and therefore are not reported in the funds. **(Note 4)** (4,655,717)

Net assets of governmental activities \$ 4,092,745

The accompanying notes are an integral part of these basic financial statements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES-GOVERNMENTAL FUNDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004

	General	Housing and Urban Development Programs	Puerto Rico Department of Labor Law 52	Debt Service	Capital Project	Other Governmental Funds	Total Governmental Funds
REVENUES							
Property taxes (Note 6)	\$ 224,096	\$ -	\$ -	\$ 89,569	\$ -	\$ -	\$ 313,665
Municipal license taxes (Note 7)	120,981						120,981
Licenses and permits	207,215						207,215
Charges for service and rents	28,239						28,239
Intergovernmental revenues (Note 13):							
Federal grants and contributions		338,005				260,808	598,813
State contributions	2,223,483		747,365		546,304		3,517,152
Interest, fines, and penalties	2,884			702			3,586
Other revenues	946,487						946,487
Total revenues	<u>3,753,365</u>	<u>338,005</u>	<u>747,365</u>	<u>90,271</u>	<u>546,304</u>	<u>260,808</u>	<u>5,736,138</u>
EXPENDITURES							
Current:							
General government	2,759,719		747,365				3,507,084
Public safety	294,816						294,816
Public works	715,913						715,913
Culture	70,994						70,994
Recreation	166,108						166,108
Health and welfare	209,924	338,005				260,808	808,737
Capital outlays					1,294,110		1,294,110
Debt service:							
Principal retirement				59,019			59,019
Interest and other				165,384			165,384
Total expenditures	<u>4,217,474</u>	<u>338,005</u>	<u>747,365</u>	<u>224,403</u>	<u>1,294,110</u>	<u>260,808</u>	<u>7,082,165</u>
Excess (deficiency) of revenues over (under) expenditures	<u>(464,039)</u>	<u>-</u>	<u>-</u>	<u>(134,132)</u>	<u>(747,806)</u>	<u>-</u>	<u>(1,346,027)</u>
OTHER FINANCING SOURCES (USES)							
Transfers in	767			220,318			221,085
Transfers out	(220,318)			(767)			(221,085)
Total other financing sources (uses)	<u>(219,551)</u>	<u>-</u>	<u>-</u>	<u>219,551</u>	<u>-</u>	<u>-</u>	<u>-</u>
Excess (deficiency) of revenues and other sources over expenditures and other uses	<u>(683,640)</u>	<u>-</u>	<u>-</u>	<u>85,419</u>	<u>(747,806)</u>	<u>-</u>	<u>(1,346,027)</u>
FUND BALANCE (DEFICIT) AT BEGINNING OF YEAR							
	<u>(202,646)</u>			<u>48,495</u>	<u>1,835,774</u>		<u>1,681,623</u>
FUND BALANCE (DEFICIT) AT END OF YEAR							
	<u>\$ (886,286)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 133,914</u>	<u>\$ 1,087,968</u>	<u>\$ -</u>	<u>\$ 335,596</u>

The accompanying notes are an integral part of these basic financial statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA
RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES AND
CHANGES IN FUND BALANCES OF GOVERNMENTAL FUNDS TO THE
STATEMENT OF ACTIVITIES
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

Net change in fund balances - total governmental funds \$(1,346,027)

Amounts reported for governmental activities in the statement of activities are different because:

- 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 and reported as depreciation expense. 1,294,110
- Depreciation expense on capital assets is reported in the statement of activities, but do not require the use of current financial resources. Therefore, depreciation expense is not reported as expenditure in governmental funds. (253,588)
- Governmental funds report principal payments on long-term obligations as expenditures, whereas the principal payments reduces the long-term obligations in the statement of activities. 59,019
- Change in accrued interest expense which does not require the use of current financial resources. 3,383
- Some expenses reported in the statement of activities do not require the use of current financial resources; therefore, are not reported as expenditures in governmental funds. (1,451,197)

Changes in net assets of governmental activities \$(1,694,300)

The accompanying notes are an integral part of these basic financial statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA
STATEMENT OF REVENUES AND EXPENDITURES - BUDGET AND ACTUAL-GENERAL AND DEBT SERVICE FUNDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

	General Fund				Debt Service Fund			
	Budgeted Amounts		Actual	Variance with Final Budget- Positive (Negative)	Budgeted Amounts		Actual	Variance with Final Budget- Positive (Negative)
	Original	Final			Original	Final		
REVENUES								
Property taxes	\$ 1,890,630	\$ 1,881,186	\$ 1,999,459	\$ 118,273	\$ 72,511	\$ 72,511	\$ 89,569	\$ 17,058
Municipal license taxes	201,875	201,875	120,980	(80,895)				
Licenses and permits	964,000	964,000	207,215	(756,785)				
Charges for services and rent	50,000	50,000	28,239	(21,761)				
Intergovernmental revenues:								
State contributions	456,093	456,093	448,121	(7,972)				
Interest, fines and penalties	12,600	12,600	2,885	(9,715)				
Other revenues	396,300	1,041,955	2,891,396	1,849,441				
Total revenues	3,971,498	4,607,709	5,698,295	1,090,586	72,511	72,511	89,569	17,058
EXPENDITURES								
Current:								
General government	2,420,603	3,234,814	4,750,968	(1,516,154)				
Public safety	171,297	325,990	294,816	31,174				
Public works	774,078	689,564	715,914	(26,350)				
Culture and recreation	250,797	244,212	237,102	7,110				
Health and welfare	354,723	374,539	378,343	(3,804)				
Debt service:								
Principal					67,341	67,341	59,019	(8,322)
Interest					5,170	5,170	165,384	160,214
Total expenditures	3,971,498	4,869,119	6,377,143	(1,508,024)	72,511	72,511	224,403	151,892
Excess of expenditures over revenues	\$ -	\$ (261,410)	\$ (678,848)	\$ (417,438)	\$ -	\$ -	\$ (134,834)	\$ (134,834)

The accompanying notes are an integral part of these basic financial statements.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA
NOTES TO THE FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

1. ORGANIZATION

The Municipality of Culebra, Puerto Rico (Municipality) was founded in 1880. The Municipality is a political legal entity with full legislative and administrative faculties in every affair of municipal character, with perpetual succession existence and legal identity, separate and independent from the central government of the Commonwealth of Puerto Rico. The Municipality provides a full range of services including: public safety, public works, culture, recreation, health and welfare, education and other miscellaneous services.

The Municipal Government comprises the executive and legislative branches. The executive power is exercised by the Mayor and the legislative by the Municipal Assembly, which has 15 members. The members of these branches are elected every four years in the Puerto Rico general elections.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying financial statements of the Municipality have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) as applicable to governmental entities. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

For fiscal year ended June 30, 2004, the Municipality implemented; GASB Statement No. 34 (GASB 34), Basic Financial Statements - Management's Discussion and Analysis - for State and Local Governments; GASB Statement No. 37 (GASB 37), Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments: Omnibus; and GASB Statement No. 38 (GASB 38), Certain Financial Statements Disclosures.

GASB 34, as amended by GASB 37, establishes new requirements and a new reporting model for the financial statements of state and local governments. GASB 34 was developed to make the financial statements easier to understand and more useful to the people who use governmental financial information to make decisions.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

The financial information of the Municipality is presented in this report as follows:

- **Management's Discussion and Analysis** - Introduces the basic financial statements and provides an analytical overview of the Municipality's financial activities.
- **Government - Wide Financial Statements** - This reporting model includes financial statements prepared using full accrual of accounting for all of the government's activities. This approach includes not just current assets and liabilities, but also capital assets and long-term liabilities (such as buildings and infrastructure, including bridges and roads, and general obligation debt).
- **Statement of Net Assets** - The statement of net assets is designed to display the financial position of the Municipality, including capital assets and infrastructure. The net assets of the Municipality will be broken down into three categories; invested in capital assets, net of related debt; restricted; and unrestricted.
- **Statement of Program Activities** - The new government - wide statement of activities report expenses and revenues in a format that focuses on the cost of each of the government's functions. The expense of individual functions is compared to the revenues generated directly by the function.
- **Budgetary comparison schedules** - Demonstrating compliance with the adopted budget is an important component of a government's accountability to the public. Under the new reporting model, the Municipality will continue to provide budgetary comparison information in their financial statements. An important change, however, is a requirement to add the government's original budget to the current comparison of final budget and actual results.

The following is a summary of the more significant policies.

a. Reporting Entity

In evaluating how to define the Municipality for financial reporting purposes, management has considered all potential component units. The decision to include a potential component unit in the reporting entity was made by applying the provisions of Statement No. 14, "The Financial Reporting Entity", of the GASB. The basic, but not the only criterion for including a potential component unit within

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004

the reporting entity is if elected officials of a primary government appoints a voting majority of the entity's governing body, and if either one of the following conditions exist: the primary government can impose its will on the other entity or the potential exist for the other entity to (1) provide specific financial benefits to or (2) impose specific financial burdens on the primary government. A second criterion used in evaluating potential component units is if the nature and significance of the relationship between the entity and a primary government are such that to exclude the entity from the financial reporting entity would render the financial statements misleading or incomplete. GAAP details two methods of presentation: blending the financial data of the component units' balances and transactions in a manner similar to the presentation of the Municipality's balances and transactions or discrete presentation of the component units' financial data in columns separate from the Municipality's balances and transactions. Based on the aforementioned criteria, the Municipality has no component units.

b. Government-Wide and Fund Financial Statements

The government-wide financial statements (i.e., the statement of net assets and the statement of changes in net assets) report information on all the activities of the Municipality. For the most part, the effect of interfund activity has been removed from these statements. Governmental activities are supported mainly by taxes and intergovernmental revenues.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function or segment. Program revenues include 1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items not properly included among program revenues are reported instead as general revenues.

The fund financial statements segregate transactions related to certain functions or activities in separate funds in order to aid financial management and to demonstrate legal compliance. These statements present each major fund as a separate column on the fund financial statements; all non-major funds are aggregated and presented in a single column.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

c. Measurement Focus, Basis of Accounting and Financial Statement Presentation

The government-wide financial statements are reported using the *economic resources measurement focus and the accrual basis of accounting*. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenues in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Governmental fund financial statements are reported using the *current financial resources measurement focus and the modified accrual basis of accounting*. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the government considers revenues to be available if they are collected within the current period or soon enough thereafter. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures, as well as expenditures related to compensated absences and claims and judgments, are recorded only when payment is due.

Property taxes, franchise taxes, licenses, and interest associated with the current fiscal period are all considered to be susceptible to accrual and so have been recognized as revenues of the current fiscal period. Only the portion of special assessments receivable due within the current fiscal period is considered to be susceptible to accrual as revenue of the current period. All other revenue items are considered to be measurable and available only when cash is received by the government.

The Municipality reports the following major governmental funds:

1) General Fund

This is the operating fund of the Municipality and accounts for all financial resources, except those required to be accounted for in another fund.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

2) Housing and Urban Development Programs (HUD Programs)

This fund account for revenue sources for the development of viable urban communities, decent housing, suitable living environment, rental assistance to help very low-income families afford decent, safe and sanitary housing by encouraging property owners to rehabilitate substandard housing and lease the units with rental subsidies to low-income family.

3) Special Communities Fund

This fund account for revenue sources for improvements and construction of housing projects for low-income people.

4) Puerto Rico Department of Labor - Law 52

This fund is used to account for revenues sources from the Puerto Rico Department of Labor to create job opportunities in the public sector.

5) Debt Service Fund

This fund is used to account for the resources accumulated and payments made for principal and interest on long-term general obligation debt of governmental funds.

6) Capital Project Fund

This fund is used to account for the financial resources used for the acquisition and construction of major capital facilities, financed with the proceeds of general obligation bonds.

Private-section standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed in the government-wide financial statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

As a general rule the effect of interfund activity has been eliminated from the government-wide financial statements.

Amounts reported as *program revenues* include 1) charges to customers or applicants for goods, services, licenses, permits, or privileges provided, 2) operating grants and contributions, and 3) capital grants and contributions, including special assessments. Internally dedicated resources are reported as *general revenues* rather than as program revenues. Likewise, general revenues include all taxes.

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

d. Cash and Cash with Fiscal Agent

The Municipality's Finance Director is responsible for investing available resources. The Municipality is restricted by law to invest only in savings accounts and certificates of deposit with banks qualified as a depository of public funds by the Puerto Rico Treasury Department (PRTD) or in instruments of the Government Development Bank for Puerto Rico (GDB).

Cash with fiscal agent in the capital projects fund consists of unused proceeds from appropriations from the Legislature of Puerto Rico, for the payment of current liabilities, and bonds and notes issued for the acquisition and construction of major capital improvements. Cash with fiscal agent in the debt service fund represents special additional property tax collections retained by the Commonwealth of Puerto Rico and restricted for the payment of the Municipality's debt service, as established by law.

e. Interfund Receivables and Payables

Activity between 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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

(i.e., the non-current portion of interfund loans). All other outstanding balances between funds are reported as due to/from other funds.

f. Capital Assets

Capital assets purchased or acquired are carried at historical cost or estimated historical cost. Contributed assets are recorded at fair market value as of the date donated. Additions, improvements and other capital outlays that significantly extend the useful life of an asset are capitalized. Other costs incurred for repairs and maintenance are expensed as incurred. Depreciation in capital assets is calculated on the straight-line basis over the following estimated useful lives:

	<u>Useful Life</u>
Infrastructure	25-50 years
Buildings and building improvements	20-50 years
Furniture and fixtures	5-10 years
Vehicles and equipment	5-20 years

g. Reservation of Fund Balance

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

1) Encumbrances

Represent future expenditures under purchase orders, contracts and other commitments. These committed amounts generally will become liabilities in future periods as the goods or services are received.

2) Debt Service

Represents net assets available to finance future debt service payments.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

3) Capital Projects Fund

Represents the reservation of amounts to be used for future expenditures for capital projects under contracts and other commitments. The committed amounts generally will become liabilities in future periods as the projects are completed.

h. Risk Financing

The Municipality carries insurance to cover casualty, theft, tort claims and other losses. Insurance policies are negotiated by the Puerto Rico Treasury Department and costs are allocated among all the municipalities of Puerto Rico. Cost of insurance allocated to the Municipality and deducted from the gross property tax collections by the Municipal Revenue Collection Center (the "CRIM") for the year ended June 30, 2004 amounted to \$87,853. The current insurance policies have not been cancelled or terminated. The CRIM also deducted \$108,113 for workers compensation insurance covering all municipal employees.

i. Compensated Absences

Employees are entitled to 30 days vacations leave and 18 days sick leave per year. Sick leave is recorded as an expenditure in the year paid. Employees are entitled to payment of unused sick leave upon retirement if have been employed for at least 10 years in the municipal government. On July 1997, state Law 152 supra amended the Article 12.016, Section b (2) of the Municipal Law, authorizing the Municipality to pay any excess of vacations and sick leave accumulated over the maximum previously permitted by law. Calculations must be made until December 31 of every year. Excess of sick leave must be paid until March 31 next every natural year. Excess of vacations can be paid after July 1 of every fiscal year.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

j. Future Adoption of Accounting Pronouncements

The Governmental Accounting Standards Board has issued the following statements that the Municipality has not yet adopted:

<u>Statement Number</u>	<u>Statement Name</u>	<u>Adoption Required in Fiscal Year</u>
40	Deposits with Financial Institutions, Investments (Including Repurchase Agreements), and Reverse Repurchase Agreements.	2004-05
42	Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries	2004-05
43	Financial Reporting for Post-employment Benefit Other than Pension Plans	2005-06
44	Economic Condition Reporting: The Statistical Section - an amendment on NCGA Statement I	2005-06
45	Accounting and Financial Reporting for Employers for Post-employment Benefits Other than Pensions	2009-10

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

k. Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities at the date of the

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

financial statements and the reported amounts of revenues and expenditures/expenses during the reporting period. The most significant estimates consist of the contribution received from the Puerto Rico Electric Power Authority and the Municipal Revenue Collection Center caused by the delay of the notification of the actual revenues and expenditures to the presented in the financial statements of the agencies mentioned above.

3. 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 and the debt service funds.

Revenues and Expenditures - Budget and Actual (Budgetary Basis), accordingly, includes only the operations of the general and the debt service funds. The amounts budgeted under the Special Revenue Fund were excluded since they are received and expended over a period of time which generally exceeds the current year.

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

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

authorized that an unspent balance from the prior year be carried forward and made available for current spending.

b. Budget/GAAP Reconciliation

The following schedule presents comparisons of the legally adopted budget with actual data on a budget basis. Because accounting principles applied for purposes of developing data on a budget basis differ significantly from those used to present financial statements in conformity with GAAP, a reconciliation of entity and timing differences in the excess of revenues and other financing sources over expenditures and other financing uses for the year ended June 30, 2004 is presented below for the general fund and debt service funds:

	<u>General Fund</u>	<u>Debt Service Fund</u>
Deficiency of revenues over expenditures - budgetary basis	(\$678,848)	(\$134,834)
Entity differences:		
Non-budgeted revenues	139,421	702
Timing differences:		
Prior year encumbrances recorded as current year expenditures for GAAP basis	(154,799)	
Current year encumbrances recorded as expenditures for budgetary basis	147,244	
Basis of accounting differences:		
Net change in accounts payable and accrued liabilities	(136,658)	-
Deficiency of revenues over expenditures - GAAP basis	<u>(\$683,640)</u>	<u>(\$134,132)</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

c. Legal Compliance

The legal level of budgetary control is at the individual department level for general fund expenditures, and principal and interest due for the debt service fund.

4. RECONCILIATION OF GOVERNMENT-WIDE AND FUND FINANCIAL STATEMENTS

The governmental fund balance sheet includes a reconciliation between fund balance-governmental funds and net assets of governmental activities as reported in the government-wide statement of net assets. One element of that reconciliation explains that some liabilities, including bonds payable, are not due and payable in the current period and therefore are not reported in the funds. The details of the approximately \$4.7 million difference are as follows:

Note payable	\$2,552,453
Bonds payable	130,000
Accrued interest payable	162,001
Compensated absences	479,059
Claims and judgements	1,097,087
Other liabilities	<u>235,117</u>
 Net adjustment to reduce fund balance governmental funds to arrive at net assets of governmental activities	 <u>\$4,655,717</u>

5. DEPOSITS

Under Puerto Rico statutes, public funds deposited in commercial banks must be fully collateralized for the amount deposited in excess of federal depository insurance. All securities pledged as collateral are held by the Secretary of the Treasury of Puerto Rico. In addition, the Municipality maintains deposits with the Government Development Bank for Puerto Rico (GDB).

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

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, 2004. 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.

The Municipality's bank balances in commercial bank of approximately \$2.1 million in the governmental activities were fully collateralized at June 30, 2004 (Category 1). The deposits at GDB of \$171,820 that are restricted principally for capital projects, and the \$133,914 in the debt service fund are unsecured and uncollateralized, as no collateral is required to be carried by governmental banks (Category 3).

The Municipality maintains its deposits in one (1) bank located at Puerto Rico. All kind of deposit is guaranteed by the Federal Deposit Insurance Corporation (FDIC) up to \$100,000.

The excess is covered by collateral provided by banks and held by the Treasury Department of the Commonwealth of Puerto Rico pursuant to applicable laws and regulations.

6. PROPERTY TAXES

The Municipal Revenues Collection Center (CRIM) of the Commonwealth of Puerto Rico is responsible by law for the assessment, levy and collection of all real and personal property taxes. The tax on personal property is self assessed by the taxpayer. The assessment is made in a return which must be filed with the CRIM by May 15 of each year. The tax on real property is assessed by the CRIM. The assessment is made as of January 1 of each year and is based on estimated current

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

values of the property as of year 1957. The tax on personal property must be paid in full together with the return on or before May 15. The tax on real property is due in two equal installments in July 1 and January 1, following the assessment date.

The rates are 8.08% for real property and 6.08% for personal property. The composition is as follows:

	<u>Real</u>	<u>Personal</u>
Basic property	6.00%	4.00%
Additional special property - state	1.03%	1.03%
Additional special property - municipal	1.25%	1.25%
Discounts made by state to tax payer	< .20% >	< .20% >
	<u>8.08%</u>	<u>6.08%</u>

The Municipality's basic property tax rate represents the portion which is appropriated for general purposes and accounted for in the general fund.

The "Additional special property tax - municipal" is restricted for debt service and retained by GDB for such purposes and it is recorded as revenue in the Debt Service Fund when collected by the CRIM and reported to the Municipality.

The "Additional special property tax - state" is collected by the CRIM for the payment of principal and interest of general obligation bonds and certain other obligations issued by the state government.

Residential real property occupied by its owner is exempt by law from the payment of property taxes on the first \$15,000 of the assessed value. For such exempted amounts, the Department of Treasury assumes payment of the basic tax to the Municipality, except for property assessed at less than \$3,500, for which no payment is made. Revenue related to the basic tax on exempt property is recorded in the General Fund when payments are received from the CRIM.

Complete exemption from personal property taxes up to an assessment of \$50,000 is granted to merchants with an annual volume of net sales less than \$150,000.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

Prior to the beginning of each fiscal year, the CRIM informs the Municipality of the estimated amount of property tax expected to be collected for the ensuing fiscal year. Throughout the year, the CRIM advances funds to the Municipality based on the initial estimated collections. The CRIM is required by law to prepare a settlement statement on a fiscal year basis, whereby a comparison is made between the amounts advanced to the Municipality and amounts actually collected from taxpayers. This settlement has to be completed on a preliminary basis not later than three months after fiscal year-end, and a final settlement made not later than six months after year end. If the CRIM remits to the Municipality property tax advances, which are less than the tax actually collected, a receivable from the CRIM is recorded at June 30. However, if advances exceed the amount actually collected by the CRIM, a payable to the CRIM is recorded at June 30.

Currently, the Municipality has received the preliminary settlement from CRIM related to fiscal year 2003-04, but not the final settlement as the six months period after fiscal year end, provided by law to CRIM to issue this, has not yet expired. Management believes, based in part on the experience from prior years, that when received, the final settlement from CRIM will not show a significant difference from the preliminary settlement and that such difference, if any, will not have a material effect on the financial condition of the Municipality.

Based on the preliminary settlement already received, during the year ended June 30, 2004, the amount received in advances from CRIM exceeded the amount collected from taxpayers and charges by CRIM for the same period by approximately \$16,000. Such amount is presented as intergovernmental payable in the general fund in the basic financial statements. (Refer to Note 11).

7. MUNICIPAL LICENSE TAX

Municipal License Tax receivables are recorded in the fiscal year in which payment is due and, accordingly, represent taxes which are due and uncollected at June 30, 2004. The annual Municipal License Tax is determined based on the gross income of all commerce and industrial organizations who have operations in the Municipality of Culebra, and are not totally or partially exempt under the Industrial Incentive Law of Puerto Rico.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

An annual return of business volume should be filed on or before April 15 of each year and payable in two equal installments due on July 1 and January 1. A discount of 5% is allowed when full payment is made on or before April 15. The rates of municipal license in the Municipality of Culebra, are as follows:

Financial institutions	=	1.5%
Other organizations	=	.5%

The amounts collected in advance are recorded as deferred revenues in the General Fund. The Municipality invoiced and collected in advance during the current year \$66,758, corresponding to the next fiscal year municipal license.

8. DUE FROM OTHER AGENCIES

Represents grants and contributions due from local and federal agencies:

HUD - Program	\$254,005
Puerto Rico Department of Labor - Law 52	358,038
Puerto Rico Ports Authority	230,725
Other governmental funds	<u>143,019</u>
Total	<u>\$985,787</u>

9. INTERFUND TRANSACTIONS

a. Due from/to Other Funds:

The due from and due to other fund balances as of June 30, 2004, are as follows:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
General	HUD Programs	\$ 206,624
General	Law 52	83,034
General	Other Governmental	63,618
Capital Projects	General	131,629
Capital Projects	HUD Programs	56,654
Capital Projects	Law 52	281,784
Capital Projects	Other Governmental	<u>100,103</u>
Total		<u>\$923,446</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

The balance of \$206,624 due to the general fund from the HUD Programs and \$281,784 due to the Capital Project fund from Law 52 represents payrolls which will be reimbursed.

All remaining balances resulted from the time lag between the dates that (1) interfund goods and services are provided or reimbursable expenditures occur, (2) transactions are recorded in the accounting system, and (3) payments between funds are made.

b. Interfund Transfers:

Interfund transfers for the year ended June 30, 2004 consisted of the following:

<u>Transfer In</u>	<u>Transfer Out</u>	<u>Amount</u>
General	Debt Service	\$ 767
Debt Service	General	<u>220,318</u>
Total		<u>\$221,085</u>

The transfer from the general fund to the Debt Service fund of \$220,318 represents funds used for the payment of debt service as become due.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

10. CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2004 was as follows:

	Balance June 30, 2003 (As Restated)	Increases	Decreases	Balance June 30, 2004
Capital assets, not being depreciated:				
Land	\$ 3,366,886	\$ -	\$ -	\$ 3,366,886
Total capital assets, not being depreciated	<u>3,366,886</u>	<u>-</u>	<u>-</u>	<u>3,366,886</u>
Capital assets, being depreciated:				
Buildings and building improvements	5,285,605	1,000,000		6,285,605
Furniture and fixtures	672,604			672,604
Vehicles and equipment	1,626,395			1,626,395
Total capital assets, being depreciated	<u>7,584,604</u>	<u>1,000,000</u>	<u>-</u>	<u>8,584,604</u>
Less accumulated depreciation for:				
Buildings and building improvements	1,281,868	157,285		1,439,153
Furnitures and fixtures	659,680	11,189		670,869
Vehicles and equipment	1,343,488	85,114		1,428,602
Total accumulated depreciation	<u>3,285,036</u>	<u>253,588</u>	<u>-</u>	<u>3,538,624</u>
Total capital assets, being depreciated, net	<u>4,299,568</u>	<u>746,412</u>	<u>-</u>	<u>5,045,980</u>
Governmental activities capital assets, net	<u>\$ 7,666,454</u>	<u>\$ 746,412</u>	<u>\$ -</u>	<u>\$ 8,412,866</u>

The beginning balance of capital assets at July 1, 2003 has been restated to conform with the adoption of GASB 34.

In addition, management has not recorded certain general infrastructure assets and accordingly, has not recorded depreciation expense on those assets.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

11. DUE TO OTHER AGENCIES

Due to other agencies at June 30, 2004 are as follows:

Puerto Rico Electric Power Authority	\$112,042
Retirement System Administration	88,895
Municipal Revenues Collection Center	15,775
Human Resources Office of the Commonwealth of Puerto Rico	8,545
Puerto Rico Ports Authority	7,947
Puerto Rico Treasury Department	2,141
Puerto Rico Water and Sewer Authority	571
General Services Administration	150
Work and Human Resources Department (Unemployment)	113
Commercial Development Administration	<u>30</u>
 Total	 <u>\$236,029</u>

12. DEFERRED REVENUES

a. Municipal License Tax

The deferred revenues of \$66,758 in the general fund related to municipal license tax collected in fiscal year 2003-04 that will be earned in fiscal year 2004-05.

b. State Government

Represents monies received from the Commonwealth of Puerto Rico for the Special Communities Fund

c. Federal Government

The deferred revenues presented as federal government represents the portion of federal grants received for which qualifying expenditures have not been incurred. The amounts were determined taking into consideration the specific years of the grant.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

13. INTERGOVERNMENTAL REVENUES

Intergovernmental revenues in the general and capital projects funds consist mainly of collections from the Commonwealth of Puerto Rico and the CRIM, and payments in lieu of taxes from the Puerto Rico Electric Power Authority.

14. LONG-TERM DEBTS

Bonds and notes payable and other debt outstanding at June 30, 2004 are as follows:

Bonds

\$170,000 series of 2002, payable in annual installments ranging from \$25,000 to \$30,000 until July 1, 2009, interest ranging up to 4.10%.

\$130,000

Note Payable

Note payable of \$2.6 million represents a repayment agreement with GDB and CRIM to repay the excess of property taxes advances from fiscal years up to 2001. The CRIM will retain the principal and interest from the property taxes advances. The amounts retained by CRIM will be remitted to GDB on July 1 of each year through 2032. The repayment agreement is payable in annual aggregate principal installments ranging from \$35,574 to \$184,365 of \$184,365 plus interest rate of 6.25%.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

<u>Primary Government</u>	<u>Beginning Balance</u>	<u>Additions</u>	<u>Payments</u>	<u>Ending Balance</u>	<u>Due within One Year</u>
Governmental Activities:					
Bonds payable	\$ 150,000	\$ -	\$ (20,000)	\$ 130,000	\$ 25,000
Note payable	2,585,904	-	(33,451)	2,552,453	35,574
Total long-term debt	2,735,904	-	(53,451)	2,682,453	60,574
Due to Treasury Department	38,975		(5,568)	33,407	5,568
Due to PR Health Insurance Administration (ASES)	201,710	-	-	201,710	-
Claims and judgements	-	1,097,087	-	1,097,087	-
Compensated absences	393,805	86,649	(1,395)	479,059	60,000
Total other liabilities	634,490	1,183,736	(6,963)	1,811,263	65,568
Total noncurrent liabilities	\$ 3,370,394	\$ 1,183,736	\$ (60,414)	\$ 4,493,716	\$ 126,142

The annual debt service requirements for the bonds payable and advances from CRIM at June 30, 2004, are as follows:

As described in Note 6, the Municipality levies an annual special tax of 1.25% of the assessed value of real property. The proceeds of this tax are required to be credited to the Debt Service Fund for payment of general obligation bonds and notes of the Municipality. The property taxes are collected and retained by the CRIM.

	<u>Bonds</u>		<u>Note Payable</u>	
	<u>Principal</u>	<u>Interest</u>	<u>Principal</u>	<u>Interest</u>
2005	\$ 25,000	\$ 4,610	\$ 35,574	\$ 157,391
2006	25,000	3,888	37,809	155,176
2007	25,000	3,085	40,187	152,780
2008	25,000	2,200	42,710	150,255
2009	30,000	1,230	45,393	147,572
2010-2014			273,508	691,379
2015-2019			370,910	593,896
2020-2024			502,856	461,751
2025-2029			682,243	282,584
2030-2034			521,263	57,852
	<u>\$ 130,000</u>	<u>\$ 15,013</u>	<u>\$ 2,552,453</u>	<u>\$ 2,850,636</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

15. RETIREMENT PLAN

a. Plan Description

The Employee's Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS) is the administrator of a cost-sharing multiple-employer retirement system established by the Commonwealth of Puerto Rico. The System was created under the Act 447, approved on May 15, 1951, as amended, and became effective on January 1, 1952.

ERS covers all regular employees of the Commonwealth of Puerto Rico and its instrumentalities and of certain municipalities and components units not covered by their own retirements systems.

Participation is mandatory except for members of the Legislature, Government Secretaries, Heads for Agencies and Public Instrumentalities, Assistants to the Governor, the Comptroller of Puerto Rico, Gubernatorial Board and Committee appointees and Experimental Service Station employees.

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

Members who have attained an age of at least fifty-five (55) years and have completed at least twenty-five (25) years of creditable service or members who have attained an age of at least fifty-eight (58) years and have completed at least fifty-eight (58) years and have completed at least ten (10) years of creditable service, are entitled to an annual benefit, payable monthly for life.

The amounts of the annuity shall be one and one-half percent of the average compensation multiplied by the number of years of creditable service up to twenty years, plus 2% of the average compensation multiplied by the number of years of creditable service in excess of twenty years. In no case the annuity will be less than \$200 per month.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

Participants who have completed at least thirty (30) years of creditable service are entitled to receive the Merit Annuity. Participants who have not attained fifty-five (55) years of age will receive 65% of the average compensation or if they have attained fifty-five (55) years of age will receive 75% of the average compensation. Disability retirement benefits are available to members for occupational and non-occupational disability. However, for non-occupational disability a member must have at least ten (10) years of service.

No benefit is payable if the participant receives a refund of his accumulated contributions.

On September 24, 1999, an amendment to Act No. 447 of May 15, 1951, which created ERS, was enacted with the purpose of establishing a new pension program (System 2000). Employees participating in the current system as of December 31, 1999, may elect to stay in the defined benefit plan or transfer to the new program. Persons joining the Municipality on or after January, 2000, will only be allowed to become members of System 2000. System 2000 will reduce the retirement age from 65 years to 60 for those employees who joined the current plan on or after April 1, 1990.

System 2000 is a hybrid defined contribution plan, also known as a cash balance plan. Under this new plan, there will be a pool of pension assets, which will be invested by ERS, together with those of the current defined benefit plan. Benefits at retirement age will not be guaranteed by the Commonwealth of Puerto Rico. The annuity will be based on a formula which assumes that each year the employee's contribution (with a minimum of 8.275% of the employee's salary upon to a maximum of 10%) will be invested in an account which will either: (1) earn a fixed rate based on the two-year Constant Maturity Treasury Note or, (2) earn rate equal to 75% of the return of the ERS's investment portfolio (net of management fees), or (3) earn a combination of both alternatives. Participants will receive periodic account statements similar to those of defined contribution plans showing their accrued balances. Disability pensions will not be granted under System 2000. The employer's contribution (9.275% of the employee's salary) will be used to fund the current plan.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

b. Contribution Requirements

Commonwealth legislation requires employees to contribute 5.775% of gross salary up to \$6,600 plus 8.275% of gross salary in excess of \$6,600. The Municipality's contributions are 9.275% of gross salary. Contributions' requirements are established by law. The actuarially determined contribution requirement and contributions actually made for the year ended June 30, 2004 was approximately \$69,000. The Municipality's payroll for employees covered by ERS was approximately \$744,000. The Municipality total payroll for all employees was approximately \$2.9 million.

Additional information on the ERS is provided in its financial statements for the year ended June 30, 2004, a copy of which can be obtained from the ERS, Minillas Station, PO Box 42003, San Juan, PR 00940.

16. RISK MANAGEMENT

The Risk Management Division of the Municipality's Legal Department is responsible of assuring that the Municipality's property is properly insured. Annually, the Risk Management Division compiles the information of all property owned and its respective market value. After evaluating this information, the Risk Management Division submits the data regarding the Municipality's properties to the Area of Public Insurance at the Department of the Treasury of the Commonwealth of Puerto Rico who is responsible for purchasing all property and casualty insurance policies of all municipalities.

17. LEASES

Operating Leases

Leasing Arrangement with the Municipality as Lessor:

- a. The Municipality leases spaces under operating lease agreements with terms ranging from one to five years.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

- b. Total income from leases during the year ended June 30, 2004 was approximately \$28,000.
- c. The Municipality retains title to its leased property. The lessee pays taxes, licenses, insurance, and maintenance costs of the leased assets.

Leasing arrangements with the Municipality as lessee:

The Municipality is obligated under noncancellable operational leases, with periods not longer than one year.

18. CONTINGENCIES

- a. The Municipality receives Federal Grants for specific purposes that are subject to review and audit by the grantor agencies. Although such audits could generate expenditure disallowances under the terms of the grants, management believes that any required reimbursements would not be material.
- b. The Municipality is a defendant and/or co-defendant in various lawsuits which claims for actual damages. Some of these lawsuits are covered by insurance. The Municipality's management and outside counsels believe that is probable that any potential liability that might exist, if any, in excess of the insurance, will not affect significantly the financial position of the Municipality.

19. COMMITMENTS

The Municipality of Culebra had several outstanding or planned construction projects as of June 30, 2004. These projects are evidenced by contractual commitments with contractors. The construction projects are commitments of the Capital Projects' funds that amounted to approximately \$1.1 million.

20. MUNICIPAL SOLID WASTE LANDFILL POSTCLOSURE

State and federal laws and regulations require the Municipality to place a final cover on the Municipality's landfill site when it stops accepting waste and to perform certain maintenance and monitoring functions at the site for 30 years after closure. In

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004

accordance with Statement No. 18 of the GASB (GASB 18), "Accounting for Municipal Solid Waste Landfill Closure and Postclosure Care Costs", the Municipality has to performed a study of the activities that need to be implemented at the Municipality's landfill to guarantee the maximum yield of available space and to comply with applicable state and federal regulations. As of June 30, 2004, the Municipality has not performed a study of the estimated closing and postclosing costs that will be recognized in the basic financial statements as required by the GASB 18.

PART II - SINGLE AUDIT SECTION

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

<u>Federal Grantor/Program Title</u>	<u>Federal CDFA Number</u>	<u>Pass-Through Grantor's Number</u>	<u>Federal Disbursements/ Expenditures</u>
U.S. Department of Health and Human Services (HHS)			
Pass-through Regional Elderly Office - Office of the Governor:			
Special Program for Aging, Title III, Part B	93.044		\$ 5,267
Pass-through Administration of Children and Families:			
Child Care and Development Block Program	93.575		<u>204,346</u>
Subtotal of U.S. Department of HHS			<u>209,613</u>
U.S. Department of Housing and Urban Development (HUD)			
Pass-through Office of Commissioner of Municipal Affairs			
State Block Grant Program (SBGP)	14.228		<u>338,005</u>
Subtotal of U.S. Department of HUD			<u>338,005</u>
U.S. Department of Agriculture			
Pass-through Department of Education:			
Child and Adult Care Food Program	10.558		16,051
Pass-through Department of Agriculture:			
Rural Housing Preservation Grant	10.433		<u>28,001</u>
Subtotal U.S. Department of Agriculture			<u>44,052</u>
TOTAL			<u>\$591,670</u>

See notes to schedule of expenditures of federal awards.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA
NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

1. SIGNIFICANT ACCOUNTING POLICIES

The accompanying Schedule of Expenditures of Federal Awards is a summary of the activity of the Municipality of Culebra's federal award programs presented on the modified accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America.

2. BASIS OF PRESENTATION

The expenditures of the schedule are included in the Municipality's basic financial statements. The reconciliation of expenditures in the basic financial statements to the Schedule of Expenditures of Federal Awards is as follows:

	<u>Expenditures</u>
Total federal expenditures per schedule	<u>\$591,670</u>
Federal expenditures per basic financial statements included within:	
Housing and Urban Development Programs	338,005
Federal expenditures included in other governmental funds	<u>253,665</u>
Total	<u>\$591,670</u>



ORTIZ, RODRIGUEZ, RIVERA & CO.

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

To the Honorable Mayor and
Municipal Legislature
Municipality of Culebra
Culebra, 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 Culebra as of and for the year ended June 30, 2004, which collectively comprise the Municipality of Culebra's basic financial statements and have issued our report thereon dated January 5, 2005, 2005. 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.

Compliance

As part of obtaining reasonable assurance about whether the Municipality of Culebra's basic financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect of 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 test disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*. However, we noted certain immaterial instances of noncompliance that have reported to management of the Municipality of Culebra in a separate letter dated January 5, 2005.

Internal Control over Financial Reporting

In planning and performing our audit, we considered Municipality of Culebra's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the basic financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the basic financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

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

Ortiz, Rodriguez, Rivera & Co.

San Juan, Puerto Rico
January 5, 2005

The stamp 2000975 was affixed
to the original of this report.





ORTIZ, RODRIGUEZ, RIVERA & CO.

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

To the Honorable Mayor
and Municipal Legislature
Municipality of Culebra
Culebra, Puerto Rico

Compliance

We have audited the compliance of Municipality of Culebra 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, 2004. Municipality of Culebra's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of Municipality of Culebra's management. Our responsibility is to express an opinion on Municipality of Culebra'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 Municipality of Culebra's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We

believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on Municipality of Culebra's compliance with those requirements.

In our opinion, the Municipality of Culebra 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, 2004. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements that are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as items 04-1 and 04-2.

Internal Control over Compliance

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

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components do not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

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

San Juan, Puerto Rico
January 5, 2005

The stamp 2000976 was affixed to the original of this report.



Ortiz, Rodriguez, Rivera & Co.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

1. SUMMARY OF AUDIT RESULTS

- a. The auditors' report expressed a qualified opinion on the basic financial statements of the Municipality of Culebra.
- b. There were no reportable conditions on internal controls over financial reporting.
- c. No instances of noncompliance material to the financial statements of Municipality of Culebra were disclosed during the audit.
- d. There were no reportable conditions on internal controls over major programs.
- e. The auditors' report on compliance with requirements applicable to federal award programs for the Municipality of Culebra expressed an unqualified opinion.
- f. Audit findings relative to the major federal award programs for Municipality of Culebra are reported in number 3 of this schedule.
- g. The program tested as major program is State Block Grant Program - CFDA 14.228.
- h. The threshold for distinguishing types A and B programs was \$300,000.
- i. Municipality of Culebra was determined to be a high-risk auditee.

2. FINDINGS - FINANCIAL STATEMENTS AUDIT

None.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

**3. FINDINGS AND QUESTIONED COSTS - MAJOR FEDERAL AWARD PROGRAM
AUDIT**

<u>Program</u>	<u>Finding/Noncompliance</u>	<u>Questioned Costs</u>
<p>SBGP CFDA No. 14.228</p>	<p>Condition 04-1</p> <p>The Municipality' internal control over compliance with the cash management requirements of the federal program is not effective since it is not minimizing the time elapsed between the receipt and final disbursements of funds.</p> <p><u>Criteria</u></p> <p>The 24CFR 85.20(b)(7) establishes that the federal funds recipient shall adopt the necessary policies and procedures to minimize the time between the receipt of funds and the disbursements for expenditures.</p> <p><u>Cause</u></p> <p>The Municipality does not keep adequate cash forecasting procedures because the Municipality has requested and received federal funds in excess of its immediate needs.</p> <p><u>Effect</u></p> <p>The continued occurrence of this condition may expose the Municipality to the assessment of interest cost relating to the excess cash on hand which would be paid from local funds.</p>	<p>\$ <u>-0-</u></p>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

<u>Program</u>	<u>Finding/Noncompliance</u>	<u>Questioned Costs</u>															
	<p style="text-align: center;"><u>Recommendation</u></p> <p>The Municipality should modify the cash forecasting process by establishing a system to forecast the cash needs for the next five days, as established by federal regulations. Federal funds should only be requested when they are going to be disbursed immediately after receipt, or within three (3) business days.</p>																
<p>SBGP CFDA No. 14.228</p>	<p>Condition 04-2</p> <p>The Municipality did not comply with the requirement of preparing and filing its federal financial reports on a timely basis. During our examination of the Federal Financial Reports, we noted that the Municipality did not send on time the quarterly report for the following period ended:</p> <table border="1" style="margin-left: auto; margin-right: auto;"> <thead> <tr> <th style="text-align: center;"><u>Quarter Ended</u></th> <th style="text-align: center;"><u>Due Date</u></th> <th style="text-align: center;"><u>Date Submitted</u></th> </tr> </thead> <tbody> <tr> <td style="text-align: center;">09-03</td> <td style="text-align: center;">October 31, 2003</td> <td style="text-align: center;">No evidence</td> </tr> <tr> <td style="text-align: center;">12-03</td> <td style="text-align: center;">January 31, 2004</td> <td style="text-align: center;">No evidence</td> </tr> <tr> <td style="text-align: center;">03-04</td> <td style="text-align: center;">April 30, 2004</td> <td style="text-align: center;">No evidence</td> </tr> <tr> <td style="text-align: center;">06-04</td> <td style="text-align: center;">July 31, 2004</td> <td style="text-align: center;">No evidence</td> </tr> </tbody> </table> <p><u>Criteria</u></p> <p>The Municipality is not in compliance with 43 CFR 13.41-(b)(3) which requires federal fund recipients to periodically monitor the performance of grant-supported activities to ensure that time schedules are being met, projected work units by time periods are being accomplished, and other performance goals are being achieved by the preparation of federal financial reports. To achieve these goals, program</p>	<u>Quarter Ended</u>	<u>Due Date</u>	<u>Date Submitted</u>	09-03	October 31, 2003	No evidence	12-03	January 31, 2004	No evidence	03-04	April 30, 2004	No evidence	06-04	July 31, 2004	No evidence	<p><u>\$ -0-</u></p>
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**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

<u>Program</u>	<u>Finding/Noncompliance</u>	<u>Questioned Costs</u>
	<p>management shall prepare accurate and timely federal financial reports.</p> <p><u>Cause</u></p> <p>The above situation occurred because the Municipality did not ensure to verify and understand its reporting requirements for this program.</p> <p><u>Effect</u></p> <p>The continued failure to file the required reports may result in sanctions by the Federal grantor, such as grant payment withholdings.</p> <p><u>Recommendation</u></p> <p>The Municipality should verify and become familiar with all administrative requirements applicable to each federal financial assistance program, especially with new grants are received. This can be achieved by obtaining the information applicable to the program from the pass-thru grantor, federal grantor, or the Catalog of Federal Domestic Assistance ("CFDA"), which is available from the federal government.</p>	
SBGP CFDA No. 14.228	<p><u>Condition 04-3</u></p> <p>The Municipality does not have effective internal controls over compliance with the property management requirement.</p> <p><u>Criteria</u></p> <p>The 24CFR 85.32(c)(4), (d)(3) and (4) state that a control system must be developed to ensure adequate</p>	\$ <u>-0-</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

<u>Program</u>	<u>Finding/Noncompliance</u>	<u>Questioned Costs</u>
	<p>safeguards to prevent loss, damage, or theft of the property.</p> <p><u>Cause</u></p> <p>The above situation results from the failure to establish formal policies regarding property physical inventories, and to require reconciliation of the inventory with the property subsidiary ledger. Accordingly, this may expose the Municipality to the unauthorized use or disposition of property because there is no effective control to detect or prevent these situations.</p> <p><u>Effect</u></p> <p>The continued failure to establish internal controls over compliance with the above requirements expose the Municipality to unauthorized use or disposition of the programs' property and equipment.</p> <p><u>Recommendation</u></p> <p>The Municipality should immediately perform a physical inventory of the program's property and equipment to update its property records. All missing equipment should be reported to the federal government for proper disposition, together with the counting and updating of the property, plant and equipment subsidiary ledger.</p>	

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA
SCHEDULE OF STATUS OF PRIOR YEAR
AUDIT FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

During the current examination, follow-up was given to the findings informed to the Municipality in prior years. It was noted that corrective action has been taken, except for certain conditions that still exist and require further action. These are included in the accompanying Schedule of Prior Year Audits Findings and Questioned Costs.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA
SCHEDULE OF STATUS OF PRIOR YEAR
AUDIT FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2004**

<u>Program</u>	<u>Finding/Noncompliance</u>	<u>Status</u>
State Block Grant Program CFDA No. 14288	Condition 03-111-01 The Municipality does not have adequate procedures to ensure that all disbursements are properly authorized and all supporting documents stamped as paid.	Condition was corrected.
Child Care and Development Program CFDA No. 93.575	Condition 03-111-01 The Municipality does not have adequate procedures to ensure that all disbursements are properly authorized and all supporting documents stamped as paid.	Condition was corrected.
State Block Grant Program CFDA No. 14288	Condition 03-111-02 Federal financial assistance is sometimes requested and not used to cover immediate expenditures incurred.	Condition still prevails.
State Block Grant Program CFDA No. 14288	Condition 03-111-03 The Municipality does not maintain appropriate real property records as required by federal regulation.	Condition still prevails.

PART III - CORRECTIVE ACTION PLAN

ORTIZ, RODRIGUEZ, RIVERA & CO.

CERTIFIED PUBLIC ACCOUNTANTS • VALUE ADDED SERVICES

Suite 152, PO Box 70250, San Juan, P.R. 00936-7250 • Phone (787) 756-8524. Fax (787) 274-0562

CORRECTIVE ACTION PLAN

January 5, 2005

Cognizant or Oversight Agency for Audit:

Municipality of Culebra respectfully submits the following corrective action plan for the year ended June 30, 2004

Name and address of independent public accounting firm: Ortiz, Rodríguez, Rivera & Co., Suite 152, PO Box 70250, San Juan, Puerto Rico 00936-7250.

Audit period: Fiscal year ended June 30, 2004

The findings from the June 30, 2004 schedule of findings and questioned costs are discussed below. The findings are numbered consistently with the numbers assigned in the schedule.

FINDINGS - FEDERAL AWARD PROGRAM AUDITS

Finding 04-1: SBGP - CFDA 14.228

Reportable Condition: See Condition 04-1

Recommendation

The Municipality should modify the cash forecasting process by establishing a system to forecast the cash needs for the next five days, as established by federal regulations. Federal funds should only be requested when they are going to be disbursed immediately after receipt, or within three (3) business days.

Action Taken

The Municipality is taking regulation upon request of Federal Funds. It will come to Municipal Revenue Office, then it will be transfer to the Federal Funds Office and has to be check with the bank statement and funds available in the check account upon receiving

Finding 04-2: SBGP - CFDA 14.228

Reportable Condition: See Condition 04-2

Recommendation

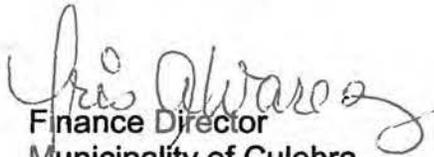
The Municipality should verify and become familiar with all administrative requirements applicable to each federal financial assistance program, especially with new grants are received. This can be achieved by obtaining the information applicable to the program from the pass-thru grantor, federal grantor, or the Catalog of Federal Domestic Assistance ("CFDA"), which is available from the federal government.

Action Taken

The Municipality is going to send the employees regarding this situation federals and municipal employees so when both systems work together al the information should be familiar to boths and flow easy.

If the Cognizant or Oversight Agency for Audit has questions regarding this plan, please call Iris N. Alvarez, Finance Director, at (787) 742-3577.

Sincerely yours,


Iris Alvarez
Finance Director
Municipality of Culebra



ESTADO LIBRE ASOCIADO DE PUERTO RICO
GOBIERNO MUNICIPAL DE CULEBRA
CULEBRA, PUERTO RICO 00775



Fra de junio de 2005.

Sra. Elsie Ramirez Dross, MBA
Comisionado Auxiliar
Area de Reglamentacion e Intervencion
Oficina del Comisionado de Asuntos Municipales
P.O. Box 79167
San Juan, Puerto Rico 00936

6/8/05 - 322

UNIDAD DE CORREO

JUN - 6 PM 1:07

Estimada señora Ramirez:

Reciba un cordial saludo de todos los que laboramos en el Municipio de Culebra.

Acuso recibo de su carta fechada el 24 de mayo del corriente en donde indica que no ha recibido copia de la Auditoría Sencilla, el Contrato de Servicios Profesionales para realizar la Auditoria Sencilla correspondiente al año fiscal 2004-2005 y el Informe de Cumplimiento con las recomendaciones del Contralor número M-02-56. Adjunto encontrará los documentos de relacionados con la mismas.

Agradeciéndole su atención al particular, y reiterándome siempre a sus órdenes, quedo,

Cardialmente,

Carolyn Vizcarondo
Carolyn Vizcarondo
Directora de Finanzas

*6/8/05
falte
Dagmar
Espinoza
C*

JUN - 6 PM 1:02

UNIDAD DE CORREO