

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

MUNICIPIO DE CULEBRA
AUDITORIA 2005-2006
30 DE JUNIO DE 2006

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COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA
CULEBRA, PUERTO RICO

BASIC FINANCIAL STATEMENTS

FISCAL YEAR ENDED JUNE 30, 2006

(WITH THE ADDITIONAL REPORTS AND
INFORMATION REQUIRED BY
THE GOVERNMENT AUDITING STANDARDS AND
OMB CIRCULAR A-133)

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA, PUERTO RICO
**BASIC FINANCIAL STATEMENTS ACCOMPANIED
BY REQUIRED SUPPLEMENTARY INFORMATION**
JUNE 30, 2006

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

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

INDEPENDENT AUDITOR'S REPORT

TO THE HONORABLE MAYOR AND
MEMBERS OF THE MUNICIPAL LEGISLATURE
MUNICIPALITY OF CULEBRA, PUERTO RICO

We have audited the accompanying financial statements of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the Municipality of Culebra, Puerto Rico, as of and for the year ended June 30, 2006, 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. We did not audit the financial statements of Culebra Conservation and Development Authority- component units, which represent 8 percent, 11 percent, and 15 percent, respectively, of the assets, net assets, and revenues of the Municipality of Culebra. Those financial statements were audited by other auditors whose report thereon has been furnished to us, and our opinion, insofar as it relates to the amounts included for Conservation and Development Authority- component units, is based on the report of the other auditors.

Except as discussed in the following paragraph, 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 respective financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the respective financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statements presentation. We believe that our audit and the report of other auditors provide a reasonable basis for our opinions.

The Municipality has not maintained complete and adequate records in order to obtain sufficient and competent evidential matter related to the Capital Assets reported in the governmental activities and, accordingly, the amount by which this departure would affect the assets, net assets, and expenses of the governmental activities is not reasonably determinable.

In our opinion, based on our audit and the report of other auditors, because of the effects of the matter discussed in the third paragraph, 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, Puerto Rico, as of June 30, 2006, and the changes in financial position, thereof for the year then ended.

MUNICIPALITY OF CULEBRA

INDEPENDENT AUDITOR'S REPORT

PAGE 2

In addition, in our opinion, based on our audit and the report of other auditors, the financial statements referred to above present fairly, in all material respects, the financial position of each major fund, and the aggregate remaining fund information of the Municipality of Culebra, Puerto Rico, as of June 30, 2006, and the respective changes in financial position, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we also issued our report dated December 1, 2006, on our consideration of the Municipality's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on 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 3 through 7 and the Budgetary Comparison Schedule-General Fund on page 27 are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries 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 have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

Mendoza & Ramos, CPA

MENDOZA & RAMOS
CERTIFIED PUBLIC ACCOUNTANTS, C.S.P.

Guayama, Puerto Rico
December 1, 2006

Stamp number 2134168 was
affixed to the original of this report.



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

FOR THE FISCAL YEAR ENDED JUNE 30, 2006

The management of **Municipality of Culebra, Puerto Rico (Municipality)** offers this narrative overview and analysis of the financial activities of the **Municipality** for the fiscal year ended June 30, 2006. The new reporting model required by Governmental Accounting Standards Board Statement No. 34 was implemented during fiscal 2004. The financial statements associated with it are described in the following narrative as well as in the Notes to Financial Statements. The Government Wide Financial Statements includes the financial activities of the Culebra Conservation and Development Authority, a component unit of the **Municipality**. This component unit issued separate Financial Statements for the Fiscal Year 2005-2006.

The Management's Discussion and Analysis (MD&A) is designed to focus on the current year activities, resulting changes and currently known facts, and much of the information is comparable to prior year. We encourage readers to consider this information with the **Municipality's** basic financial statements that follow.

FINANCIAL HIGHLIGHTS

The following are key financial highlights for the fiscal year:

- ❖ The net assets of the **Municipality** exceeded its liabilities at June 30, 2006 by \$3.3 million.
- ❖ The **Municipality's** total net assets increase by \$786 thousand during 2006 and \$3.2 million during 2005.
- ❖ As of June 30, 2006, the **Municipality's** governmental funds reported combined ending fund balances of \$3.1 million, a decrease of \$123 thousand from the prior year.
- ❖ At June 30, 2006, the Unrestricted (Deficit) was \$7.2 million. During Fiscal Year 2005-2006 the **Municipality** issue \$1.1 millions in debt.
- ❖ The **Municipality's** capital assets inventory has no movement during fiscal year.
- ❖ The investment in capital assets for this year was not determinable, last year was of \$11.9 million.
- ❖ Loans principal payments were \$80 thousand and \$50 thousand in 2006 and 2005, respectively.

OVERVIEW OF THE BASIC FINANCIAL STATEMENTS

This discussion and analysis are intended to serve as an introduction to the **Municipality's** financial statements. The **Municipality's** basic financial statements comprise three components: government-wide financial statements; fund financial statements; and notes to the financial statements. This report also contains other supplementary information in addition to the basic financial statements themselves.

Government-wide Financial Statements

The government-wide financial statements are designed to provide readers with a broad overview of the **Municipality's** finances, in a manner similar to a private-sector business.

The **Statement of Net Assets** presents information on all of the **Municipality's** assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the **Municipality** is improving or deteriorating.

The **Statement of Activities** presents information showing how the **Municipality's** net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the related cash flows. Thus, revenues and expenses are reported in this statement for some items that will result in cash flows in future fiscal periods.

Both of the government-wide financial statements of the **Municipality** are principally supported by taxes and intergovernmental revenues. The governmental activities of the **Municipality** include general government, public safety, public works, human services and welfare, culture and recreation, physical environment, education and urban development. Property taxes, municipal license tax, state and federal grants finance most of these activities.

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MANAGEMENT'S DISCUSSION AND ANALYSIS

FOR THE FISCAL YEAR ENDED JUNE 30, 2006

Fund Financial Statements

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 other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

Governmental funds

The **Municipality's** basic services are reported in the government fund financial statements. The government funds are reported using an accounting method called modified accrual accounting, which measures cash and all other financial assets that can readily be converted into cash. 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, as well as on balances of spendable resources available at the end of the fiscal year. Such information may be useful in evaluating a government'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 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 government's near-term financing decisions.

The **Municipality** adopts an annual appropriated budget for its general fund. A budgetary comparison statement has been provided for the general fund to demonstrate compliance with this budget.

Notes to the Basic Financial Statements

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

Other Information

In addition to the basic financial statements and accompanying notes, this report also presents certain required supplementary information containing budget to actual comparisons for the general and major funds.

GOVERNMENT-WIDE FINANCIAL ANALYSIS

Governmental Net Assets

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. In the

Table 1 Statement of Net Assets As of June 30,		
	2006	2005
Current and non-current assets.....	\$ 7,292,481	\$ 5,664,524
Capital assets.....	<u>8,412,866</u>	<u>8,412,866</u>
Total Assets.....	<u>15,705,347</u>	<u>14,077,390</u>
Current liabilities.....	287,210	308,077
Deferred revenues.....	117,516	153,646
Long-term liabilities.....	<u>5,752,001</u>	<u>4,853,331</u>
Total Liabilities.....	<u>6,156,727</u>	<u>5,315,054</u>
Net Assets:		
Investment in capital assets.....	8,167,866	8,112,866
Restricted.....	8,583,699	6,805,537
Deficit.....	<u>(7,202,945)</u>	<u>(6,156,067)</u>
Total Net Assets.....	<u>\$ 9,548,620</u>	<u>\$ 8,762,336</u>

case of the **Municipality**, assets exceeded liabilities by \$9.5 million as of June 30, 2006 versus \$8.8 million as of June 30, 2005. Our analysis below focuses on the net assets (Table 1) and changes in net assets of the **Municipality's** governmental activities.

The largest portion of the **Municipality's** net assets reflects its investment in capital assets (e.g. land, buildings, machinery and equipment), less any related debt used to acquire those assets still outstanding. These capital assets are used to provide services to citizens; consequently these assets are not available for future spending. It should also be

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MANAGEMENT'S DISCUSSION AND ANALYSIS**

FOR THE FISCAL YEAR ENDED JUNE 30, 2006

noted that the resources required to repay the related debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

An additional portion of the **Municipality's** net assets represents resources that are subject to external restrictions on how they may be used. The remaining balance of unrestricted net assets may be used to meet the **Municipality's** ongoing obligations to citizens and creditors.

Total Net Assets of the **Municipality's** governmental activities were \$9.5 million. The Unrestricted (Deficit), was approximately of \$7.2 million at June 30, 2006.

Governmental Activities

During fiscal year 2005-06 the **Municipality** offer services that are intended to be primarily funded by taxes, as opposed to charges for services and grants, and those taxes and other general revenues, however revenues exceed expenses by \$1.1 million. The **Municipality** expended several of the resources restricted projects in the community.

Table 2 presents the cost of each of the **Municipality's** largest programs.

Table 2		
Changes in Net Assets For Fiscal Years Ending June 30,		
	2006	2005
Revenues:		
Program Revenues:		
Grants and Contributions.....	\$ 3,033,286	\$ 4,894,828
General Revenues:		
Property Taxes.....	420,187	413,687
Volume of Business Taxes	131,269	79,966
Construction Taxes	290,851	-
Intergovernmental	2,583,451	2,526,533
Other General Revenues	449,373	339,793
Total revenues	<u>6,908,417</u>	<u>8,254,807</u>
Expenses:		
General Administration.....	2,086,742	3,352,466
Public Safety.....	193,844	264,273
Public Works.....	504,190	577,280
Health and Sanitation.....	62,185	43,226
Culture and Recreation.....	79,032	163,353
Human Services and Welfare	1,238,826	2,436,577
Urban Development	1,466,943	2,891,396
Education.....	171,383	-
Interest Costs.....	18,871	6,186
Total expenses	<u>5,822,016</u>	<u>9,734,757</u>
Changes in net assets	1,086,401	(1,479,950)
Net assets – beginning, as Restated*	<u>8,462,219</u>	<u>10,242,286</u>
Net assets – ending	<u>\$ 9,548,620</u>	<u>\$ 8,762,336</u>
Prior Period Adjustments.		

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FOR THE FISCAL YEAR ENDED JUNE 30, 2006

FINANCIAL ANALYSIS OF THE GOVERNMENT'S FUNDS

As noted 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 balances 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 its fiscal year.

The **Municipality** has an Unreserved (Deficit) of \$1.8 million in its Operating Fund. The remainder of the balance is reserved to indicate that it is not available for new spending because it has already been committed (1) to liquidate prior year obligations \$93 thousand, (2) to pay debt service \$126 thousand or (3) for other restricted purposes \$4.7 million.

BUDGETARY HIGHLIGHTS

Budget and actual comparison schedules are provided in the Basic Financial Statements for the General Fund. The Budgetary Comparison Schedule of the General Fund shows the original adopted budgets, the final revised budget, actual results, and variance between the final budget and actual results for the general and major special revenue funds.

After the original budget is approved, it may be revised for a variety of reasons such as unforeseen circumstances and other unanticipated revenues. Differences between the original 2005 budget and the final amended budget for the General Fund were relatively minor and can be summarized as follows:

- ❖ Revenues primarily decreased from a State reduction in intergovernmental revenues.
- ❖ The original budget was amended to increase expenditures between expenditures accounts.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

The **Municipality's** investment in capital assets for its governmental type activities as of June 30, 2006 amounted to \$15.7 million (net of accumulated depreciation). This investment in capital assets includes land, buildings, improvements, machinery and equipment, parks, roads, highways, and bridges. The total increase in the **Municipality's** investment in capital assets for the current fiscal year was \$2.7 million.

Additions during the fiscal year was principally for building construction, purchase of new vehicles and machinery and equipment, necessary to provides services to our citizens. **Table 3** present the major classes of capital assets.

Land.....	\$3.4
Buildings.....	4.9
Machinery and Equipment.....	<u>0.1</u>
Total Capital Assets.....	<u>\$8.4</u>

General Obligations	\$ 1.4
Others	<u>4.4</u>
Total Capital Assets	<u>\$ 5.8</u>

Long-term Debt

At June 30, 2006 the **Municipality** had total of \$5.8 million in general obligations and others outstanding debts, as shown in **Table 4**. Of this amount, \$1.4 million comprises debt backed by the full faith and credit of the government and \$4.4 million is other obligations.

The **Municipality** is required to limit the amount of general obligation debt to 10% of the total assessment of property located within the **Municipality** in order for the

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FOR THE FISCAL YEAR ENDED JUNE 30, 2006

bonds to be repaid with the proceeds of property taxes restricted for debt services. Other obligations include accrued vacation and sick leaves and advances of property taxes. More detailed information about the Municipality's long-term liabilities is presented in the notes to the financial statements. The **Municipality** continues to meet its financial needs through prudent use of its revenues and creative debt financing programs.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

Local, national and international economic factors influence the **Municipality's** revenues. Positive economic growth is correlated with increased revenues from property taxes, volume of business taxes, charges for services, as well as state and federal grants. Economic growth in the local economy may be measured by a variety of indicators such as employment growth, unemployment, new construction, assessed valuation, and other revenues.

All of these factors were considered in preparing the **Municipality's** budget for the 2006 fiscal year. Some cost reductions helped fund improvements of existing facilities, public safety and works, economic development initiatives and human service improvements.

REQUESTS FOR INFORMATION

This financial report is designed to provide a general overview of the **Municipality's** finances for all those with an interest in the government's finances. Questions concerning any of the information provided in this report or requests for additional information contact the **Municipality's** Finance Department at (787) 742-3577.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA, PUERTO RICO

STATEMENT OF NET ASSETS

June 30, 2006

	<u>Governmental Activities</u>	<u>Component Unit</u>
ASSETS:		
Cash and Investments.....	\$ 1,641,527	\$ 375,676
Cash with Fiscal Agent.....	1,293,337	-
Receivables (net):		
Property Taxes.....	4,483	-
Federal Grants.....	4,254,107	-
Others.....	99,027	-
	<u>7,292,481</u>	<u>375,676</u>
Capital Assets (Note5):		
Land, Improvements, and Construction in Progress.....	3,366,886	640,000
Other Capital Assets, [Net of Depreciation].....	5,045,980	386,184
Total Capital Assets.....	<u>8,412,866</u>	<u>1,026,184</u>
TOTAL ASSETS.....	<u>15,705,347</u>	<u>1,401,860</u>
LIABILITIES:		
Accounts Payable and Accrued Expense.....	275,163	89,335
Accrued Interest.....	12,047	-
Deferred Revenue.....	117,516	36,258
Long-Term Liabilities (Note 6):		
Due within One Year.....	369,137	70,481
Due in More than One Year.....	5,382,864	18,413
Total Liabilities.....	<u>6,156,727</u>	<u>214,487</u>
NET ASSETS		
Invested in Capital Assets, Net of Related Debt.....	8,167,866	1,026,184
Restricted for:		
State Assignment.....	3,455,834	-
CDBG.....	3,765,269	-
Other Governmental Funds.....	1,236,333	-
Debt Service.....	126,263	-
Unrestricted (Deficit).....	(7,202,945)	161,189
Total Net Assets.....	<u>\$ 9,548,620</u>	<u>\$ 1,187,373</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA, PUERTO RICO

STATEMENT OF ACTIVITIES

FOR THE FISCAL YEAR ENDED JUNE 30, 2006

Functions/Programs	Expenses	Program Revenues			Net (Expense) Revenue	Component Unit
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions		
Governmental Activities:						
Mayor and Municipal Legislature.....	\$ 423,631	\$ -	\$ -	\$ -	\$ (423,631)	
General Government.....	1,663,111	-	-	-	(1,663,111)	
Public Safety.....	193,844	-	-	-	(193,844)	
Public Works.....	504,190	-	-	-	(504,190)	
Culture and Recreation.....	79,032	-	-	-	(79,032)	
Sanitation.....	62,185	-	-	-	(62,185)	
Human Services and Welfare.....	1,238,826	-	621,543	-	(617,283)	
Urban Development.....	1,466,943	-	2,204,564	53,944	791,565	
Education.....	171,383	-	153,235	-	(18,148)	
Interest on Long-Term Debt.....	18,871	-	-	-	(18,871)	
Total Governmental Activities...	\$ 5,822,016	\$ -	\$ 2,979,342	\$ 53,944	(2,788,730)	
Component Unit:						
Human Services and Welfare.....	\$ 892,961	\$ 221,920	\$ -	\$ -		\$ (671,041)
General Revenues:						
Taxes:						
Property Taxes, levied for General Purposes.....					330,833	-
Property Taxes, levied for Debt Services.....					89,354	-
Volume of Business Taxes.....					131,269	-
Construction Taxes.....					290,851	-
Intergovernmental.....					2,583,451	800,000
Rent.....					20,789	-
Miscellaneous.....					428,584	800
Total General Revenues and Special Items.....					3,875,131	129,759
CHANGE IN NET ASSETS.....					1,086,401	129,759
Net Assets - Beginning of Year.....					8,462,219	1,057,614
NET ASSETS - END OF YEAR.....					\$ 9,548,620	\$ 1,187,373

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA, PUERTO RICO

BALANCE SHEET - GOVERNMENTAL FUNDS

June 30, 2006

	General Fund	State Assignment Fund	CDBG Fund	Other Governmental Funds	Total Funds
ASSETS:					
Cash and Investments (Note 2).....	\$ 477,443	\$ 965,395	\$ 40,169	\$ 158,520	\$ 1,641,527
Cash with Fiscal Agent.....	-	-	-	1,293,337	1,293,337
Receivables:					
Property Taxes.....	-	-	-	4,483	4,483
Federal Grants.....	-	-	3,885,081	77,309	3,962,390
Due from Other Funds.....	197,858	2,213,733	-	50,769	2,462,360
State Government.....	-	291,717	-	99,027	390,744
Total Assets.....	\$ 675,301	\$ 3,470,845	\$ 3,925,250	\$ 1,683,445	\$ 9,754,841
LIABILITIES AND FUND BALANCES:					
Liabilities:					
Accounts Payable and Accrued Liabilities.....	\$ 54,340	\$ -	\$ -	\$ -	\$ 54,340
Bonds and Notes Payable.....	-	-	-	80,000	80,000
Accrued Interest.....	-	-	-	12,047	12,047
Due to Governmental Units.....	140,823	-	-	-	140,823
Due to Other Funds.....	2,111,478	15,011	159,981	175,890	2,462,360
Deferred Revenue:					
Volume of Business Tax.....	64,604	-	-	-	64,604
Federal Grants.....	-	-	3,765,269	91,987	3,857,256
Total Liabilities.....	2,371,245	15,011	3,925,250	359,924	6,671,430
Fund Balances:					
Reserve For:					
Encumbrances.....	93,130	-	-	-	93,130
Debt Service.....	-	-	-	126,263	126,263
Other Purposes.....	-	3,455,834	-	1,197,258	4,653,092
Unreserved (Deficit).....	(1,789,074)	-	-	-	(1,789,074)
Total Fund Balances.....	(1,695,944)	3,455,834	-	1,323,521	3,083,411
TOTAL LIABILITIES AND FUND BALANCES...	\$ 675,301	\$ 3,470,845	\$ 3,925,250	\$ 1,683,445	\$ 9,754,841

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA, PUERTO RICO**

**RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET
TO THE STATEMENT OF NET ASSETS**

JUNE 30, 2006

Total Fund Balances – Governmental Funds (Page 10)..... \$ 3,083,411

Amounts reported for Governmental Activities in the Statement of Net Assets (Page 8) are different because:

Capital Assets used in governmental activities are not financial resources and therefore are not reported in the funds. In the current period, these amounts are:

Non Depreciable Capital Assets.....	\$ 3,366,886	
Depreciable Capital Assets	8,584,604	
Accumulated Depreciation	<u>(3,538,624)</u>	
Total Capital Assets.....		8,412,866

Some of the **Municipality's** revenues will be collected after year-end but are not available soon enough to pay for the current period's expenditures and therefore are deferred in the funds:

CDBG.....	3,765,269	
Child Care	<u>39,075</u>	
Total Deferred Revenues.....		3,804,344

Some liabilities are not due and payable in the current period and therefore are not reported in the funds. Those liabilities consist of:

General Bonds and Notes Payable	1,366,000	
Compensated Absences	284,137	
Claims and Judgments.....	1,939,759	
Treasury Department.....	22,271	
Municipal Revenue Collection Center.....	<u>2,139,834</u>	
Total Long-Term Liabilities.....		(5,752,001)

Total Net Assets of Governmental Activities (Page 8) \$ 9,548,620

See accompanying Notes to Basic Financial Statements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA, PUERTO RICO

STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE - GOVERNMENTAL FUNDS

FOR THE FISCAL YEAR ENDED JUNE 30, 2006

	General Fund	State Assignment Fund	CDBG Fund	Other Governmental Funds	Total Funds
REVENUES					
Property Taxes.....	\$ 330,833	\$ -	\$ -	\$ 89,354	\$ 420,187
Volume of Business Taxes.....	131,269	-	-	-	131,269
Federal Assistances.....	-	-	313,072	207,769	520,841
Intergovernmental.....	2,583,451	53,944	-	632,352	3,269,747
Licenses and Permits.....	290,851	-	-	-	290,851
Rent.....	20,789	-	-	-	20,789
Miscellaneous.....	428,584	-	-	-	428,584
Total Revenues.....	3,785,777	53,944	313,072	929,475	5,082,268
EXPENDITURES					
Current:					
Mayor and Municipal Legislature.....	423,631	-	-	-	423,631
General Government.....	1,830,441	-	-	-	1,830,441
Public Safety.....	193,844	-	-	-	193,844
Public Works.....	504,190	-	-	-	504,190
Culture and Recreation.....	79,032	-	-	-	79,032
Sanitation.....	62,185	-	-	-	62,185
Human Services and Welfare.....	183,752	132,975	-	922,099	1,238,826
Urban Development.....	-	875,516	313,072	278,355	1,466,943
Education.....	-	-	-	171,383	171,383
Debt Service:					
Pincipal.....	-	-	-	80,000	80,000
Interest and Other Charges.....	-	-	-	18,871	18,871
Total Expenditures.....	3,277,075	1,008,491	313,072	1,470,708	6,069,346
OTHER FINANCING SOURCES (USES)					
Bonds Issued.....	-	-	-	1,146,000	1,146,000
Total Other Financing Sources and Uses.....	-	-	-	1,146,000	1,146,000
Net Change in Fund Balances.....	508,702	(954,547)	-	604,767	158,922
Fund Balance - Beginning as Restated (Note13)...	(2,204,646)	4,410,381	-	718,754	2,924,489
Fund Balances - Ending.....	\$(1,695,944)	\$ 3,455,834	\$ -	\$ 1,323,521	\$ 3,083,411

71,229.00

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2/20/2007

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA, PUERTO RICO**

**RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES
IN FUND BALANCE OF GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES**

FOR THE FISCAL YEAR ENDED JUNE 30, 2006

Net Change in Fund Balances – Total Governmental Funds (Page 12).....	\$ 158,922
Amounts reported for Governmental Activities in the Statement of Activities (Page 9) are different because:	
Revenues in the Statement of Activities that do not provide current financial resources are not reported as revenues in the Statement of Funds	2,117,480
Revenues in the Statement of Revenues that correspond to Prior Year resources are recorded as Revenue in the Statement of Activities.....	(291,331)
Bonds proceeds provide current financial resources to governmental funds, but issuing debt increases Long-Term Liabilities in the Statement of Net Assets. In the current period, proceeds received was.....	(1,146,000)
Repayment of long-term principal is expenditure in the governmental funds, but the repayment reduces Long-Term Liabilities in the Statement of Net Assets. In the current year the repayments were.....	80,000
Some expenses reported in the Statement of Activities do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds. These activities consist of:	
Decrease in Treasury Department Debt	\$ 5,568
Decrease in CRIM Debt.....	208,740
Increase in Compensated Absences	<u>(46,978)</u>
Total Decreased in Expenditures	<u>167,330</u>
Change in Net Assets of Governmental Activities (Page 9).....	<u>(\$1,086,401)</u>

See accompanying Notes to Basic Financial Statements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA, PUERTO RICO
NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2006

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The **Municipality of Culebra, Puerto Rico (Municipality)** was founded in the year 1880, and operates as a governmental unit of the Commonwealth of Puerto Rico, under the Law Number 81 of August 30, 1991, known as "Autonomy Municipalities Law of the Commonwealth of Puerto Rico". The governmental system of the **Municipality** is composed of the executive and legislative bodies. The Mayor is the Chief Executive Officer and is elected every four years in the general elections of the Commonwealth of Puerto Rico. The legislative body consists of 4 Legislators also elected in the general elections of Puerto Rico for a four-year period.

The **Municipality** provides services such as: health, public works, sanitation, aids and services to low-income and elderly citizens, public safety, housing and urban development, culture and recreation, planning, zoning and other general and administrative services.

The accounting policies of the **Municipality** conform to accounting principles generally accepted in the United States of America as applicable to governmental units. The following is a summary of the more significant policies.

The accompanying basic financial statements of the **Municipality** have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) as prescribed by the Governmental Accounting Standards Board (GASB). The GASB is the standard-setting body for governmental accounting and financial reporting. The GASB periodically updates its codification of the existing Governmental Accounting and Financial Reporting Standards which, along with subsequent GASB pronouncements (Statements and Interpretations) constitutes GAAP for governmental units.

In June 1999, the GASB issued Statement Number 34, *Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments*. This statement establishes new financial reporting requirements for state and local governments. The **Municipality** adopted the provisions of GASBS No. 34, No. 37 and No. 38. They require new information and restructure much of the information that governments have presented in the past.

The accompanying basic financial statements present the financial position and the results of operations of the **Municipality** and its various funds and fund types, and the cash flows of the proprietary funds. The basic financial statements are presented as of June 30, 2005, and for the fiscal year then ended. The more significant of these accounting policies are described below and, where appropriate, subsequent pronouncements will be referenced.

A. Financial Reporting Entity

The accompanying basic financial statements include all departments and organizations units whose funds are under the custody and control of the **Municipality**. In evaluating the **Municipality** as a reporting entity, management has addressed all the potential component units. The decision to include a potential component unit in the reporting entity was made by applying the provisions of GASBS No. 14.

The basic criteria for including a potential component unit within the reporting entity is if potential component units are financially accountable and other organizations for which the nature and significance of their relationship with the entity are such that exclusion would cause the **Municipality's** financial statements to be misleading or incomplete. The GASB has set forth criteria to be considered in determining financial accountability. These criteria include appointing a voting majority of an organization's governing body and (1) ability of the **Municipality** to impose its will on that organization or (2) the potential for the organization to provide specific financial benefits to, or impose specific financial burdens on the **Municipality**.

B. Measurement Focus and Basis of Accounting

The relative importance of each criterion must be evaluated in light of specific circumstances in order to determine which components units are to be included as part of the reporting entity. Our specific evaluations of the criteria applicable to the **Municipality** indicate that The Culebra Conservation and Development Authority meet the criteria to be included as discretely component unit. This Culebra Conservation and Development Authority was created in June 22, 1975 to formulate, adopt and administer the program and plan for the conservation, use and development of natural resources of the Municipality of Culebra.

These financial statements present the respective financial position of the governmental activities, each major fund, the aggregate remaining fund information and component unit of the **Municipality**, as of June 30, 2006, and the respective changes in financial position, where applicable, thereof for the fiscal year then ended.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA, PUERTO RICO
NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2006

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

Government-wide Financial Statements

The government-wide financial statements (the **Statement of Net Assets** and the **Statement of Activities**) are reported using the economic resources measurement focus and the accrual basis of accounting. Revenue is recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grant and similar items are recognized as revenue as soon as all eligibility requirements have been met.

Governmental Fund Financial Statements

The governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recorded when susceptible to accrual; as soon as it is both measurable and available. "Available" means collectible within the current period or soon enough thereafter, normally within sixty (60) days, to be used to pay liabilities of the current period. Expenditures are generally recognized when the related liability is incurred.

The exception to this general rule is the principal and interest on general obligation long-term debt and compensated absences, if any, are recognized when due.

In applying the "susceptible to accrual" concept to intergovernmental revenues (federal grants) pursuant to GASBS No. 33, *Accounting and Financial Reporting for Nonexchange Transactions* (the **Municipality** may act as either provider or recipient), the provider should recognize liabilities and expenses and the recipient should recognize receivables and revenue when the applicable eligibility requirements including time requirements, are met. Resources transmitted before the eligibility requirements are met should, under most circumstances, be reported as advances by the provider and deferred revenue by the recipient.

There are essentially two types of revenue. For some grants, funds must be expended by the **Municipality** on the specific purpose or project before any amounts will be reimbursed. Revenue is, therefore, recognized as expenditures are incurred to the extent available. For the other revenue, moneys are virtually unrestricted and are generally revocable only for failure to comply with prescribed compliance requirements. These resources are reflected as revenue at the time of receipt or earlier if the susceptible to accrual criteria is met. Expenditures are generally recorded when a liability is incurred, as under accrual accounting. Modifications to the accrual basis of accounting include the following:

- Employee's vested annual vacation and sick leave is recorded as expenditure when utilized. The amount of accumulated annual vacation and sick leave unpaid at June 30, 2006, has been reported only in the government-wide financial statements.

C. Financial Statement Presentation

The basic financial statements include both government-wide (based on the **Municipality** as a whole) and fund financial statements. While the previous financial reporting model emphasized fund types (the total of all funds of a particular type), in the new financial model the focus is on either the **Municipality** as a whole, or major individual funds (within the basic financial statements). Both the government-wide and fund financial statements (within the basic financial statements) categorize primary activities as either governmental or business type.

Government-wide Financial Statements

The government-wide financial statements (the **Statement of Net Assets** and the **Statement of Activities**) report information of all the activities of the **Municipality**. For most part, the effect of interfund activity has been removed from these government-wide financial statements. Governmental activities, which normally are supported by taxes and intergovernmental revenues, are reported separately from business-type activities, which rely to a significant extent on fees and charges for support.

The focus of the **Statement of Net Assets** is designed to be similar to bottom line results for the **Municipality** and its governmental activities. This statement, for the first time, combines and consolidates governmental fund's current financial resources (short-term expendable resources) with capital assets and long-term obligations.

The **Statement of Net Assets** presents the reporting entities' assets and liabilities, with the difference reported as net assets. Net assets are reported in three categories:

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA, PUERTO RICO
NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2006

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

C. Financial Statement Presentation (continuation)

- **Invested in Capital Assets, Net of Related Debt** – These consists of capital assets, net of accumulated depreciation and amortization, and reduced by outstanding balances for bonds, notes, and other debt that are attributed to the acquisition, construction, or improvement of those assets.
- **Restricted Net Assets** – These results when constraints are placed on net assets use, which can be either externally imposed by creditors, grantors, contributors, and the like, or imposed by law through constitutional provisions or enabling legislation.
- **Unrestricted Net Assets** – These consists of net assets which do not meet the definition of the two preceding categories. Unrestricted net assets often are designated, to indicate that management does not consider them to be available for general operations. Unrestricted net assets often have constraints on resources that are imposed by management, but can be removed or modified.

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

The **Statement of Activities** is focused on both the gross and net costs per functional category. The statement reduces gross expenses (including depreciation) by related program revenues, operating and capital grants. This is intended to summarize and simplify the user's analysis of cost of various governmental services.

Governmental Fund Financial Statements

The fund financial statements (the **Balance Sheet** and the **Statement of Revenues, Expenditures, and Changes in Fund Balances**) are, in substance, very similar to the financial statements presented in the previous financial reporting model. Emphasis here is on the major funds in the governmental category. Non-major funds are summarized into a single column.

Traditional users of governmental financial statements will find the Fund Financial Statements presentation more familiar. The focus is on Major Funds, rather than the previous financial model's fund types. The Governmental Major Fund Statements are presented on current financial resources and modified accrual basis of accounting.

This is the manner in which these funds are normally budgeted. This presentation deemed most appropriate to (a) demonstrate legal and covenant compliance, (b) demonstrate the source and use of liquid resources, and (c) demonstrate how the **Municipality's** actual experience conforms to the budgeted fiscal plan.

Since the governmental fund statements are presented in a different measurement focus and basis of accounting than the government-wide statements, reconciliation is presented and a separate explanation for each differences.

The **Municipality** reports its financial position (**Balance Sheet**) and results of operations (**Statement of Revenues, Expenditures and Changes in Fund Balance**) in funds, which are considered separate accounting entities. The operations of each fund are accounted for within a set of self-balancing accounts. 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 new model as defined in GASBS No. 34 established criteria (percentage of the assets, liabilities, revenues, or expenditures/expenses of either fund category in the governmental fund) for the determination of major funds. The non-major funds are combined in a single column in the fund financial statements. The **Municipality** reports the following major fund:

General Fund – This is the general operating fund of the **Municipality**. It is used to account for all financial resources, except those required to be accounted for in another fund.

State Assignment Fund – This is the fund used to account for all the transactions of the State Assignment by Legislature Resolutions. The primarily objectives of these assignments is the development of projects on communities, not-for-profit organizations, purchase of equipment and indirect assignment to persons of low and moderate income.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA, PUERTO RICO
NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2006

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

CDBG Fund – This is the fund used to account for all the transactions of the State Block Grant Program. The primary objectives of this program is to development of viable communities by providing decent housing, a suitable living environment and expanded economic opportunities, principally for persons of low and moderate income.

GASBS No. 34 eliminates the presentation of Account Groups, but provides for these records to be maintained and incorporates the information into the Governmental column in the government-wide **Statement of Net Assets**.

D. Budgetary Data

The **Municipality** annually adopts the Budget Resolution for all operating funds of the **Municipality** except for certain restricted accounts of Proprietary Funds and Special Revenue Funds. Budgetary control is legally maintained at the fund level. The budget is prepared using the modified accrual basis of accounting with encumbrance included as budgetary basis expenditures. The **Municipality's** Budget Resolution provides transfer authority (1) to the Mayor and the Management and Budget Director, within and between departments and funds, as long as the total budget of the **Municipality** (net of interfund transfers) is not increased; (2) to the Management and Budget Director to implement grant budgets as the grant applications are accepted by the **Municipality**; and (3) to the Management and Budget Director to amend (re-appropriate) each new year's budget, to the extent of outstanding encumbrances, and/or unexpended project/grant appropriations at year end. **Municipality's** Legislature action is required for (1) use of the budgeted Legislature contingency, and (2) the approval of a supplemental appropriation(s). During the year, several supplemental appropriations were necessary.

The budget columns (original and final budgets) of the Budgetary Comparison – General Fund reflect the original budget and the amended budget (which have been adjusted for legally authorized revisions of the annual budgets during the year). Appropriations, except remaining project appropriations, encumbrances, and unexpended grant appropriations, lapse at the end of each fiscal year.

Amendments to the budget, including transfers, require the approval of the Municipal Legislature. Unencumbered appropriations lapse at the end of the next fiscal year. The **Municipality** follows these procedures, in accordance with law, in order to establish the budgetary data reflected in the basic financial statements:

1. Prior of May 15 of each fiscal year, the Mayor submits to the Municipal Legislature a proposed budget for the fiscal year commencing the following July 1 in addition of a budget message.
2. The budget document is available for public inspection prior to its approval by the Municipal Legislature.
3. The Commissioner of Municipal Affairs examines the budget to verify if it complied with the law's standards and sends it to the Mayor for any comments or recommendation before the limited date establishes by the Law.
4. Prior to June 13, the annual budget is legally enacted through passage of the annual appropriation ordinance.
5. If a budget is not adopted prior to the end of the end of the fiscal year, the annual budget for the preceding fiscal year, as approved by the Municipal Legislature and the Mayor, is automatically renewed for the ensuing fiscal year until a new budget is approved. This permits the **Municipality** to continue making payments for its operating and other expenses until the new budget is approved.
6. Subsequent to the enactment of the annual appropriation ordinance, the Municipal Legislature has the authority to make necessary amendments made during the fiscal year and are reflected in the budget information included in the Budgetary Comparison Schedule – General Fund.

Since the budgetary basis differs from accounting principles generally accepted in the United States of America (GAAP), actual amounts for the General Fund in the accompanying Budgetary Comparison Schedule, is presented on the budgetary basis to enhance comparability.

The principal differences between the budgetary and GAAP bases are the following:

1. Encumbrances are recorded as expenditures under the budgetary basis and as a reserve of fund balances under GAAP.
2. The non-exonerated portion of the property tax advances are presented as revenue in the budgetary basis and as other financing sources under GAAP (See Note 9).

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA, PUERTO RICO
NOTES TO THE BASIC FINANCIAL STATEMENTS**

FOR THE FISCAL YEAR ENDED JUNE 30, 2006

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

3. Interfund transactions of the General and Special Revenue Funds are not included in the budgetary basis.
4. Certain accrued liabilities and other debts are not included in the budgetary basis.
5. Certain revenues susceptible to accrual, i.e., both measurable and available, are not included in the budgetary data.

All encumbrance appropriations in the operating budget lapse at the end of the fiscal year. Property taxes collected during the current year by the Municipal Revenue Collection Center (Fiscal Agent) are presented as revenues in the accounting basis but are not considered in the budgetary schedule.

The special funds of the Special Revenue Fund have not been included in the budgetary comparison because balances are not budgeted. Also the budget prepared for the Federal Finance Awards Programs included in the Capital Projects and Special Revenue Funds is based on a program period which is not necessarily a year. Accordingly, it's not practical to present an annual comparison of budget for such programs.

E. Cash, Cash Equivalent and Investment

The Director of Finance of the **Municipality** is responsible for investing the available resources in certificates of deposit and other short-term investments. Investments are made from the available combined funds of the **Municipality** and, accordingly, it is not practical to disclose certificates of deposit and other short-term investments individually by fund in the combined financial statements. Interest earned on certificates of deposit and other short-term investments are recognized as revenue in the General Fund. Cash in the Special Revenue, Debt Service and Capital Project Funds are restricted; accordingly, resources available were not used for pool investments.

Cash with fiscal agent represents property tax collections retained by the Municipal Revenues Collection Center and undisbursed proceeds of certain bonds, loans or grants which are maintained in a cash custodian account by the Government Development Bank of the Commonwealth of Puerto Rico.

This sinking fund is maintained by the Governmental Development Bank of Puerto Rico, agency which acts as the insurer and payer of the **Municipality's** bonds and notes issued in accordance with law.

F. Receivable

Receivable are stated nets of estimated allowances for uncollectible accounts, which are determined upon past collection experience and current economic conditions. Receivable from Federal Government represents amounts owed to the **Municipality** for reimbursement of expenditures incurred pursuant to federally funded programs.

G. Inventories

The General, Special Revenue and Capital Project Funds, purchases office and printing supplies, gasoline, oil and other expendable supplies held for consumption. The cost of purchases is recorded as expenditure in the appropriate fund and the inventory is not recorded in the basic financial statements.

H. Capital Assets

Property, plant and equipment purchased or acquired is carried at historical cost or estimated historical cost. Contributed assets are recorded at fair market value as of the date received. The **Municipality's** capitalization levels are \$500 on personal property. For improvements other than buildings, the capital outlay must be greater than \$10,000, extend the estimated useful life for ten years, and be greater than 10% of the original cost of the asset. Other costs incurred for repairs and maintenance is expensed as incurred.

TABLE 1	
CAPITAL ASSETS	YEARS
Buildings and site Improvements	20-50
Infrastructure	20-50
Motor Vehicles, furniture and fixtures	5-10
Machinery and Equipments	5-20

H. Capital Assets

Depreciation on all assets is provided on the straight-line basis over the following estimated useful lives: (See Table 1)

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA, PUERTO RICO
NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2006

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

I. Compensated Absences

The Municipality accrues accumulated unpaid vacation and sick leave and associated employee-related costs when earned (or estimated to be earned) by the employee. The Municipality's employees are granted 30 days of vacations and 18 days of sick leave annually. Vacations may be accumulated up to a maximum of sixty (60) days and sick leave up to a maximum of ninety (90) days. In the event of employee resignation, the employee is paid for accumulated vacation days up to the maximum allowed. Separation from employment prior to use of all or part of the sick leave terminates all rights for compensation, except for employees with ten years of service who are entitled to sick leave pay up to the maximum allowed. The Municipality accrued a liability for compensated absences, which meet the following criteria:

1. The Municipality's obligation relating to employee's rights to receive compensation for future absences is attributable to employee's services already rendered.
2. The obligation relates to rights that vest or accumulate.
3. Payment of the compensation is probable.
4. The amount can be reasonably estimated.

In accordance with the above criteria and requirements as established by GASBS No. 16; the Municipality has accrued a liability for compensated absences, which has been earned but not taken by Municipality's employees. For the government-wide statements, the current portion is the amount estimated to be used in the following year. For the governmental funds statements, all of the compensated absences are considered long-term and therefore, are not a fund liability and represents a reconciling item between the fund level and government-wide presentations (see Note 7).

The following is a summary of changes in the balance of Compensated Absences for the fiscal year ended June 30, 2006 (Table 2).

BALANCE JULY 1, 2005	NEW ISSUES	RETIREMENTS AND CURRENT MATURATES	BALANCE JUNE 30, 2006	CURRENT PORTION	LONG-TERM PORTION
\$ 237,159	\$ 46,978	\$ -	\$ 284,137	\$ 284,137	\$ -

J. Insurance

The Municipality has insurance coverage for its public facilities, primarily to provide protection from catastrophic losses. Also, principal officials of the Municipality are covered under various surety bonds. The Secretary of the Treasury Department of the Commonwealth of Puerto Rico is the agent commissioned to place all of the Municipality's insurance coverage. Corresponding premiums payable are withheld by the Municipal Revenue Collection Center from quarterly advances of annual property tax and subsidy send to the Municipality.

K. Interfund Transactions

Interfund transactions are reflected as loans, reimbursements or transfers. Loans are reported as receivables and payables as appropriate and are subject to elimination upon consolidation. Reimbursements occur when one fund incurs a cost, charges the appropriate benefiting fund and reduces its related cost as a reimbursement. All other interfund transactions are treated as transfers. Transfers between governmental or proprietary funds are netted as part of the reconciliation to the government-wide columnar presentation. The Municipality has the following types of transactions among funds:

Interfund Transfers – Legally required transfers that are reported when incurred as transfers-in by the recipient fund and as transfers-out by the disbursing fund, with receivables and payables presented as amounts due to and due from other funds. Advances between funds are also presented as amounts due to and due from other funds. However, these transfers and related amounts receivables and payables are considered internal balances and activities that have been eliminated in the government-wide financial statements.

Residual Equity Transfers – Nonrecurring or no routine transfers of equity between funds. During the Fiscal Year 2005-2006 no transfers of this kind was made.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA, PUERTO RICO
NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2006

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)

L. Reservations of Fund Balance – Governmental Funds

The governmental fund financial statements present fund balance reserves for those portions of fund balance (1) not available for appropriation for expenditures or (2) legally segregated for a specific future use. The reserves for related assets such as inventories and prepayments are examples of the former. Reserves for debt service and other specific purposes are examples of the latter.

M. Claims and Judgments

The estimated amount of the liability for claims and judgments, if any, which is due on demand, such as from adjudicated or settled claims, is recorded in the General Fund. The Long-Term Liabilities includes an amount estimated as a contingent liability or liabilities with a fixed or expected due date, which will require future available financial resources for its payment.

N. Use of Estimates

The preparation of the basic 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 disclosures of contingent assets and liabilities at the date of the basic financial statements and the reported revenue and expenses during the reporting period. Actual result could differ from those estimates.

NOTE 2 CASH AND CASH EQUIVALENTS

The Municipality's cash and cash equivalents at year-end were entirely covered by the Federal Deposit Insurance Corporation (FDIC) coverage, up to a maximum of \$100,000 in each bank, and the excess by collateral provided by the banks and held by the Department of the Treasury pursuant the applicable laws and regulations. Cash with fiscal agent is maintained in interest bearing accounts in the Government Development Bank of Puerto Rico and is not collateralized.

Puerto Rico laws authorize governmental entities to invest in direct obligations or obligations guaranteed by the federal government or the Commonwealth of Puerto Rico. The Municipality is also allowed to invest in bank acceptances, other bank obligations and certificates of deposit in financial institutions authorized to do business under the federal and Commonwealth laws. During the year, the Municipality invested its funds in interest bearing bank accounts.

NOTE 3 INTERFUND TRANSFER AND BALANCES

A. INTERFUND TRANSFERS

There are no indicative of funding during fiscal year 2005-2006.

B. INTERFUND RECEIVABLE AND PAYABLE BALANCES

Interfund receivables and payables at June 30, 2006 are summarized as follows: (See Table 5)

INTERFUND RECEIVABLE	INTERFUND PAYABLE	TABLE 5 AMOUNT
General Fund	CDBG Fund	\$ 21,968
General Fund	Other Governmental	175,890
State Assignment	General Fund	2,075,719
State Assignment	CDBG Fund	138,014
Other Governmental	General Fund	35,758
Other Governmental	State Assignment	15,011
TOTAL		<u>\$2,462,360</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA, PUERTO RICO
NOTES TO THE BASIC FINANCIAL STATEMENTS**

FOR THE FISCAL YEAR ENDED JUNE 30, 2006

NOTE 4 DUE TO OTHER GOVERNMENTAL UNITS

As of June 30, 2006, balance due to other governmental units of the General Fund for services rendered to the Municipality, consists of the following:

	<u>AMOUNT</u>
Water & Sewer Company.....	\$ 2,605
State Treasury Department	113,356
State Retirement System	18,427
ELA Employee Association	1,748
General Services Administration.....	<u>4,687</u>
 Total Due to Governmental Units.....	 <u>\$ 140,823</u>

NOTE 5 CAPITAL ASSETS

Capital Assets activities for the fiscal year ended June 30, 2006 was as follows (See Table 6)

TABLE 6	BALANCE JULY 1, 2005	ADJUSTMENTS	ADDITIONS	RETIREMENTS	BALANCE JUNE 30, 2006
Non-Depreciable Capital Assets:					
Land	\$ 3,366,886	\$ -	\$ -	\$ -	\$ 3,366,886
Construction in Progress.....	-	-	-	-	-
Total Non-Depreciable Capital Assets	<u>3,366,886</u>	-	-	-	<u>3,366,886</u>
Depreciable Capital Assets:					
Buildings	6,285,605	-	-	-	6,285,605
Infrastructure	-	-	-	-	6,285,605
Machinery and Equipment.....	672,604	-	-	-	672,604
Motor Vehicles.....	<u>1,626,395</u>	-	-	-	<u>1,626,395</u>
Total Depreciable Capital Assets.....	<u>8,584,604</u>	-	-	-	<u>8,584,604</u>
Less Accumulated Depreciation:					
Buildings	(1,439,153)	-	-	-	(1,439,153)
Infrastructure	-	-	-	-	-
Machinery and Equipment.....	(670,869)	-	-	-	(670,869)
Motor Vehicles.....	<u>(1,428,602)</u>	-	-	-	<u>(1,428,602)</u>
Total Accumulated Depreciation	<u>(3,538,624)</u>	-	-	-	<u>(3,538,624)</u>
Total Depreciable Capital Assets (Net).....	<u>5,045,980</u>	-	-	-	<u>5,045,980</u>
CAPITAL ASSETS, NET	<u>\$ 8,412,866</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 8,412,866</u>

During Fiscal Year 2005-2006 no depreciation expense were charged to governmental functions/programs: (See Table 7)

TABLE 7	AMOUNT
General Government	\$ -
Mayor and Municipal	-
Public Safety	-
Public Works	-
Urban Development.....	-
Sanitation	-
Human Services and Welfare.....	-
Culture and Recreation.....	-
 Total Depreciation Expenses	 <u>\$ -</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA, PUERTO RICO
NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2006

NOTE 6 GENERAL LONG-TERM DEBTS

A. GENERAL OBLIGATIONS BONDS

The principal long-term obligations of the **Municipality** are general obligations bonds and special notes issued to finance the construction and improvements of public facilities and purchase of equipment. The **Municipality's** obligations long-term debt retirements are appropriated and paid from resources accumulated in the Debt Service Fund (See Note 8).

General obligations bonds as of June 30, 2006, are comprised of the following individual issues:

DESCRIPTION	AMOUNT
General Obligations Bonds:	
\$170,000, Series 2003, for capital outlay purposes, payable in semi annual installments ranging from \$20,000 to \$30,000, excluding interests at 4.10, through July 1, 2009.....	\$ 80,000
\$220,000, Series 2005, for capital outlay purposes, payable in semi annual installments ranging from \$25,000 to \$35,000, excluding interests at 4.62%, through July 1, 2011.....	165,000
\$220,000, Series 2006, for capital outlay purposes, payable in semi annual installments ranging from \$25,000 to \$35,000, excluding interests at 6.00%, through July 1, 2012.....	195,000
\$926,000, Series 2006, for capital outlay purposes, payable in July 1, 2007, excluding interests at 4.50%.....	<u>926,000</u>
Total General Obligations – Bonds	<u>\$1,366,000</u>

The annual requirements to amortize the general obligations outstanding as of June 30, 2006 are as follows (See Table 8):

YEAR ENDING JUNE 30,	PRINCIPAL PAYMENT	INTEREST PAYMENT	TOTAL PAYMENT
2007	\$ 85,000	\$ 61,890	\$ 146,890
2008	1,011,000	38,932	1,049,932
2009	95,000	14,055	109,055
2010	70,000	9,492	79,492
2011	70,000	5,817	75,817
2012-2016	<u>35,000</u>	<u>2,100</u>	<u>37,100</u>
TOTAL	<u>\$1,366,000</u>	<u>\$ 132,286</u>	<u>\$ 1,498,286</u>

B. OTHER LONG-TERM DEBTS

Following are the Other Long-Term Debts (See Table 9):

DESCRIPTION	BALANCE JULY 1, 2005	NEW ISSUES	RETIREMENTS AND ADJUSTMENT	BALANCE JUNE 30, 2006
Property Taxes – MRCC.	2,348,574	\$ -	\$ 208,740	\$2,139,834
Treasury Department	27,839	-	5,568	22,271
Claims and Judgments ...	1,939,759	-	-	1,939,759
Compensated Absences.	<u>237,159</u>	<u>46,978</u>	-	<u>284,137</u>
TOTAL.....	<u>\$4,553,331</u>	<u>\$ 46,978</u>	<u>\$ 214,308</u>	<u>\$4,386,001</u>

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA, PUERTO RICO
NOTES TO THE BASIC FINANCIAL STATEMENTS**

FOR THE FISCAL YEAR ENDED JUNE 30, 2006

NOTE 6 GENERAL LONG-TERM DEBTS (continuation)

C. CHANGES IN GENERAL LONG-TERM DEBTS

The following is a summary of changes in long-term debts for the year ended June 30, 2006 (See Table 10):

TABLE 10	BALANCE	NEW	RETIREMENTS	BALANCE	AMOUNTS	AMOUNTS
DESCRIPTION	JULY 1, 2005	ISSUES	AND ADJUSTMENT	JUNE 30, 2006	DUE WITHIN ONE YEAR	DUE AFTER NEXT YEAR
General	\$ 300,000	\$ 1,146,000	\$ 80,000	\$1,366,000	\$ 85,000	\$1,281,000
Others Debts.....	<u>4,553,331</u>	<u>46,978</u>	<u>214,308</u>	<u>4,386,001</u>	<u>284,137</u>	<u>4,101,864</u>
TOTAL	<u>\$4,853,331</u>	<u>\$ 1,192,978</u>	<u>\$ 294,308</u>	<u>\$5,752,001</u>	<u>\$ 369,137</u>	<u>\$5,382,864</u>

NOTE 7 DEBT RETIREMENT

Revenues of the debt service fund consists of the ad-valorem property taxes which are recognized as revenue when collected from taxpayers and reported by the Municipal Revenue Collection Center of the Commonwealth of Puerto Rico to the **Municipality** (See Note 9).

These property taxes are accumulated by the Municipal Revenue Collection Center in costs of the general obligations bonds issued by the **Municipality** (See Note 7). Payments are made to the Government Development Bank of the Commonwealth of Puerto Rico from such accumulated funds by the Municipal Revenue Collection Center of Puerto Rico.

NOTE 8 PROPERTY TAXES

The Municipal Revenue Collection Center of the Commonwealth of Puerto Rico is responsible for the assessment of all real and personal property located within the **Municipality** and for the levy, administration and collection of the corresponding tax contribution.

The property tax contribution is levied each year over the appraised value of the property at the beginning of the calendar year. The real property assessment is based on the current value existing in the year 1957 and the personal property at the current value at the date of the assessment.

The tax rate per annum is 8.08% for real property and 6.08% for personal property of which 1.03% of both belong to the Commonwealth of Puerto Rico and 7.25% and 5.25%, respectively, belongs to the **Municipality**. From the portion belonging to the **Municipality**, 6.00% and 4.00%, respectively, represents the **Municipality's** basic tax rate that is appropriated for general purposes and therefore accounted for through the General Fund.

The remaining portion belonging to the **Municipality** of 1.25% represents the ad-valorem property taxes withheld by the Municipal Revenue Collection Center of the Commonwealth of Puerto Rico and restricted for debt service, which is accounted for through the Debt Service Fund (See Note 8). The **Municipality** has not reached the maximum statutory tax rate limit for the basic tax while there is no limitation for the ad-valorem tax rate.

The Commonwealth of Puerto Rico grants complete real property tax exoneration on the first \$15,000 assessed valuation on residential units occupied by their owners. However, the **Municipality** receives the full amount levied, except for residential units assessed at less than \$3,500 on which a complete exemption is granted. The Municipal Revenue Collection Center, instead of the property taxpayer, becomes the source of payment in these cases.

The **Municipality** grants a complete exemption from personal property taxes up to an assessment value of \$50,000 to retailers with an annual net sales volume of less than \$150,000. The Municipal Revenue Collection Center advances to the **Municipality**, on monthly payments, 100% of the contribution assessed over property for each fiscal year. In accordance to Law, these advances will be contributions by the Municipal Revenue Collection Center from taxpayers. The Municipal Revenue Collection Center periodically informs to the **Municipality** the amounts collected from taxpayers and applied to outstanding advances.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA, PUERTO RICO
NOTES TO THE BASIC FINANCIAL STATEMENTS**

FOR THE FISCAL YEAR ENDED JUNE 30, 2006

NOTE 8 PROPERTY TAXES (continuation)

The **Municipality** records as revenue in the general fund the property tax contribution when received from monthly advances from Municipal Revenue Collection Center.

Due to the fact that collections of property tax are applied to the advances of property tax paid by the Municipal Revenue Collection Center, the amortization of the advance at end of year was not available due to that is in process of verification by external auditors.

NOTE 9 VOLUME OF BUSINESS TAX

The volume of business tax is levied each year based on the prior year's gross revenues for all commercial and industrial organizations doing business in the **Municipality** and which are not totally or partially exempt from this tax under the Industrial Incentives Laws of the Commonwealth of Puerto Rico. All taxpayers are required to file their declarations by April 23 of each year. The tax rates are as follows:

- a. 1.50% for financial institutions and savings and loan associations.
- b. 0.50% for all other organizations.

Taxes are payable in two equal semi-annual installments on July 1 and January 1 following the date of levy. If they are paid with declaration, the taxpayer is granted a 5% of discount. Collections of taxes during current fiscal year, applicable to the next fiscal year, are recorded as deferred revenues in the General Fund.

NOTE 10 INTERGOVERNMENTAL REVENUES

Intergovernmental revenues consist primarily of funds received from the Commonwealth of Puerto Rico, "in lieu of tax" payments from the quasi-public corporation, Puerto Rico Electric Power Authority, and federal financial assistance received from federal government.

Grants and subsidies received from the Commonwealth of Puerto Rico and federal agencies include, among others, a general subsidy for urban development and capital improvements. Intergovernmental revenues are accounted for through the General Fund except for those directly related to urban development and capital improvements, which are accounted for through the Special Revenue and the Capital Project Funds. Federal Financial Assistance is recorded in the Special Revenue Fund.

NOTE 11 EMPLOYEE'S RETIREMENT PLAN

The Employee's Retirement System of the Government of Puerto Rico and its instrumentality (ERS) is the administrator of a cost-sharing multiple-employer retirement system established by the Commonwealth of Puerto Rico. The ERS 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 instrumentality and of certain municipalities and components units not covered by their own retirement systems.

Participation is mandatory except for members of the Legislature, Government Secretaries, Head of Agencies and Public Instrumentality, Assistants of the Governor, the Comptroller of the 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.

The **Municipality** adopted the requirements of GASBS No. 25 for all the career employees that are covered under the Commonwealth of Puerto Rico Employee's Retirement System, a multiple-employer public employee retirement system, established by State Laws.

Under the plan, the employees and employer portions are contributed, for which, the employee amount is withheld from salaries. Covered employees are required by Commonwealth statute to contribute 5.775% for the first \$550 of monthly salary plus 8.275% for the excess of this amount, or on the alternative, 8.275% of all salary. The **Municipality** contributes to the system 9.275% of the participating employee's salaries.

Law Number 305 of September 24, 1999, amends the Act Number 447 that establish a savings program. All employees active in the system as of December 31, 1999 may elect to transfer from define contribution programs to the new savings

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA, PUERTO RICO
NOTES TO THE BASIC FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2006

NOTE 11 EMPLOYEE'S RETIREMENT PLAN (continuation)

program (a defined contribution plan). Employees in the savings program may now contribute from a minimum of 8.275% up to a maximum of 10% of their monthly salary, and will invested in an account which will either: (a) earn a fixed rate based on the two-year Constant Maturity Treasury Note or, (b) earn a rate equal to 75% of the return of the System's investment portfolio (net of management fees), or (c) earn a combination of both alternatives. If at time of retirement accumulated benefits amount to \$10,000 or less may elect to receive a lump sum distribution up to the accumulated benefits. Under the new program the retirement age is reduced from 65 to 60 for those employees who joined the current plan on or after April 1, 1990.

The pension benefit for participants who retire with less than 30 years of service is computed at the rate of 1½% of their average compensation for each year of credit service for the remaining years. The System also provides for death and disability benefits and the assets of the System pertaining to the participant employees.

A variety of significant actuarial assumptions are used to determine the standard measure of the pension benefit obligation and these assumptions are summarized below:

- a. The present value of the future pension payments was computed by using a discount of 9%.
- b. Future pension payments reflect an assumption of a 6% salary increase.

All employees that do not elect to transfer for the new program and who at the time of employment are 55 years old or less are eligible to participate in the System. Pension benefits for participants with 30 years of service are as follows (See Table 11)

YEARS OF SERVICE	PARTICIPANT'S AGE	PENSION BENEFITS	TABLE 11
30 or more	55 or less	65% of the average of the three years of highest salary during the employee's service period.	
30 or more	58 or more	75% of the average of the three years of highest salary during the employee's service period.	
30 or more	65 or more	75% of the average of the three years of highest salary during the employee's service period (employees started working after April 1, 1990).	

The amount of the total pension benefit obligation is based on a standardized measurement established by GASBS No. 27, *Financial Reporting for Defined Benefit Pension Plans and Notes Disclosure for Defined Contributions Plans*. The standardized measurement is the actuarial present value of estimated defined pension benefits, adjusted for the effects of projected salary increases and step-rate benefits, estimated to be payable in the future as a result of employee services performed to date. The measure is intended to help users assess the System's funding status on a going-concern basis, assess progress made in accumulating sufficient assets to pay benefits when due, and make comparisons among other public retirement systems. The measure is independent of the actuarial funding method used to determine contributions to the plan.

The membership of retirees and beneficiaries currently receiving benefits and terminated employees entitled to benefits, but not yet receiving benefits, and active employees and the distribution of active employees between vested and non-vested is not readily available.

Contributions in 2005 and prior years were made based on percentages established by the law. Such percentage has not been based on actuarial studies, as required by accounting principles generally accepted in the United States of America. An actuarial compilation of the annual contribution applicable to the Municipality has not been prepared. Accordingly, the accounts by which the actual contributions differ from the required actuarial contributions are not known.

The total pension expenditures recorded in the category of administration for the Fiscal Year Ended June 30, 2006 was approximately \$125,370. All employees who at the time of employment are 55 years old or less are eligible to participate in the System. No benefit is payable if the participant receives a refund of his accumulated contributions.

The historical trend information regarding the accumulation of assets and pension benefit obligation in the ERS is not available. For the ten-year trend information, refer to the separately issued financial statements of the ERS as of and for the fiscal year ended June 30, 2006. The P.R. Retirement Plan Administration provides additional information of the ERS. They issue a publicly available financial report that includes financial statements and required supplementary information for ERS, as a component unit of the Commonwealth of Puerto Rico. That report may be obtained by writing to the Administration at PO Box 42003, Minillas Station, San Juan, PR 00940.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA, PUERTO RICO
NOTES TO THE BASIC FINANCIAL STATEMENTS**

FOR THE FISCAL YEAR ENDED JUNE 30, 2006

NOTE 12 CONTINGENCIES

A. CLAIMS AND JUDGMENTS

The Municipality is, at present, a defendant in a number of legal matters that arise from alleged improper application of policies and negligence in the ordinary course of the Municipality's activities. The legal counsel of the Municipality has advised that at this stage in the proceedings of lawsuits he cannot offer an opinion as to the probable outcome.

In addition, the Municipality is a defendant or co-defendant in several legal proceedings, which are in discovery stage. Certain of these claims are covered by insurance. Legal counsel with the information currently available can not determine the final outcome of these claims.

The financial statements include a debt for claim and judgments from fiscal year 2004-2005 related to a collection claim by a contractor. This lawsuit is in appeal in court.

B. FEDERAL GRANTS

In the normal course of operations, the Municipality receives grants from various Federal and State agencies. The grant programs are subject to audit by agents of the granting authority, the purpose of which is to ensure compliance with conditions precedent to the granting of funds. Any liability for reimbursement which may arise as the result of these audits is not believed to be material.

NOTE 13 ACCOUNTING CHANGES, CHANGES IN REPORTING ENTITY AND RESTATEMENTS

Table 12 reconciles the June 30, 2005 Fund Balance and Net Assets, as previously reported to Beginning Fund Balances and Net Assets as restated, July 1, 2005.

Table 12			
NET ASSETS RESTATED			
The following schedule reconciles the June 30, 2005 Net Assets, as previously reported to Beginning Net Assets, as restated, July 1 2005			
Net Assets as, Previously Reported, at June 30 2005.....			\$8,762,336
Adjustments to Assets.....			(179,892)
Restatement as per GAAP.....			<u>(120,225)</u>
Beginning Net Assets, as Restated, At July 1, 2005.....			<u>\$8,462,219</u>
FUND BALANCE RESTATED			
	GENERAL	STATE ASSIGNMENT FUND	OTHER GOVERNMENTAL FUND
Fund Balance (Deficit)/Net Assets, as Reported, June 30, 2005	\$(1,837,031)	\$4,349,867	\$ 693,477
Interfund Transaction adjustment.....	(367,615)	188,227	17,789
Restatement as per GAAP	-	<u>(127,713)</u>	<u>7,488</u>
Beginning Fund Balance (Deficit) as Restated, July 1, 2005	<u>\$(2,204,646)</u>	<u>\$4,410,381</u>	<u>\$718,754</u>

END OF NOTES

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA, PUERTO RICO

REQUIRED SUPPLEMENTARY INFORMATION
BUDGETARY COMPARISON SCHEDULE - GENERAL FUND

FOR THE FISCAL YEAR ENDED JUNE 30, 2006

	Budget Amounts		Actual Amounts (Budgetary Basis) (See Note A)	Variance with Final Budget Positive (Negative)
	Original	Final		
BUDGETARY FUND BALANCE, JULY 1, 2005	\$(2,204,646)	\$(2,204,646)	\$ (2,204,646)	
Resources (Inflows)				
Property Taxes.....	333,570	330,833	330,833	-
Volume of Business Taxes.....	249,738	180,933	131,269	(49,664)
Intergovernmental Revenues.....	2,074,051	2,255,986	2,583,451	327,465
License and Permits.....	1,358,777	1,141,440	290,851	(850,589)
Rent.....	60,000	21,600	20,789	(811)
Miscellaneous.....	710,700	505,300	388,717	(116,583)
Total Resources (Inflows).....	4,786,836	4,436,092	3,745,910	(690,182)
Amounts Available for Appropriation.....	2,582,190	2,231,446	1,541,264	(690,182)
Charges to Appropriations (Outflows)				
Mayor and Municipal Legislature.....	624,935	604,369	436,024	168,345
General Government.....	2,527,859	2,405,821	1,811,977	593,844
Public Safety.....	334,258	258,251	194,358	63,893
Public Works.....	725,178	635,742	514,273	121,469
Culture and Recreation.....	266,849	167,677	79,349	88,328
Sanitation.....	72,083	135,354	62,185	73,169
Human Services and Welfare.....	235,674	228,878	184,085	44,793
Total Charges to Appropriations.....	4,786,836	4,436,092	3,282,251	1,153,841
BUDGETARY FUND BALANCE, JUNE 30, 2006.....	\$(2,204,646)	\$(2,204,646)	\$ (1,740,987)	\$ 463,659

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA, PUERTO RICO**

**BUDGETARY COMPARISON SCHEDULE – GENERAL FUND
NOTE TO REQUIRED SUPPLEMENTARY INFORMATION**

FOR THE FISCAL YEAR ENDED JUNE 30, 2006

NOTE A Explanation of Differences between Budgetary Inflows and Outflows and GAAP Revenues and Expenditures

	<u>GENERAL FUND</u>
Sources/Inflows of Resources:	
Actual Amounts (Budgetary Basis) "Available for Appropriation" from the Budgetary Comparison Schedule (See Page 27)	\$ 1,541,264
Difference – Budget to GAAP:	
The Fund Balance at the Beginning of Year is a budgetary resource but is not a Current-Year Revenue for financial reporting purposes.....	2,204,646
Prior and Current Adjustments to Revenues.....	<u>39,867</u>
Total Revenues as Reported on the Statement of Governmental Funds Revenues, Expenditures and Changes in Fund Balance (See Page 12)	<u>\$ 3,785,777</u>
Uses/Outflows of Resources:	
Actual Amounts (Budgetary Basis) "Total Charges to Appropriation" from the Budgetary Comparison Schedule (See Page 27)	\$ 3,282,251
Difference – Budget to GAAP:	
Prior Year expenditures are not outflows of budgetary resources but are expenditures For financial reporting purposes.....	112,498
Encumbrances for supplies and equipment ordered but not received are reported in the year the order is placed for budgetary reporting purposes.	(89,166)
Adjustment to Expenditures.	<u>(28,508)</u>
Total Expenditures as Reported on the Statement of Governmental Funds Revenues, Expenditures and Changes in Fund Balance (See Page 12)	<u>\$ 3,277,075</u>

NOTE B Explanation of Differences between Budgetary Fund Balance and GAAP Fund Balance

Budgetary Fund Balance, June 30, 2006 (See Page 27).....	\$ (1,740,987)
Timing Differences:	
Net Change in Encumbrances.....	(3,964)
Non-budgetary Items.....	<u>(44,123)</u>
Unreserved Fund Balance, June 30, 2006 (See Page 10).....	<u>\$ (1,789,074)</u>

END OF THIS SECTION

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA, PUERTO RICO
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

FEDERAL GRANTOR / PASS THROUGH GRANTOR / PROGRAM OR CLUSTER TITLE	FEDERAL CFDA NUMBER	PASS-THROUGH ENTITY IDENTIFYING NUMBER	TOTAL EXPENDITURES
U. S. Department of Agriculture:			
Pass Through State – Department of Education			
Child and Adult Care Food Program	10.558	N/AV	\$ <u>29,143</u>
U.S. Department of Housing and Urban Development:			
Pass Through State – Office of the Commissioner of Municipal Affairs			
State Block Grant Program (SBGP)	14.228	05-FD 04-FD 03-FD 02-FD 01-FD 00-FD 99-FD 98-FD 97-FD 96-FD	<u>313,072</u>
U.S. Department of Interior:			
Direct Program:			
Fish & Wildlife Management Assistance	15.608		<u>8,549</u>
U.S. Department of Health and Human Services			
Subtotal Expenditures of Federal Awards			
(Balance Carry Forward)			<u>350,764</u>

continue

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA, PUERTO RICO
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

FEDERAL GRANTOR / PASS THROUGH GRANTOR / PROGRAM OR CLUSTER TITLE	FEDERAL CFDA NUMBER	PASS-THROUGH ENTITY IDENTIFYING NUMBER	TOTAL EXPENDITURES
Subtotal Expenditures of Federal Awards			
(Balance Brought Forward)			\$ 350,764
Pass-Through Office of the Governor, Regional Elderly Office:			
Special Program for Aging, Title III, Part B.....	93.045	N/AV	963
Pass-Through Administration of Children and Families:			
Child Care and Development Block Grant	93.575	N/AV	<u>171,384</u>
Total U.S. Department of Health and Human Services			<u>172,347</u>
TOTAL EXPENDITURES OF FEDERAL AWARDS			<u>\$ 523,111</u>

See accompanying Notes to Schedule of Expenditures of Federal Awards.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA, PUERTO RICO
NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

NOTE 1 GENERAL

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of the Municipality of Culebra, Puerto Rico (Municipality) and is presented on the modified accrual basis. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the general-purpose financial statements. The reporting entity is defined in Note (1) (A) to the general-purpose combined financial statements.

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

NOTE 3 FEDERAL CFDA NUMBER

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

NOTE 4 PASS-THROUGH GRANTOR'S NUMBER

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

NOTE 5 MAJOR PROGRAMS

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

INDEPENDENT AUDITORS' 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
MEMBERS OF THE MUNICIPAL LEGISLATURE
MUNICIPALITY OF CULEBRA, PUERTO RICO

We have audited the accompanying financial statements of the governmental activities, the aggregate discretely presented component unit, each major fund, and the remaining fund information of Municipality of Culebra, Puerto Rico (Municipality) as of and for the fiscal year ended June 30, 2006, which collectively comprise the Municipality's basic financial statements and have issued our report thereon dated December 1, 2006. 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's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying Schedule of Findings and Questioned Costs as item 06-II-01.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Municipality's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Municipality's ability to initiate, record, process, and report financial data consistent with the assertions of management in the financial statements. Reportable condition is described in the accompanying Schedule of Findings and Questioned Costs as item 06-II-01.

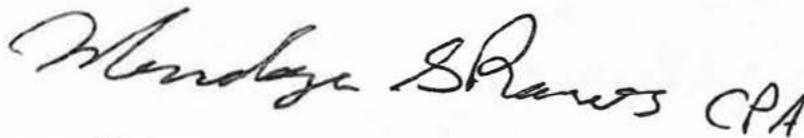
MUNICIPALITY OF CULEBRA

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

PAGE 2

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider item 06-II-01 to be material weakness.

This report is intended solely for the information and use of the management, Office of the Commissioner of Municipal Affairs, and 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.



MENDOZA & RAMOS
CERTIFIED PUBLIC ACCOUNTANTS, C.S.P.

Guayama, Puerto Rico
December 1, 2006

Stamp number 2134169 was
affixed to the original of this
report.



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

TO THE HONORABLE MAYOR AND
MEMBERS OF THE MUNICIPAL LEGISLATURE
MUNICIPALITY OF CULEBRA, PUERTO RICO

Compliance

We have audited the compliance of the Municipality of Culebra, Puerto Rico (Municipality) with the types of compliance requirements described in the *U. S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the fiscal year ended June 30, 2006. The Municipality's major federal programs are identified in the summary of auditor's result section of the accompanying Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the Municipality's management. Our responsibility is to express an opinion on the Municipality's compliance based on my audit.

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

In our opinion, the Municipality, complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the fiscal year ended June 30, 2006. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying Schedule of Findings and Questioned Costs as item 06-III-02.

Internal Control Over Compliance

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

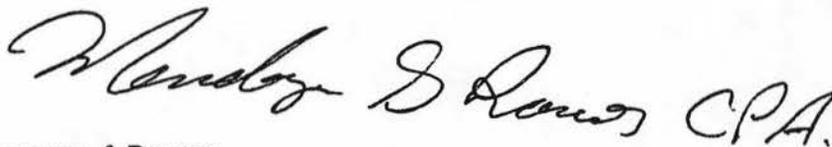
MUNICIPALITY OF CULEBRA

INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM AND INTERNAL CONTROL OVER COMPLIANCE REQUIRED BY OMB CIRCULAR A-133
PAGE 2

We noted certain matter involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect the Municipality's ability to administer a major federal program in accordance with the applicable requirements of laws, regulations, contracts and grants. Reportable condition is described in the accompanying Schedule of Findings and Questioned Costs as item 06-III-02.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider item 06-III-02 to be a material weakness.

This report is intended solely for the information and use of the management, the Honorable Mayor and Members of the Municipal Legislature, Office of the Commissioner of Municipal Affairs, and 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.



MENDOZA & RAMOS
CERTIFIED PUBLIC ACCOUNTANTS, C.S.P.

Guayama, Puerto Rico
December 1, 2006

Stamp number 2134170
affixed to the original of this
report.



**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA, PUERTO RICO
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

Section I – Summary of Auditor’s Results

Financial Statements

- Type of auditors’ report issued: Unqualified Opinion Qualified Opinion
 Adverse Opinion Disclaimer Opinion
- Internal control over financial reporting:
- Reportable condition(s) identified? Yes None Reported
 - Material weakness (es) identified? Yes No
- Noncompliance material to financial statements noted? Yes No

Federal Awards

- Internal control over major programs:
- Reportable condition(s) identified? Yes None Reported
 - Material weakness (es) identified? Yes No
- Type of auditors’ report issued on compliance for Major Programs: Unqualified Opinion Qualified Opinion
 Adverse Opinion Disclaimer Opinion
- Any audit finding disclosed that are required to be reported in accordance with OMB Circular A-133? Yes No

Identification of Major Program:

CFDA NUMBER	NAME OF FEDERAL PROGRAM OR CLUSTER
14.228	Community Development Block Grant

- Dollar threshold used to distinguish between Type A and Type B Programs: \$300,000
- Auditee qualified as low-risk auditee? Yes No

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA, PUERTO RICO
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2006**

Section II – Financial Statement Findings

FINDING	NUMBER 06-II-01
REQUIREMENT	REPORTABLE CONDITION OVER PROPERTY, PLANT AND EQUIPMENT
CONDITION	The Municipality has not maintained complete and adequate records in order to obtain sufficient, competent evidential matter with respect to the Capital Assets reported in governmental activities and, accordingly, the amount by which this departure would affect the assets, net assets, and expenses of the governmental activities is not determinable.
CRITERIA	Chapter IX, Article 9.002 of State Act Number 81 of August 30, 1991 states that the municipality should maintain updated property accounting records. Also the GASB Statements No. 34 requires that all capital assets, including infrastructure, must be presented in the Statements of Net Assets and that these assets must be depreciated during its useful life.
CAUSE	Competent and sufficient evidential matter related to the capital assets was not available to support the value, completeness and ownership of these assets.
EFFECT	The Municipality's Government Wide Financial Statements do not present fairly, the financial position of the governmental activities, and the change in financial position of the Municipality.
RECOMMENDATION	We recommend that the Municipality should continue the compilation of documents to support the value, completeness and ownership of its capital assets, to comply with the requirements of the GASB Statement No. 34.
QUESTIONED COSTS	NONE
MANAGEMENT RESPONSE	Pending the Corrective Action Plan.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA, PUERTO RICO
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2006**

Section III – Federal Award Findings and Questioned Costs

FINDING	NUMBER 06-III-02
FEDERAL PROGRAMS	STATE BLOCK GRANT PROGRAM (SBGP) (CFDA NO. 14.228) U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT PASS THROUGH STATE – OFFICE OF COMMISSIONER OF MUNICIPAL AFFAIRS
REQUIREMENT	COMPLIANCE AND INTERNAL CONTROL
NONCOMPLIANCE	EQUIPMENT AND REAL PROPERTY MANAGEMENT
CONDITION	Federal Program Department does not have a property register that includes all the required information; it only includes the property number and its description.
CRITERIA	<p>Subpart C, 24 CFR 85.32 (d) (1), stated that property records must be maintained and it shall includes:</p> <ul style="list-style-type: none">• a description of the property,• serial number or other identification number,• the source of property, percentage of Federal participation in the property,• the location,• use and condition of the property,• any ultimate disposition data including the date of disposal,• sale price of property, <p>Also, a physical inventory of the property must be taken and the result reconciled with the property records at least on every two years, respectively.</p>
EFFECT	The Municipality is not in compliance with Subpart C, 24 CFR 85.32 (d) (1).
CAUSE	The Municipality does not maintain the appropriate information on the real property records to assure that it is in accordance with the federal regulation.
RECOMMENDATION	The Municipality should revise and update its property records according to the federal regulation
QUESTIONED COSTS	None
MANAGEMENT RESPONSE	Pending the Corrective Action Plan.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA, PUERTO RICO
SCHEDULE OF PRIOR AUDITS' FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

(1) Audit Findings that have been Fully Corrected:

FISCAL YEAR 2005

Finding Number 05-III-01 Allowable Cost/ Cost Principle- supporting documents not cancelled.

CFDA Number 14.228

Questioned Cost None

Auditee Comments System and procedures corrected.

Finding Number 05-III-03 Allowable Cost/ Cost Principle- supporting documents not available.

CFDA Number 14.228

Questioned Cost None

Auditee Comments System and procedures corrected.

Finding Number 05-III-04 Davis Bacon- monitoring system to verify the wage payments.

CFDA Number 14.228

Questioned Cost None

Auditee Comments System and procedures corrected.

Finding Number 05-III-04 Special Test and Provisions- deficiencies in the Housing Rehabilitation participant's file.

CFDA Number 14.228

Questioned Cost None

Auditee Comments System and procedures corrected.

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA, PUERTO RICO
SCHEDULE OF PRIOR AUDITS' FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

(2) Audit Findings not Corrected or Partially Corrected:

FISCAL YEAR 2005

Finding Number 05-III-02 Equipment and Real Property Management- Property Register.
CFDA Number 14.228
Questioned Cost None
Auditee Comments The Federal Programs Director will implement internal control procedures to assure compliance with this finding.

FISCAL YEAR 2004

Finding Number 04-III-03 Equipment and Real Property Management- Subsidiary Records.
CFDA Number 14.228
Questioned Cost None
Auditee Comments The Federal Programs Director will implement internal control procedures to assure compliance with this finding.

FISCAL YEAR 2003

Finding Number 03-III-03 Equipment and Real Property Management- Subsidiary Records.
CFDA Number 14.228
Questioned Cost None
Auditee Comments The Federal Programs Director will implement internal control procedures to assure compliance with this finding.

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

None

(4) Audit findings is no longer valid:

None