



COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CULEBRA, PUERTO RICO  
BASIC FINANCIAL STATEMENTS ACCOMPANIED  
BY REQUIRED SUPPLEMENTARY INFORMATION  
JUNE 30, 2008

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**MENDOZA & RAMOS**  
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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, 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, 2008, 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 conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the respective financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the respective financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statements presentation. We believe that our audit and the report of other auditors provide a reasonable basis for our opinions.

As discussed in Note 5 to the financial statements, 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.

As discussed in Note 8 to the financial statements, the Municipality did not comply with the requirements established by Statement No. 18, *Accounting for Municipal Solid Waste Landfill Closure and Postclosure Care Costs*, issued by the Governmental Accounting Standards Board and the regulations set forth by the U.S. Environment Protection Agency. At June 30, 2008, the accompanying statement of net assets does not include the required liability for closure and postclosure care costs of the Municipality's solid waste landfill. In addition the expenses and result of operations reported in the statement of activities are understated and overstated, respectively, for amounts that could not be determined for the fiscal year ended June 30, 2008.

In our opinion, based on our audit and the report of other auditors, because of the effects of the matter discussed in the preceding paragraphs, the financial statements referred to above do not present fairly, in conformity with accounting principles generally accepted in the United States of America, the financial position of the governmental activities of the Municipality of Culebra, Puerto Rico, as of June 30, 2008, and the changes in financial position, thereof for the year then ended.

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, 2008, and the respective changes in financial position, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis on pages 3 through 7 and the Budgetary Comparison Schedule-General Fund on page 28 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.

In accordance with *Government Auditing Standards*, we have also issued a report dated March 2, 2009, on our consideration of the Municipality's internal control structure over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

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

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

Guayama, Puerto Rico  
December 1, 2008

Stamp number 2395325 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, 2008

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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, 2008. 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 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 assets of the Municipality exceeded its liabilities at June 30, 2008 by \$7.9 million.
- ❖ The Municipality's total net assets increase by \$658 thousands during 2008.
- ❖ As of June 30, 2008, the Municipality's governmental funds reported combined ending fund balances of \$3.8 million, an increase of \$438 thousand from the prior year.
- ❖ At June 30, 2008, the Unrestricted (Deficit) was \$5.3 million.
- ❖ The Municipality's capital assets inventory has no movement during fiscal year.
- ❖ The investment in capital assets for this year was not determinable.
- ❖ Loans principal payments were \$85 thousand in 2008 and 2007, 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.

**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.

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

FOR THE FISCAL YEAR ENDED JUNE 30, 2008

**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

	2008	2007
Current and non-current assets.....	\$ 4,366,336	\$ 6,334,946
Capital assets .....	<u>8,412,866</u>	<u>8,412,866</u>
<b>Total Assets.....</b>	<b><u>12,779,202</u></b>	<b><u>14,747,812</u></b>
Current liabilities.....	342,116	425,999
Deferred revenues .....	183,045	149,352
Long-term liabilities .....	<u>4,314,223</u>	<u>6,174,378</u>
<b>Total Liabilities .....</b>	<b><u>4,839,384</u></b>	<b><u>6,749,729</u></b>
Net Assets:		
Investment in capital assets .....	8,277,866	8,222,866
Restricted.....	4,954,794	7,467,828
Deficit.....	<u>(5,292,842)</u>	<u>(7,692,611)</u>
<b>Total Net Assets.....</b>	<b><u>\$ 7,939,818</u></b>	<b><u>\$ 9,548,620</u></b>

case of the Municipality, assets exceeded liabilities by \$7.9 million as of June 30, 2008 versus \$8.0 million as of June 30, 2007. 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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MUNICIPALITY OF CULEBRA, PUERTO RICO  
MANAGEMENT'S DISCUSSION AND ANALYSIS**

FOR THE FISCAL YEAR ENDED JUNE 30, 2008

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 \$7.9 million. The Unrestricted (Deficit) was approximately of \$5.2 million at June 30, 2008.

**Governmental Activities**

During fiscal year 2007-2008 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 \$659 thousand. 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.

<b>Table 2</b>		
<b>Changes in Net Assets For Fiscal Years Ending June 30,</b>		
	<b>2008</b>	<b>2007</b>
<b>Revenues:</b>		
Program Revenues:		
Grants and Contributions .....	\$ 1,447,923	\$ 2,106,658
General Revenues:		
Property Taxes .....	532,897	515,075
Volume of Business Taxes .....	122,504	213,294
Construction Taxes .....	993,608	152,928
Sales Taxes .....	1,009,280	-
Intergovernmental .....	2,590,326	2,628,734
Other General Revenues .....	168,964	216,255
<b>Total revenues</b> .....	<u>6,865,502</u>	<u>5,832,944</u>
<b>Expenses:</b>		
General Administration .....	2,426,662	2,567,577
Public Safety .....	166,661	186,542
Public Works .....	476,509	564,832
Health and Sanitation .....	91,555	96,187
Culture and Recreation .....	121,893	108,681
Human Services and Welfare .....	787,143	2,254,956
Urban Development .....	1,960,935	1,063,038
Education .....	157,558	179,153
Interest Costs .....	17,667	23,280
<b>Total expenses</b> .....	<u>6,206,583</u>	<u>7,044,246</u>
<b>Changes in net assets</b> .....	<b>658,919</b>	<b>(1,211,302)</b>
Net assets – beginning, as Restated ...	<u>7,280,899</u>	<u>9,209,385</u>
<b>Net assets – ending</b> .....	<b><u>\$ 7,939,818</u></b>	<b><u>\$ 7,998,083</u></b>

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MANAGEMENT'S DISCUSSION AND ANALYSIS**

FOR THE FISCAL YEAR ENDED JUNE 30, 2008

**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 \$1.2 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 \$70 thousand, (2) to pay debt service \$421 thousand or (3) for other restricted purposes \$4.5 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 2007 budget and the final amended budget for the General Fund were relatively minor and can be summarized as follows:

- ❖ 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, 2008 amounted to \$8.3 million (net of accumulated depreciation). This investment in capital assets includes land, buildings, improvements, machinery and equipment, parks, roads, highways, and bridges. 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.....	\$ 1.2
Others .....	<u>3.1</u>
Total Capital Assets.....	<u>\$ 4.3</u>

**Long-term Debt**

At June 30, 2008 the Municipality had total of \$4.3 million in general obligations and others outstanding debts, as shown in Table 4. Of this amount, \$1.2 million comprises debt backed by the full faith and credit of the government and \$3.1 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 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-

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

FOR THE FISCAL YEAR ENDED JUNE 30, 2008

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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 2008 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, 2008

	<u>Governmental Activities</u>
<b>ASSETS:</b>	
Cash and Investments.....	\$ 2,536,386
Cash with Fiscal Agent.....	1,038,484
Receivables (net):	
Property Taxes.....	88,128
Federal Grants.....	319,205
State Grants.....	384,133
	<u>4,366,336</u>
Capital Assets (Note5):	
Land, Improvements, and Construction in Progress.....	3,366,886
Other Capital Assets, [Net of Depreciation].....	5,045,980
	<u>8,412,866</u>
<b>Total Capital Assets.....</b>	<b><u>12,779,202</u></b>
 <b>LIABILITIES:</b>	
Accounts Payable and Accrued Expense.....	333,948
Accrued Interest.....	8,168
Deferred Revenue.....	183,045
Long-Term Liabilities (Note 6):	
Due within One Year.....	1,439,767
Due in More than One Year.....	2,874,456
	<u>4,839,384</u>
<b>Total Liabilities.....</b>	<b><u>4,839,384</u></b>
 <b>NET ASSETS</b>	
Invested in Capital Assets, Net of Related Debt.....	8,277,866
Restricted for:	
Debt Service.....	420,996
State Assignment.....	2,752,951
Sales Tax Fund.....	633,731
Other Specified Purposes.....	1,147,116
Unrestricted (Deficit).....	<u>(5,292,842)</u>
<b>Total Net Assets.....</b>	<b><u>\$ 7,939,818</u></b>

See accompanying notes to basic financial statements.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CULEBRA, PUERTO RICO  
STATEMENT OF ACTIVITIES

FOR THE FISCAL YEAR ENDED JUNE 30, 2008

Functions/Programs	Expenses	Program Revenues			Net (Expense) Revenue
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	
<b>Governmental Activities:</b>					
Mayor and Municipal Legislature.....	\$ 547,826	\$ -	\$ -	\$ -	\$ (547,826)
General Government.....	1,878,836	-	-	-	(1,878,836)
Public Safety.....	166,661	-	-	-	(166,661)
Public Works.....	476,509	-	-	-	(476,509)
Culture and Recreation.....	121,893	-	-	-	(121,893)
Sanitation.....	91,555	-	-	-	(91,555)
Human Services and Welfare.....	787,143	-	527,678	-	(259,465)
Urban Development.....	1,960,935	-	-	762,687	(1,198,248)
Education.....	157,558	-	157,558	-	-
Interest on Long-Term Debt.....	17,667	-	-	-	(17,667)
<b>Total Governmental Activities...</b>	<b>\$ 6,206,583</b>	<b>\$ -</b>	<b>\$ 685,236</b>	<b>\$ 762,687</b>	<b>(4,758,660)</b>

General Revenues:

Taxes:

Property Taxes, levied for General Purposes.....	385,647
Property Taxes, levied for Debt Services.....	147,250
Volume of Business Taxes.....	122,504
Construction Taxes.....	993,608
Sales Taxes, levied for General Purposes.....	808,084
Sales Taxes, levied for Debt Services.....	201,196
Intergovernmental.....	2,590,326
Rent.....	20,627
Miscellaneous.....	148,337
<b>Total General Revenues and Special Items.....</b>	<b>5,417,579</b>
<b>CHANGE IN NET ASSETS.....</b>	<b>658,919</b>
Net Assets - Beginning of Year.....	7,280,899
<b>NET ASSETS - END OF YEAR.....</b>	<b>\$ 7,939,818</b>

See accompanying notes to basic financial statements.

COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CULEBRA, PUERTO RICO  
BALANCE SHEET - GOVERNMENTAL FUNDS

June 30, 2008

	General Fund	State Assignment Fund	CDBG Fund	Sales Tax Fund	Other Governmental Funds	Total Funds
<b>ASSETS:</b>						
Cash and Investments (Note 2).....	\$ 561,710	\$ 593,128	\$ 32,809	\$ 633,731	\$ 513,812	\$ 2,335,190
Cash with Fiscal Agent.....	-	-	-	-	1,239,680	1,239,680
Receivables:						
Property Taxes.....	88,128	-	-	-	-	88,128
Federal Grants.....	-	-	265,739	-	53,466	319,205
Due from Other Funds.....	382,385	1,868,106	-	-	58,799	2,309,290
State Grants.....	-	291,717	-	-	92,416	384,133
<b>Total Assets.....</b>	<b>\$ 1,032,223</b>	<b>\$ 2,752,951</b>	<b>\$ 298,548</b>	<b>\$ 633,731</b>	<b>\$ 1,958,173</b>	<b>\$ 6,675,626</b>
<b>LIABILITIES AND FUND BALANCES:</b>						
<b>Liabilities:</b>						
Accounts Payable and Accrued Liabilities.....	\$ 69,357	\$ -	\$ 27,041	\$ -	\$ -	\$ 96,398
Bonds and Notes Payable.....	-	-	-	-	85,000	85,000
Accrued Interest.....	-	-	-	-	8,168	8,168
Due to Governmental Units.....	152,550	-	-	-	-	152,550
Due to Other Funds.....	1,838,161	-	271,507	-	199,622	2,309,290
Deferred Revenue:						
Volume of Business Tax.....	85,774	-	-	-	-	85,774
Federal Grants.....	-	-	-	-	97,271	97,271
<b>Total Liabilities.....</b>	<b>2,145,842</b>	<b>-</b>	<b>298,548</b>	<b>-</b>	<b>390,061</b>	<b>2,834,451</b>
<b>Fund Balances:</b>						
Reserve For:						
Encumbrances.....	69,868	-	-	-	-	69,868
Debt Service.....	-	-	-	-	420,996	420,996
Other Purposes.....	-	2,752,951	-	633,731	1,147,116	4,533,798
Unreserved (Deficit).....	(1,183,487)	-	-	-	-	(1,183,487)
<b>Total Fund Balances.....</b>	<b>(1,113,619)</b>	<b>2,752,951</b>	<b>-</b>	<b>633,731</b>	<b>1,568,112</b>	<b>3,841,175</b>
<b>TOTAL LIABILITIES AND FUND BALANCES...</b>	<b>\$ 1,032,223</b>	<b>\$ 2,752,951</b>	<b>\$ 298,548</b>	<b>\$ 633,731</b>	<b>\$ 1,958,173</b>	<b>\$ 6,675,626</b>

See accompanying notes to basic financial statements.

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

JUNE 30, 2008

**Total Fund Balances – Governmental Funds (Page 8) ..... \$ 3,841,175**

Amounts reported for Governmental Activities in the Statement of Net Assets (Page 6)  
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 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.....	1,196,000	
Compensated Absences .....	359,806	
Claims and Judgments.....	314,738	
Treasury Department.....	16,703	
Social Security Debt.....	9,853	
Municipal Revenue Collection Center .....	<u>2,417,123</u>	
Total Long-Term Liabilities.....		( 4,314,223)

**Total Net Assets of Governmental Activities (Page 6)..... \$ 7,939,818**

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, 2008

	General Fund	State Assignment Fund	CDBG Fund	Sales Tax Fund	Other Governmental Funds	Total Funds
<b>REVENUES</b>						
Property Taxes.....	\$ 385,647	\$ -	\$ -	\$ -	\$ 147,250	\$ 532,897
Volume of Business Taxes.....	122,504	-	-	-	-	122,504
Sales Taxes.....	-	-	-	808,084	201,196	1,009,280
Federal Assistances.....	-	-	477,713	-	242,631	720,344
Intergovernmental.....	2,590,326	263,586	-	-	463,993	3,317,905
Licenses and Permits.....	993,608	-	-	-	-	993,608
Rent.....	20,627	-	-	-	-	20,627
Miscellaneous.....	162,628	-	-	-	-	162,628
<b>Total Revenues.....</b>	<b>4,275,340</b>	<b>263,586</b>	<b>477,713</b>	<b>808,084</b>	<b>1,055,070</b>	<b>6,879,793</b>
<b>EXPENDITURES</b>						
Current:						
Mayor and Municipal Legislature.....	547,826	-	-	-	-	547,826
General Government.....	2,028,970	-	-	-	-	2,028,970
Public Safety.....	166,661	-	-	-	-	166,661
Public Works.....	476,509	-	-	-	-	476,509
Culture and Recreation.....	121,893	-	-	-	-	121,893
Sanitation.....	91,555	-	-	-	-	91,555
Human Services and Welfare.....	181,021	-	-	99,287	506,835	737,143
Urban Development.....	-	1,278,138	477,713	75,066	130,018	1,960,935
Education.....	-	-	-	-	157,558	157,558
Debt Service:						
Principal.....	-	-	-	-	85,000	85,000
Interest and Other Charges.....	-	-	-	-	17,667	17,667
<b>Total Expenditures.....</b>	<b>3,614,435</b>	<b>1,278,138</b>	<b>477,713</b>	<b>174,353</b>	<b>897,078</b>	<b>6,441,717</b>
<b>OTHER FINANCING SOURCES (USES)</b>						
Transfer- In.....	-	-	-	-	-	-
Transfer- Out.....	-	-	-	-	-	-
<b>Total Other Financing Sources and Uses.....</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Net Change in Fund Balances.....</b>	<b>660,905</b>	<b>(1,014,552)</b>	<b>-</b>	<b>633,731</b>	<b>157,992</b>	<b>438,076</b>
Fund Balance - Beginning as Restated (Note12)....	(1,774,524)	3,767,503	-	-	1,410,120	3,403,099
<b>Fund Balances - Ending.....</b>	<b>\$(1,113,619)</b>	<b>\$ 2,752,951</b>	<b>\$ -</b>	<b>\$ 633,731</b>	<b>\$ 1,568,112</b>	<b>\$ 3,841,175</b>

*CAB*  
*5/11/09*

See accompanying notes to basic financial statements.

**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, 2008

<b>Net Change in Fund Balances – Total Governmental Funds (Page 10).....</b>		<b>\$ 438,076</b>
Amounts reported for Governmental Activities in the Statement of Activities (Page 7) are different because:		
Revenues in the Statement of Revenues that correspond to Prior Year resources are recorded as Revenue in the Statement of Activities .....		(14,291)
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. ....		85,000
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 MRCC Debt .....	\$ 21,761	
Decrease in Social Security Debt.....	131,393	
Decrease in Treasury Department Debt.....	5,568	
Increase in Compensated Absences.....	<u>(8,588)</u>	
Total Decreased in Expenditures.....		<u>150,134</u>
<b>Change in Net Assets of Governmental Activities (Page 7).....</b>		<b><u>\$ 658,919</u></b>

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, 2008**

**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. The basic financial statements are presented as of June 30, 2008, 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 no organizations meet the criteria to be included as component units. Accordingly, these basic financial statements present only the Municipality as the reporting entity.

These financial statements present the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information of the Municipality, as of June 30, 2008, 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, 2008

**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, 2008, 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, 2008

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**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, 2008

**NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)**

**CDBG Fund** – This is the fund used to account for all the transactions of the Community Development 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.

**Sales Tax Fund** – This is the fund used to account for all the transactions related to the citizenship contribution of 1.0% over all business or personal transactions related to sale of goods and services made on the Municipality. In addition, this fund is used to account the State contribution to the Municipality of the Sales Tax. The resources collected by this tax are used in activities like health services, improvements in the control and management of solid waste disposal and recycling programs, public improvements, public safety and maintenance of all public facilities of the Municipalities.

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.

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

**FOR THE FISCAL YEAR ENDED JUNE 30, 2008**

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**NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)**

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).
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.

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

FOR THE FISCAL YEAR ENDED JUNE 30, 2008

**NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)**

**H. Capital Assets (continuation)**

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

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

**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, 2008 (Table 2).

Table 2					
BALANCE JULY 1, 2007	NEW ISSUES	RETIREMENTS AND CURRENT MATURATES	BALANCE JUNE 30, 2008	CURRENT PORTION	LONG-TERM PORTION
\$ 351,218	\$ 8,588	\$ -	\$ 359,806	\$ 359,806	\$ -

**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 sent 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

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

FOR THE FISCAL YEAR ENDED JUNE 30, 2008

**NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continuation)**

**K. Interfund Transactions (continuation)**

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 loans** – Represent amounts provided with a requirement for repayment, which are recorded as “due from” in the lender governmental fund and “due to” in the borrower governmental fund. Interfund receivables, which are not considered currently available financial resources, are reported as advances. For amounts not expected to be collected within a reasonable period, interfund receivables/payables are reduced to the estimated realizable value and the amount that is not expected to be repaid is reported as a transfer from the governmental fund that made the loan.

**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 maintains its deposits in various commercial banks located in Puerto Rico and Government Development Bank for Puerto Rico (GDB). Proceeds from bonds and funds related to certain grant awards are required by law to be held with GDB.

The Municipality adopted the provisions of GASB Statement No. 40 (GASB No. 40), *Deposit and Investment Risk Disclosure, an Amendment to GASB Statement No. 3*. This statement requires that state and local governments disclose essential risk information about deposits and investments. The disclosure requirements cover four main areas: (1) credit risk, (2) interest rate risk, (3) custodial credit risk, (4) foreign exchange exposure.

**Credit risk** – This is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. In compliance with the laws and regulations of the Commonwealth, the Municipality has adopted, as its custodial and credit risk policy, the *Statement of Investment Guidelines for the Government of the Commonwealth of Puerto Rico*. Accordingly the Municipality invests only in obligations of the Commonwealth, obligations of the United States of America, certificates of deposits, commercial paper, bankers' acceptances, or in pools of obligations of the municipalities of Puerto Rico, which are managed by GDB. According to the aforementioned investment guidelines, the Municipality does not invest in marketable securities or any types of investments for which credit risk exposure may be significant. Therefore, the Municipality's management has concluded that the risk related to any possible loss related to defaults by commercial banks on the Municipality's deposits is considered low at June 30, 2008.

**Interest rate risk** – This is the risk that changes in interest rates of debt investments will adversely affect the fair value of an investment. The Municipality manages its exposure to declines in fair values by: (1) not including debt investments in its investment portfolio at June 30, 2008, (2) limiting the weighted average maturity of its investments to three months or less, and (3) keeping most of its bank deposits in interests bearing accounts generating interests at prevailing market rates. At June 30, 2008, the Municipality's investments in certificates of deposits are recorded at cost, which approximates their fair value. Therefore, the Municipality's management has concluded that at June 30, 2008, the interest rate risk associated with the Municipality's cash and cash equivalents is considered low.

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

FOR THE FISCAL YEAR ENDED JUNE 30, 2008

**NOTE 2 CASH AND CASH EQUIVALENTS (continuation)**

**Custodial credit risk** – In the case of deposits, this is the risk that in the event of a bank failure, the Municipality's deposits may not be recovered. Pursuant to the *Statement of Investment Guidelines for the Government of the Commonwealth of Puerto Rico* the balances deposited in commercial banks by the Municipality are insured by the Federal Deposit Insurance Corporation (FDIC) generally up to a maximum of \$100,000 per depositor. In addition, public funds deposited in commercial banks by the Municipality are fully securities pledged as collateral are held, in the Municipality's name, by the agents of the Commonwealth's Secretary of Treasury. Deposits with GDB are uninsured and uncollateralized. However, no losses related to defaults by GDB on deposit transactions have been incurred by the Municipality through June 30, 2008. Therefore, the Municipality's management has concluded that at June 30, 2008 the custodial credit risk associated with the Municipality's cash and cash equivalents is considered low.

**Foreign exchange risk** – The risk that changes in exchange rates will adversely affect the value of an investment or a deposit. According to the aforementioned investment guidelines, the Municipality is prevented from investing in foreign securities or any other types of investments in which foreign exchange risk exposure may be significant. Accordingly, management has concluded that the foreign exchange risk related to the Municipality's deposits is considered low at June 30, 2008.

At June 30, 2008 the total deposits are as follows:

	<b>MAJOR GOVERNMENTAL FUNDS</b>					<b>TOTAL GOVERNMENTAL FUNDS</b>
	<b>GENERAL FUND</b>	<b>STATE ASSIGNMENT FUND</b>	<b>CDBG FUND</b>	<b>SALES TAX FUND</b>	<b>OTHER GOVERNMENTAL FUND</b>	
<b>Unrestricted:</b>						
Cash in commercial banks, Total unrestricted deposits	\$ 561,710	\$ 593,128	\$ 32,809	\$ 633,731	\$ 715,008	\$2,536,386
<b>Restricted (Note 1):</b>						
Cash in GDB, as fiscal agent Total carrying amount of deposits	-	-	-	-	1,038,484	1,038,484
	<b>\$ 561,710</b>	<b>\$ 593,128</b>	<b>\$ 32,809</b>	<b>\$ 633,731</b>	<b>\$ 1,753,492</b>	<b>\$3,574,870</b>

**NOTE 3 INTERFUND TRANSFER AND BALANCES**

**B. INTERFUND RECEIVABLE AND PAYABLE BALANCES**

Interfund receivables and payables at June 30, 2008 are summarized as follows: (See Table 3)

<b>TABLE 3</b>		
<b>INTERFUND RECEIVABLE</b>	<b>INTERFUND PAYABLE</b>	<b>AMOUNT</b>
General Fund	CDBG Fund	\$ 182,763
General Fund	Other Governmental	199,622
State Assignment	General Fund	1,779,362
State Assignment	CDBG Fund	88,744
Other Governmental	General Fund	58,799
<b>TOTAL</b>		<b>\$2,309,290</b>

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**NOTE 4 DUE TO OTHER GOVERNMENTAL UNITS**

As of June 30, 2008, 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 .....	\$ 4,307
State Treasury Department.....	118,231
State Retirement System.....	20,092
ELA Employee Association.....	6,033
General Services Administration.....	<u>3,887</u>
 Total Due to Governmental Units .....	 <u>\$ 152,550</u>

**NOTE 5 CAPITAL ASSETS**

Capital Assets activities for the fiscal year ended June 30, 2008 was as follows (See Table 4)

TABLE 4	BALANCE JULY 1, 2007	ADJUSTMENTS	ADDITIONS	RETIREMENTS	BALANCE JUNE 30, 2008
DESCRIPTION					
<b>Non-Depreciable Capital Assets:</b>					
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>
<b>Depreciable Capital Assets:</b>					
Buildings .....	6,285,605	-	-	-	6,285,605
Infrastructure .....	-	-	-	-	-
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>
<b>Less Accumulated Depreciation:</b>					
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>
<b>CAPITAL ASSETS, NET.....</b>	<b><u>\$ 8,412,866</u></b>	<b><u>\$ -</u></b>	<b><u>\$ -</u></b>	<b><u>\$ -</u></b>	<b><u>\$ 8,412,866</u></b>

During Fiscal Year 2007-2008 no depreciation expense were charged to governmental functions/programs: (See Table 5)

TABLE 5	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>

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**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, 2008, are comprised of the following individual issues:

DESCRIPTION	AMOUNT
<b>General Obligations Bonds:</b>	
\$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.....	\$ 30,000
\$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.....	105,000
\$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.....	135,000
\$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 .....	<b><u>\$1,196,000</u></b>

The annual requirements to amortize the general obligations outstanding as of June 30, 2008 are as follows (See Table 6):

YEAR ENDING JUNE 30,	PRINCIPAL PAYMENT	INTEREST PAYMENT	TOTAL PAYMENT
2009	\$1,021,000	\$ 13,730	\$1,034,730
2010	70,000	9,492	79,492
2011	70,000	5,817	75,817
2012	<u>35,000</u>	<u>2,100</u>	<u>37,100</u>
TOTAL	<b><u>\$1,196,000</u></b>	<b><u>\$ 31,139</u></b>	<b><u>\$1,227,139</u></b>

**B. OTHER LONG-TERM DEBTS**

Following are the Other Long-Term Debts (See Table 7):

DESCRIPTION	BALANCE JULY 1, 2007 AS RESTATED	NEW ISSUES	RETIREMENTS AND ADJUSTMENT	BALANCE JUNE 30, 2008
Property Taxes – MRCC.	\$2,438,884	\$ 8,572	\$ 30,333	\$2,417,123
Treasury Department.....	22,271	-	5,568	16,703
Claims and Judgments ...	314,738	-	-	314,738
Compensated Absences.	351,218	8,588	-	359,806
Social Security.....	<u>141,246</u>	-	<u>131,393</u>	<u>9,853</u>
TOTAL .....	<b><u>\$3,268,357</u></b>	<b><u>\$ 17,160</u></b>	<b><u>\$ 167,294</u></b>	<b><u>\$3,118,223</u></b>

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**NOTE 6 GENERAL LONG-TERM DEBTS (continuation)**

**B. Notes Payable to CRIM**

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

In addition, on July 1, 2002, the Municipality entered into a repayment agreement with GDB and CRIM to pay off the remaining \$2,617,416 of excess of property tax advances through prior fiscal year. CRIM retains the principal and interest from the property tax advances of the Municipality. The amounts retained by CRIM are remitted to GDB on July 1 of each year through July 1, 2032. The repayment agreement bears interest at variable rates determined by GDB. The outstanding principal balances of the note payable to CRIM amounted \$2,396,174, at June 30, 2008. The principal and interest maturities are as follows:

YEAR ENDING JUNE 30,	PRINCIPAL ..... PAYMENT .....	INTEREST PAYMENT	TOTAL PAYMENT
2009	45,393	147,572	192,965
2010	48,246	144,720	192,966
2011	51,277	141,688	192,965
2012	54,499	138,466	192,965
2013	57,923	135,042	192,965
2014-2018	349,002	615,825	964,827
2019-2023	473,316	491,511	964,827
2024-2028	641,910	322,916	964,826
2029-2033	674,608	97,253	771,861
<b>TOTAL</b>	<b>\$ 2,396,174</b>	<b>\$ 2,234,993</b>	<b>\$4,631,167</b>

Financing of delinquent property tax accounts sold – On July 1, 2007, the Municipality entered into a financing agreement with CRIM in the amount of \$8,571 for the payment of delinquent property tax account sold to private investors. The financing agreement in the form of a line of credit bearing interests at 6.22% during the first 5 years, and variable interests 125 points over LIBOR rate during the next 25 years. At June 30, 2008, the outstanding principal balances amounted to \$8,229.

The principal and interest maturities are as follows:

YEAR ENDING JUNE 30,	PRINCIPAL ..... PAYMENT .....	INTEREST PAYMENT	TOTAL PAYMENT
2009	343	512	855
2010	343	490	834
2011	343	469	812
2012	343	448	791
2013	343	427	769
2014-2018	1,714	1,813	3,527
2019-2023	1,714	1,280	2,994
2024-2028	1,714	746	2,460
2029-2033	1,372	213	1,585
<b>TOTAL</b>	<b>\$ 8,229</b>	<b>\$ 6,398</b>	<b>\$ 14,627</b>

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**NOTE 6 GENERAL LONG-TERM DEBTS (continuation)**

LIMS – On June 28, 2001, the Municipality entered into a financing agreement with CRIM for the payment of the Municipality's share of the cost of an information management system, acquired by CRIM on behalf of all municipalities, for the management of a digital database of taxpayers properties located in Puerto Rico. The face amount of the loan was \$30,415 and bears no interest. The note is payable in semi annual installments of \$2,040 through December 1, 2011. This note has an imputed interest rate of 5.95%. At June 30, 2008, the balance of this note amounted to \$12,719. The principal and interest maturities are as follows.

YEAR ENDING JUNE 30,	PRINCIPAL ..... PAYMENT.....	INTEREST PAYMENT	TOTAL PAYMENT
2009	3,372	.....707	4,079
2010	3,575	.....504	4,079
2011	3,791	.....288	4,079
2012	1,981	59	2,040
<b>TOTAL</b>	<b>\$ 12,719</b>	<b>..\$ 1,558</b>	<b>\$ 14,277</b>

**C. CHANGES IN GENERAL LONG-TERM DEBTS**

The following is a summary of changes in long-term debts for the year ended June 30, 2008 (See Table 8):

DESCRIPTION	BALANCE JULY 1, 2007 AS RESTATED	NEW ISSUES	RETIREMENTS AND ADJUSTMENT	BALANCE JUNE 30, 2008	AMOUNTS DUE WITHIN ONE YEAR	AMOUNTS DUE AFTER NEXT YEAR
General .....	\$1,281,000	\$ -	\$ 85,000	\$1,196,000	\$1,021,000	\$ 175,000
Others Debts ....	<u>3,268,357</u>	<u>17,160</u>	<u>167,294</u>	<u>3,118,223</u>	<u>418,767</u>	<u>2,699,456</u>
<b>TOTAL.....</b>	<b><u>\$4,549,357</u></b>	<b><u>\$ 17,160</u></b>	<b><u>\$ 252,294</u></b>	<b><u>\$4,314,223</u></b>	<b><u>\$1,439,767</u></b>	<b><u>\$2,874,456</u></b>

**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 8).

These property taxes are accumulated by the Municipal Revenue Collection Center in costs of the general obligations bonds issued by the Municipality (See Note 6). 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 LANDFILL CLOSURE AND POSTCLOSURE CARE COSTS OBLIGATION**

The Municipality owns a municipal solid waste landfill. However, the Municipality has not adopted the required provisions of Statement No. 18, *Accounting for Municipal Solid Waste Landfill Closure and Postclosure Care Costs*, issued by the Governmental Accounting Standards Board (GASB No. 18) and the regulations set forth by the U.S. Environmental Protection Agency (EPA) in its "Solid Waste Disposal Facility Criteria", issued on October 9, 1991. According to these standard and regulations, the Municipality is required to place a final cover on its landfill site when closed and perform certain maintenance and monitoring functions at the landfill site for 30 years after closure. Although closure and postclosure care costs will be paid only near or after the date that the landfill stops accepting waste, the Municipality reports a portion of these closure and postclosure care costs as an operating expense in each period based on landfill capacity used as of each statement of net assets date. The accompanying statement of net assets does not include the required liability for closure and postclosure care costs of the solid waste landfill using current cost allocated based on the actual landfill capacity used at June 30, 2008.

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**NOTE 9 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 7). 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.

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 10 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 11 SALES TAX**

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

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**NOTE 11 SALES TAXES (continuation)**

tax is administered through the Puerto Rico Treasury Department. Consequently, separate registration and filing forms are required of retailers.

In Fiscal Year 2007-2008, the Municipal Legislature of the Municipality of Culebra approved an Ordinance establishing a citizenship contribution of 1.0% over all business or personal transactions related to sale of goods and/or services made on the Municipalities boundaries. The resources collected due to this tax assesment will be used in local activities like improvements in health services, improvements in the control and management of solid waste disposal and recycling programs, public improvements, improvements of public safety, and maintenance of all public facilities of the Municipality.

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

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

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

**NOTE 12 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 13 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, amendments 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 program (a defined contribution plan). Employees in the savings program may now contribute from a minimum of 8.275% up to

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**NOTE 13 EMPLOYEE'S RETIREMENT PLAN (continuation)**

a maximum of 10% of their monthly salary, and will be 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 9)

<u>YEARS OF SERVICE</u>	<u>PARTICIPANT'S AGE</u>	<u>PENSION BENEFITS</u>	<u>TABLE 9</u>
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, 2008, was approximately \$101,915. 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, 2008. 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.

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**NOTE 14 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 2007-2008 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 15 ACCOUNTING CHANGES, CHANGES IN REPORTING ENTITY AND RESTATEMENTS**

The following schedule reconciles the June 30,2008 Net Assets, as previously reported to Beginning Net Assets, as restated, July 1, 2007.

<b>Table 10</b>	
<b>NET ASSETS RESTATED</b>	
The following schedule reconciles the June 30,2008 Net Assets, as previously reported to Beginning Net Assets, as restated, July 1, 2007	
Net Assets as, Previously Reported, at June 30 2007.....	\$7,998,083
Adjustment in CDBG Fund as per GASB 33 .....	(2,342,205)
Claims & Judgments settled by lower amount.....	<u>1,625,021</u>
Beginning Net Assets, as Restated, At July 1, 2007.....	<u>\$7,280,899</u>

The following schedule reconciles the June 30,2008 Fund Balances, as previously reported to Beginning Fund Balances, as restated, July 1, 2007.

	<b>FUND BALANCE RESTATED</b>	
	<b>GENERAL GOVERNMENTAL FUND</b>	<b>OTHER GOVERNMENTAL FUND</b>
Fund Balance (Deficit), as Reported, June 30,2008.....	\$ (1,722,524)	\$1,358,120
Interfund balance not supported.....	<u>(52,000)</u>	<u>52,000</u>
Beginning Fund Balance (Deficit) as Restated, July 1, 2007 .....	<u>\$(1,774,524)</u>	<u>\$1,410,120</u>

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

FOR THE FISCAL YEAR ENDED JUNE 30, 2008

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**NOTE 16 SUBSEQUENT EVENTS**

On July 29, 2007 was enacted the Act 80, to amend the Act. No. 120 of October 31, 1994, as amended, known as the "Puerto the Internal Revenue Code of 1994", particularly certain provisions included in Act No. 117 of July 4, 2006, known as the "Taxpayer's Justice Act of 2006", in order to make mandatory in all the Municipalities of Puerto Rico, the imposition of a uniform municipal tax of one point five (1.5) percent, from which the municipalities shall collect one (1) percent of the sales and use tax pursuant to what is established in Sections 2410 and 6189 of said Act, which may be levied discretionally, through municipal legislation, on food and food ingredients, as defined in Section 2301 (a) of the Act and to provide for the collection by the Secretary of the Treasury of the remaining point five (.5) percent without including food and food ingredients as defined in Section 2301 (a) of the Act, to be used in accordance with the purposes established in the Act 80; to provide for the establishment of the Municipal Development Fund, the Municipal Redemption Fund and the Municipal Improvement Fund, as well as for matters relative to the purposes, implementation and administration of said funds; to provide for the establishment of the necessary mechanisms for the collection of the municipal tax; and for other purposes.

**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, 2008

	Budget Amounts		Actual Amounts (Budgetary Basis) (See Note A)	Variance with Final Budget Positive (Negative)
	Original	Final		
<b>Resources (Inflows)</b>				
Property Taxes.....	\$ 385,647	\$ 385,647	\$ 385,647	\$ -
Volume of Business Taxes.....	198,770	198,770	122,504	(76,266)
Intergovernmental Revenues.....	2,626,910	2,626,910	2,590,326	(36,584)
License and Permits.....	989,160	989,160	993,608	4,448
Rent.....	12,052	12,052	20,627	8,575
Miscellaneous.....	224,950	224,950	162,628	(62,322)
<b>Total Resources (Inflows).....</b>	<b>4,437,489</b>	<b>4,437,489</b>	<b>4,275,340</b>	<b>(162,149)</b>
<b>Charges to Appropriations (Outflows)</b>				
Mayor and Municipal Legislature.....	652,885	677,262	552,403	124,859
General Government.....	2,419,303	2,404,428	2,000,273	404,155
Public Safety.....	213,468	214,165	167,501	46,664
Public Works.....	588,293	596,161	478,892	117,269
Culture and Recreation.....	180,869	162,952	128,494	34,458
Sanitation.....	139,701	134,071	91,555	42,516
Human Services and Welfare.....	242,970	248,450	173,885	74,565
<b>Total Charges to Appropriations.....</b>	<b>4,437,489</b>	<b>4,437,489</b>	<b>3,593,003</b>	<b>844,486</b>
<b>Excess (Deficiency) of Revenues over Expenditures.....</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 682,337</b>	<b>\$ 682,337</b>

See accompanying notes to required supplementary information.

**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, 2008

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

	<u>GENERAL FUND</u>
<b>Sources/Inflows of Resources:</b>	
Actual Amounts (Budgetary Basis) "Available for Appropriation" from the Budgetary Comparison Schedule (See Page 25) .....	\$ 4,275,340
Difference – Budget to GAAP:	
Differences .....	-
Total Revenues as Reported on the Statement of Governmental Funds Revenues, Expenditures and Changes in Fund Balance (See Page 10) .....	<u>\$ 4,275,340</u>
<b>Uses/Outflows of Resources:</b>	
Actual Amounts (Budgetary Basis) "Total Charges to Appropriation" from the Budgetary Comparison Schedule (See Page 25) .....	\$ 3,593,003
Difference – Budget to GAAP:	
Prior Year expenditures are not outflows of budgetary resources but are expenditures For financial reporting purposes .....	73,153
Encumbrances for supplies and equipment ordered but not received are reported in the year the order is placed for budgetary reporting purposes .....	(62,896)
Adjustment to Expenditures. ....	<u>11,175</u>
Total Expenditures as Reported on the Statement of Governmental Funds Revenues, Expenditures and Changes in Fund Balance (See Page 10) .....	<u>\$ 3,614,435</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, 2008**

FEDERAL GRANTOR / PASS THROUGH GRANTOR / PROGRAM OR CLUSTER TITLE	FEDERAL CFDA NUMBER	PASS-THROUGH ENTITY IDENTIFYING NUMBER	TOTAL EXPENDITURES
<b>U. S. Department of Agriculture:</b>			
Pass Through State – Department of Education			
Child and Adult Care Food Program.....	10.558	N/AV	\$ 16,062
<b>U.S. Department of Housing and Urban Development:</b>			
Pass Through State – Office of the Commissioner of Municipal Affairs			
State Block Grant Program (SBGP).....	14.228	03-FD 02-FD 01-FD 99-FD 98-FD 97-FD 95-FD 94-FD	<u>477,713</u>
<b>U.S. Department of Health and Human Services</b>			
Pass-Through Office of the Governor, Regional Elderly Office:			
Special Program for Aging, Title III, Part B .....	93.045	N/AV	68,527
Pass-Through Administration of Children and Families:			
Child Care and Development Block Grant .....	93.575	N/AV	<u>157,558</u>
Total U.S. Department of Health and Human Services			<u>226,085</u>
<b>U.S. Department of Homeland Security:</b>			
Pass- Through Office of the Governor:			
Public Assistant Grant.....	97.036	N/AV	<u>76,732</u>
<b>TOTAL EXPENDITURES OF FEDERAL AWARDS</b>			<b><u>\$ 796,592</u></b>

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF CULEBRA, PUERTO RICO**  
**NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**  
**FOR THE FISCAL YEAR ENDED JUNE 30, 2008**

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**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.



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

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

**INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING  
AND ON COMPLIANCE AND OTHER MATTER 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 financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the Municipality of Culebra, Puerto Rico (the "Municipality") as of and for the fiscal year ended June 30, 2008, which collectively comprise Municipality of Culebra's basic financial statements and have issued our report thereon dated December 1, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

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

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects Municipality's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of Municipality's financial statements that is more than inconsequential will not be prevented or detected by Municipality's internal control. We consider the deficiencies described in the accompanying schedule of findings and questioned costs to be significant deficiencies in internal control over financial reporting. See finding 08-01 and 08-02.

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

# INDEPENDENT AUDITORS' REPORT

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Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, of the significant deficiencies described above, we consider items 08-01 to be material weakness.

## Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Municipality's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, 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 matter that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule of findings and questioned costs as items 08-01 and 08-02.

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

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

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

Guayama, Puerto Rico  
March 2, 2009

Stamp number 2395326 was  
affixed to the original of this report.





# MENDOZA & RAMOS

Contadores Públicos Autorizados, C.S.P.

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

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

To the Honorable Mayor and  
Members of the Municipal Legislature  
MUNICIPALITY OF CULEBRA, PUERTO RICO

### Compliance

We have audited the compliance of the Municipality of CULEBRA, Puerto Rico (the "Municipality") with the types of compliance requirements described in the *U. S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the fiscal year ended June 30, 2008. The Municipality's major federal programs are identified in the summary of auditor's results section of the accompanying Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the Municipality's management. Our responsibility is to express an opinion on the Municipality's compliance based on our audit.

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

As described item 08-03, 08-04, 08-05 and 08-06 in the schedule of findings and questioned costs, the Municipality did not comply with requirements regarding Equipment and Real Property, Procurements Standards, Suspension and Debarment and Special Test that are applicable to its Community Development Block Grant Program. Compliance with such requirements is necessary, in our opinion, for the Municipality to comply with the requirements applicable to that program.

In our opinion, except for the noncompliance described in the preceding paragraph, the Municipality complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the Fiscal Year Ended June 30, 2008.

# INDEPENDENT AUDITORS' REPORT

## Internal Control Over Compliance

The management of the Municipality is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered the Municipality's internal control over compliance with the requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of Municipality's internal control over compliance.

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

A control deficiency in an entity's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects Municipality's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of federal program that is more than inconsequential will not be prevented or detected by the Municipality's internal control. We consider the deficiencies in internal control over control over compliance described in the accompanying schedule of findings and questioned costs as items 08-03, 08-04, 08-05 and 08-06 to be significant deficiencies.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of federal program will not be prevented or detected by Municipality's internal control. We do not consider any of the deficiencies described in the accompanying schedule of finding and questioned costs to be material weaknesses.

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

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

*Mendoza & Ramos CPA's*  
MENDOZA & RAMOS  
CERTIFIED PUBLIC ACCOUNTANTS, C.S.P.  
Guayama, Puerto Rico  
March 3, 2009



Stamp number 2395327 was affixed to the original of this report.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CULEBRA, PUERTO RICO  
SCHEDULE OF FINDING AND QUESTIONED COSTS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2008**

Section I – Summary of Auditor’s Results

Financial Statements

Type of auditors’ report issued:

- Unqualified Opinion, except for adverse opinion for government-wide financial statement
- Qualified Opinion
- Adverse Opinion
- Disclaimer Opinion

Internal control over financial reporting:

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

Noncompliance material to financial statements noted?  Yes  No

Federal Awards

Internal control over major programs:

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

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

- Unqualified Opinion
- Qualified Opinion
- Adverse Opinion
- Disclaimer

X

Any audit findings disclosed that are required to be reported in accordance with 510(a) OMB Circular A-133?  Yes  No

The Municipality’s major programs were:

CFDA Number	Name of Federal Program
14.228	Community Development Block Grant Program

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, 2008**

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**Section II – Financial Statement Findings**

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<b>FINDING</b>	<b>NUMBER 08-01</b>
<b>REQUIREMENT</b>	<b>SIGNIFICANT DEFICIENCIES OVER PROPERTY, PLANT AND EQUIPMENT</b>
<b>CONDITION</b>	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.
<b>CRITERIA</b>	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.
<b>CAUSE</b>	Competent and sufficient evidential matter related to the capital assets was not available to support the value, completeness and ownership of these assets.
<b>EFFECT</b>	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.
<b>RECOMMENDATION</b>	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.
<b>QUESTIONED COSTS</b>	<b>NONE</b>
<b>MANAGEMENT RESPONSE</b>	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, 2008**

**Section II – Financial Statement Findings**

FINDING	NUMBER 08-02
CATEGORY	INTERNAL CONTROLS
TOPIC SENTENCE	ACCOUNTING SYSTEM
CONDITIONS	The accounting system and manuals used by the Municipality to account and register the financial transactions during the fiscal year does not provide for the summarization of transactions that permit the preparation of Municipality's financial statements in conformity with the General Accepted Accounting Principals of the United States of America (GAAP).
CRITERIA	According to Article 8.010 (a) and (b) of Law Num. 81 for the Municipalities of Puerto Rico, the computerized system and the procedures of accounting and property will be design so that it allows the Municipality to carry out its functions, at the same time as they serve to maintain an uniform and coordinated accounting, that provide a complete picture of the financial operations of the Municipality and the necessary financial information that assist the Municipality Legislature, the Governor, and the Secretary of the Puerto Rico Treasury Department in the performance of its respective responsibilities. Municipalities accounting will be based on funds, Generally Accepted Accounting Principles and the requirements established by the Governmental Accounting Standard Board. Also the pronouncements of the National Committee on Governmental Accounting and the "Blue Book" will be used to design municipalities' accounting systems and fiscal procedures.
CAUSES	Municipality's accounting system and financial reports are subject to State's agencies requirements which does not allow nor provide the Municipality with the necessary tools capable of recapturing the financial information and provide financial statements.
EFFECT	The lack of an adequate accounting system which can captures all the financial information and generates Municipality's financial statements for each fiscal year affect the Municipality ability to measure the financial and nonfinancial performance of programs and activities; adequately safeguard significant assets and properly record various transactions; and hinder the Municipality from having reliable financial information to operate in an economical, efficient, and effective manner.
	Sound decisions on the current results and future direction of vital programs and policies are made more difficult without timely, reliable and useful financial performance information.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CULEBRA, PUERTO RICO  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2008**

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**Section II – Financial Statement Findings**

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<b>FINDING</b>	<b>NUMBER 08-02</b>
<b>RECOMMENDATION</b>	The Municipality should establish and implement the necessary measures that allow the summarization of the financial transactions in order to prepare the financial statements in conformity with GAAP.
<b>QUESTIONED COSTS</b>	None
<b>MANAGEMENT RESPONSE</b>	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, 2008**

Section III – Federal Award Findings and Questioned Costs

FINDING	NUMBER 08-03
FEDERAL PROGRAMS	COMMUNITY DEVELOPMENT BLOCK GRANT/SMALL CITIES (CDBG) (CFDA NO. 14.228) 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. <i>Inventario</i>
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"> <li>• a description of the property,</li> <li>• serial number or other identification number,</li> <li>• the source of property, percentage of Federal participation in the property,</li> <li>• the location,</li> <li>• use and condition of the property,</li> <li>• any ultimate disposition data including the date of disposal,</li> <li>• sale price of property,</li> </ul> <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	The Municipality's management gave instructions to the Federal Program Director to assure that the property records contains a description of the property, serial number, the source of property, location, use and condition of the property, any ultimate disposition data including the date of disposition data including the date of disposal and the sale price of property.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CULEBRA, PUERTO RICO  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2008**

**Section III – Federal Award Findings and Questioned Costs**

<b>FINDING</b>	<b>NUMER 08-04</b>
<b>FEDERAL PROGRAM</b>	COMMUNITY DEVELOPMENT BLOCK GRANT/SMALL CITIES (CDBG) (CFDA NO. 14.228) DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT PASS THROUGH STATE-OFFICE OF COMMISSIONER OF MUNICIPAL AFFAIRS
<b>CATEGORY</b>	COMPLIANCE
<b>NONCOMPLIANCE</b>	PROCUREMENT
<b>TOPIC SENTENCE</b>	<i>Contrato sin debida cotización</i> Lack of adequate procurement procedures
<b>CONDITIONS</b>	In testing compliance with the procurement requirement, we examined the processes carried out to procure goods and services which were paid during the fiscal year 2007-2008. In relation to such examination we determined the Projects architecture design and supervision services were contracted without obtaining at least three quotations or celebrating an adequate procurement process.
<b>CRITERIA</b>	24 CFR 85.36 (c)(1)(4) state that all procurement transactions will be conducted in a manner providing full and open competition consistent with the standards of Sec. 85.36. Grantee and subgrantees will ensure that all prequalified lists of persons, firms, or products which are used in acquiring goods and services are current and include enough qualified sources to ensure maximum open and free competition.  Chapter VIII, Part III, Section 1 of the Basic Standards for the Municipalities of Puerto Rico establishes that public bids will be announced by the municipalities each time procure goods or constructions works which exceed \$40,000 and \$100,000 dollars, respectively.
<b>CAUSE</b>	These conditions were caused due to the lack of adequate controls over the bidding process.
<b>EFFECT</b>	Not carrying out the required procurement processes does not allow the Municipality to evaluate among different alternatives and select the one which provides the best benefits. The lack of documents and information as part of the bidding files does not allow understanding the rationale method of procurement, selection of contract type, contractor selection or rejection, and the basis for the contract price. Furthermore the Municipality could be sanctioned by the State and Federal fiscal entities and adversely affected in the benefits they are entitled to receive in the future.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CULEBRA, PUERTO RICO  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2008**

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**Section III – Federal Award Findings and Questioned Costs**

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<b>FINDING</b>	<b>NUMBER 08-04</b>
<b>RECOMMENDATION</b>	As part of the procurement process, the Municipality should assure that all bidders are included as part of the bidders register before they participate of an auction.
<b>QUESTIONED COSTS</b>	None
<b>MANAGEMENT RESPONSE</b>	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, 2008**

Section III – Federal Award Findings and Questioned Costs

FINDING	NUMBER 08-05
FEDERAL PROGRAM	COMMUNITY DEVELOPMENT BLOCK GRANT/SMALL CITIES (CDBG) (CFDA NO. 14.228) DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT PASS THROUGH STATE-OFFICE OF COMMISSIONER OF MUNICIPAL AFFAIRS
CATEGORY	COMPLIANCE
NONCOMPLIANCE	SUSPENSION AND DEBARMENT
TOPIC SENTENCE	Lack of controls over Suspension and Debarment
CONDITION	<p>The Municipality does not have procedures in place to verify the status of an entity as to suspensions and debarments when contracting services or procuring goods with federal funds.</p> <p>In testing procurement, suspension and debarments, we were not able to find evidence indicating that the Municipality performs procedures to assure that the individuals and entities that receive contracts or subawards are not suspended or debarred from participation if federal programs.</p>
CRITERIA	As stated in 24 CFR 85.35 grantee and subgrantee must not make any award or permit any award (subgrant or contract) at any tier to any party which is debarred or suspended or is otherwise excluded from or ineligible for participation in Federal assistance programs under Executive Order 12549, "Debarment and Suspension".
CAUSE	The Municipality has no policies and procedures for the use of the list of parties excluded from federal procurement or non-procurement programs to assure that they do not award assistance to listed parties.
EFFECT	As a result of this deficiency, the Municipality could have procured goods or services from organizations and individuals that are suspended or debarred which could result in cost disallowances by the federal awarding agency.
RECOMMENDATION	The Municipality should amend their procurement procedures and include a step to verify whether or not the individual or entity is on the list of parties excluded from federal participation in procurement and non-procurement programs. The Municipality should also require the entities or individuals to submit a certification stating that they are not suspended or debarred.



**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CULEBRA, PUERTO RICO  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2008**

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**Section III – Federal Award Findings and Questioned Costs**

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<b>FINDING</b>	<b>NUMBER 2008-06</b>
<b>FEDERAL PROGRAM</b>	COMMUNITY DEVELOPMENT BLOCK GRANT/SMALL CITIES (CDBG) (CFDA NO. 14.228) DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT PASS THROUGH STATE-OFFICE OF COMMISSIONER OF MUNICIPAL AFFAIRS
<b>CATEGORY</b>	COMPLIANCE
<b>NONCOMPLIANCE</b>	SPECIAL TEST <i>Desembolso antes de tiempo.</i>
<b>TOPIC SENTENCE</b>	Disbursement of funds before the request for release of funds
<b>CONDITIONS</b>	During the fiscal year 2007-2008, the Program encumbered funds amounting \$11,626 before the related request of release of funds (RROF) were authorized for disbursements by the Lead Agency (OCAM). Funds were encumbered or paid five to eight months before the approval of the RROF.
<b>CRITERIA</b>	As stated in 24 CFR 58.22 neither a recipient nor any participant in the development process, including public or private nonprofit or for-profit entities, or any of their contractors, may commit HUD assistance under a program listed in 58.1(b) on an activity or project until HUD or the state has approved the recipient's RROF and the related certification from the responsible entity. In addition, until the RROF and the related certification have been approved, neither a recipient nor any participant in the development process may commit non-HUD funds on or undertake an activity or project under a program listed in 58.1(b) if the activity or project would have an adverse environmental impact or limit the choice of reasonable alternatives.
<b>CAUSE</b>	The Program incurred in such costs without receiving from the Lead Agency (OCAM) the adequate release of funds.
<b>EFFECT</b>	The Program could be sanctioned by the Lead Agency (OCAM) or any other federal awarding agency.
<b>RECOMMENDATION</b>	No funds should be encumbered or expended on an activity or project until the Lead Agency (OCAM) has approved the recipient's RROF.



**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CULEBRA, PUERTO RICO  
SCHEDULE OF PRIOR AUDITS' FINDINGS AND QUESTIONED COSTS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2008**

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**(1) Audit Findings that have been Fully Corrected:**

FISCAL YEAR 2007

Finding Number 07-03 Davis Bacon Act

CFDA Number 14.228

Questioned Cost None

Auditee Comments Fully Corrected

FISCAL YEAR 2007

Finding Number 07-04 Procurement Standard (contracts)

CFDA Number 14.228

Questioned Cost None

Auditee Comments Fully Corrected

**(2) Audit Findings not Corrected or Partially Corrected:**

FISCAL YEAR 2007

Finding Number 07-02 *Inventaris* 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 2006

Finding Number 06-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.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CULEBRA, PUERTO RICO  
SCHEDULE OF PRIOR AUDITS' FINDINGS AND QUESTIONED COSTS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2008**

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**(2) Audit Findings not Corrected or Partially Corrected: (continue)**

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