COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA

BASIC FINANCIAL STATEMENTS ACCOMPANIED BY
REQUIRED SUPPLEMENTARY INFORMATION

FISCAL YEAR ENDED JUNE 30, 2010

Corregido
30/3/11

OFICINA DEL COMISIONADO DE ASUNTOS MUNICIPALES

AREA DE ASESORAMIENTO, REGLAMENTACION E INTERVENCION FISCAL

AREA DE ARCHIVO DIGITAL

MUNICIPIO DE CULEBRA

AUDITORIA 2009-2010

30 DE JUNIO DE 2010

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA
BASIC FINANCIAL STATEMENTS ACCOMPANIED BY
REQUIRED SUPPLEMENTARY INFORMATION
FISCAL YEAR ENDED JUNE 30, 2010

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COMMONWEALTH OF PUERTO RICO

MUNICIPALITY OF CULEBRA

FINANCIAL STATEMENTS

FOR THE YEAR ENDED JUNE 30, 2010

Carlos R. Díaz Negrón

Certified Public Accountant

MEMBER:
American Institute of Certified Public Accountants
Puerto Rico Society of Certified Public Accountants

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INDEPENDENT AUDITOR'S REPORT

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

We have audited the financial statements of the governmental activities, each major funds, and the aggregate remaining fund information of the Municipality of Culebra as of and for the year ended June 30, 2010 which collectively comprise the basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Municipality's management. Our responsibility is to express an opinion on these financial statements based on our audit.

Except as discussed in the following two paragraphs, we conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audit contained in Governmental Audits Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

As described in Note 1 to the financial statements, the Municipality does not record addition to capital assets nor depreciation has been recorded. In our opinion, capital assets should be capitalized and depreciated over their estimated useful lives in the statement of net assets and activities to conform with accounting principles generally accepted in the United State of America. It was not practicable to determine the effect of that departure on the financial statement.

As discussed in Note 9 to the financial statements, the Municipality did not comply with the requirement established by Statement No. 18, Accounting for Municipal Solid Waste Landfill Closure and Post-Closure Care Costs, issued by the Governmental Accounting Standards Boards and the regulation set forth by the U.S. Environment Protection Agency. At June 30, 2010, the accompanying statement of net assets does not include the required liability for closures and post-closure 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, 2010.

In addition, because of the inadequacy of the accounting records, we were unable to the form an opinion regarding the capital assets reported in the accompanying statement of net assets for $8,412,866, net of accumulated depreciation of $3,538,624.

INDEPENDENT AUDITOR'S REPORT (CONTINUED):

In our opinion, because of the effects of not capitalizing capital assets, not recording depreciation, and not recording and disclose landfill cost, as discussed in the third and fourth paragraphs, the financial statements referred to in the first paragraph do not present fairly, in conformity with accounting principles generally accepted in the United States of America, the financial position of Municipality of Culebra, or the results of its operations for the year then ended. In addition, had there not been departures from U.S. generally accepted accounting principles as discussed in the third and fourth paragraphs, we would be unable to express an opinion on the financial statements for 2010 because of the inadequacy of the accounting records for capital assets discussed in the fifth paragraph.

In addition, in our opinion, the financial statements referred to previously present fairly, in all material respects, the respective financial position of the each major fund, and the aggregate remaining fund information of the Municipality of Culebra, as of June 30, 2010, and the respective changes in financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with Governmental Auditing Standards, we have also issued our report dated November 10, 2010, on our consideration of the Municipality of Culebra' internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Governmental Auditing Standards and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and budgetary comparison information on pages 3 through 10 and 49 through 50 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

CARLOS R. DIAZ NEGRON
CONTADOR PUBLICO AUTORIZADO
PUERTO RICO

February 11, 2011
Aguas Buenas, Puerto Rico

License No. 1339
Expire December 1, 2013

The stamp No. **2564412** of the Puerto Rico Society of Certified Public Accountants was affixed to the original of this report.

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, 2010. 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. This MD&A should be read in conjunction with the accompanying basic financial statements and the accompanying notes to those financial statements.

The new reporting model required by Governmental Accounting Standards Board Statement No. 34 was implemented during fiscal 2002-2003. This MD&A is prepared in order to comply with such pronouncement and, among other purposes, to provide the financial statements users with the following major information:

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

FINANCIAL HIGHLIGHTS

The following are key financial highlights for the fiscal year:

- The liabilities of the Municipality exceeded its assets at June 30, 2010 by $7.6 million, and at June 30, 2009 by $8.0 million, as restated;
- The Municipality's total net assets decreased by $735 thousand during fiscal year 2009-2010;
- At June 30, 2010, the unrestricted deficit was $4.0 million.
- As of June 30, 2010, the Municipality's governmental funds reported combined ending fund balances of $4.7 million, a decrease of $985 thousand from the prior year;
- 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 $105,000.

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.

GOVERNMENT-WIDE FINANCIAL STATEMENTS (CONTINUED)

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, culture and recreation, health and sanitation, solid waste disposal, human services and welfare, urban development and education. 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.

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 case of the Municipality, assets exceeded liabilities by $7,255,114 as of June 30, 2010 versus $7,990,274 as of June 30, 2009. Our analysis below focuses on the net assets (**Table 1**) and changes in net assets of the Municipality's governmental activities.

Table 1
Statement of Net Assets

	2010	2009
Current and non-current assets	$ 5,734,084	$ 7,072,783
Capital assets	8,412,866	8,412,866
Total Assets	**14,146,950**	**15,485,649**
Current liabilities	2,128,069	2,751,809
Long-term liabilities, net of current portion	4,763,767	4,743.565
Total Liabilities	**6,891,836**	**7,495,374**
Net assets:		
Investment in capital assets, net of related debt	5,321,866	6,317,866
Restricted	5,918,506	6,954,685
Deficit	(3,985,258)	(5,282,277)
Total Net Assets	**$ 7,255,114**	**$ 7,990,274**

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 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.

GOVERNMENTAL ACTIVITIES

Governmental activities decreased the Municipality's net assets. Key elements of this decrease are as follows: the Municipality's governmental activities had net expenses of $5,732,447. However, these services are intended to be primarily funded by taxes, as opposed to charges for services and grants, and those taxes and other general revenues does not exceed net expenses by $735,160.

The Municipality experienced an increase in property tax and, intergovernmental revenues. Also, a 1.5% sales tax was imposed by the Municipality, commencing on November 15, 2006. The cost of all governmental activities this year was $8,582,458. **Table 2** presents the cost of each of the Municipality's largest programs.

Table 2 **Statement of Activities**	**2010**	**2009**
Revenues		
Program revenues:		
Charge for service	3,706	
Operating grant and contribution	494,149	402,207
Capital grants and contribution	2,352,157	2,198,578
General revenues:		
Property taxes	471,649	459,616
Volume of business taxes	148,026	155,365
Sales taxes	1,237,961	1,522,495
Intergovernmental	2,686,811	2,663,828
Rent	19,397	21,702
Licenses and permits	216,714	287,726
Miscellaneous	216,729	408,753
Total revenues	7,847,298	8,120,270
Expenses		
General government	2,064,223	2,220,623
Public safety	189,177	260,421
Public works	888,470	669,946
Culture and recreation	149,480	130,292
Human services and welfare	740,342	940,498
Urban development	4,312,268	3,514,609
Education	200,530	210,495
Interest on long-term debts	37,968	56,382
Total expenses	8,582,458	8,003,266
Changes in net assets	(735,160)	117,004
Net assets – beginning, as restated	7,990,274	7,873,270
Net assets – ending	**$ 7,255,114**	**$ 7,990,274**

GOVERNMENT FUND FINANCIAL ANALYSIS

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

Table 3 **Balance Sheet**	**2010**	**2009**
Assets:		
Total assets – Major Funds	$ 7,229,830	$ 8,862,125
Total assets – Other Funds	1,445,291	1,399,764
Combined total assets	8,675,121	10,261,889
Liabilities:		
Total liabilities – Major Funds	3,485,627	4,050,829
Total liabilities – Other Funds	473,874	510,037
Combined total liabilities	3,959,501	4,560,866
Fund Balances:		
Reserved – Major Funds	4,911,836	6,047,734
Reserved – Other Funds	971,417	889,727
Unreserved – Major Funds	(1,167,633)	(1,236,438)
Combined total fund balances	4,715,620	5,701,023
Total liabilities and fund balances	**$ 8,675,121**	**$ 10,261,889**

Table 4 **Changes in Fund Balances**	**2010**	**2009**
Revenues:		
Total revenues – Major Funds	$ 6,780,889	$ 7,148,479
Total revenues – Other Funds	1,066,409	971,791
Combined total revenues	7,847,298	8,120,270
Expenditures:		
Total expenditures – Major Funds	7,847,982	6,684,980
Total expenditures – Other Funds	984,719	1,633,894
Combined total expenditures	8,832,701	8,318,874
Other financing sources (uses):		
Proceed from issuance of bonds	-	2,125,000
Transfer – In	-	627,398
Transfer – Out	-	(627,398)
Combined other financing sources (uses), net	-	2,125,000
Net changes in fund balance	(985,403)	1,926,396
Fund Balance – beginning, as restated	5,701,023	3,774,627
Fund Balance – ending	**$ 4,715,620**	**$ 5,701,023**

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. At June 30, 2010, the Municipality's governmental funds reported combined ending fund balances of $4,715,620, a decrease of $985,403 from the prior year.

The Municipality has an unreserved fund deficit of $1,103,599 in its General Fund. The remainder of the balance is reserved to indicate that it is not available for new spending because it has already been committed; (a) to liquidate prior year obligations ($64,034) (b) to pay debt service ($822,025) and (c) for other restricted purposes ($4,997,194).

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 2010 budget and the final amended budget for the General Fund were relatively minor and can be summarized as follows:

- The original budget was amended expenditures between expenditures accounts.

CAPITAL ASSETS AND DEBT ADMINISTRATION

The Municipality's investment in capital assets for its governmental type activities as of June 30, 2010 amounted to $8,412,866 (net of accumulated depreciation). This investment in capital assets includes land, buildings, improvements, machinery and equipment, parks, roads, and bridges. **Table 5** present the major classes of capital assets.

Table 5 Capital Assets	Amount
Land	$3,366,886
Buildings	4,846,452
Motor vehicles	197,793
Machinery and equipment	1,735
Total Assets	**$8,412,866**

LONG-TERM DEBT

At June 30, 2010 the Municipality had a total of $5,873,372 in general obligations and others outstanding debts, as shown in **Table 6**. Of this amount, $3,091,000 comprises debt backed by the full faith and credit of the government and $2,782,372 is other obligations.

Table 6 Long Term Debts	Amount
General obligations	$ 3,096,000
Others	2,782,372
Total Long Term Debts	**$ 5,873,372**

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 leave and advances of property taxes. More detailed information about the Municipality's long-term liabilities is presented in the notes to the financial statements. The Municipality continues to meet its financial needs through prudent use of its revenues and creative debt financing programs.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

Local, national and international economic factors influence the Municipality's revenues. Positive economic growth is correlated with increased revenues from property taxes, volume of business taxes, sales 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 2010 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) 742-3510.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA
STATEMENT OF NET ASSETS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

	Governmental Activities
ASSETS:	
Cash and Investments	$ 2,302,957
Cash with Fiscal Agent	2,685,173
Receivables (net):	
Federal Grants	614,169
Intergovernmental	131,785
	5,734,084
Capital Assets (Note5):	
Property, Plant and Equipment	11,951,490
Accumulated Depreciation	(3,538,624)
Total Capital Assets	8,412,866
Total Assets	**14,146,950**
LIABILITIES:	
Accounts Payable and Accrued Expense	616,169
Accrued Interest	2,396
Due to Governmental Units	124,099
Deferred Revenue	275,800
Long-Term Liabilities (Note 6):	
Due within One Year	1,109,605
Due in More than One Year	4,763,767
Total Liabilities	**6,891,836**
NET ASSETS	
Invested in Capital Assets, Net of Related Debt	5,321,866
Restricted for:	
Debt Service	822,025
Other Purposes	5,096,481
Unrestricted (Deficit)	(3,985,258)
Total Net Assets	**$ 7,255,114**

See accompanying Notes to Basic Financial Statements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA
STATEMENT OF ACTIVITIES
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

Functions/Programs	Expenses	Program Revenues: Charges for Services	Program Revenues: Operating Grants and Contributions	Program Revenues: Capital Grants and Contributions	Net (Expense) Revenue
Govenmental Activities:					
Mayor and Municipal Legislature	$ (523,891)	$ -	$ -	$ -	$ (523,891)
General Government	(1,540,332)	-	-	-	(1,540,332)
Public Safety	(189,177)	-	-	-	(189,177)
Public Works	(672,842)	-	-	-	(672,842)
Culture and Recreation	(149,480)	-	-	-	(149,480)
Sanitation	(215,628)	-	-	-	(215,628)
Human Services and Welfare	(740,342)	1,406	263,685	-	(475,251)
Urban Development	(4,312,268)	-	-	2,352,157	(1,960,111)
Education	(200,530)	2,300	230,463	-	32,233
Interest on Long-Term Debt	(37,968)	-	-	-	(37,968)
Total Governmental Activities....	**$ (8,582,458)**	**$ 3,706**	**$ 494,148**	**$ 2,352,157**	**(5,732,447)**

General Revenues:	
Taxes:	
Property Taxes, levied for General Purposes	333,978
Property Taxes, levied for Debt Services	137,671
Volume of Business Taxes	148,026
Construction Taxes	216,714
Sales Taxes, levied for Other Purposes	996,620
Sales Taxes, levied for Debt Services	241,341
Intergovernmental	2,686,811
Rent	19,397
Miscellaneous	216,729
Total General Revenues	4,997,287
CHANGE IN NET ASSETS	**(735,160)**
Net Assets - Beginning of Year	7,990,274
NET ASSETS - END OF YEAR	**$ 7,255,114**

See accompanying Notes to Basic Financial Statements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA
BALANCE SHEET – GOVERNMENTAL FUNDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

	General Fund	State Assignment Fund	CDBG Fund	Loans Fund	Sales Tax Fund	Other Governmental Funds	Total Funds
ASSETS:							
Cash	$ 571,913	$ 882,398	$ 102,297	$ -	$ 490,961	$ 255,388	$ 2,302,957
Cash with Fiscal Agent	-	-	-	1,731,045	-	954,128	2,685,173
Receivables:							
Federal Grants	-	-	558,232	-	-	55,937	614,169
Intergovernmental	-	4,618	-	-	-	127,167	131,785
Due from Other Funds	505,332	2,383,034	-	-	-	52,671	2,941,037
Total Assets	**$ 1,077,245**	**$ 3,270,050**	**$ 660,529**	**$ 1,731,045**	**$ 490,961**	**$ 1,445,291**	**$ 8,675,121**
LIABILITIES AND FUND BALANCES:							
Liabilities:							
Accounts Payable and Accrued Liabilities	$ 86,448	$ -	$ 203,155	$ -	$ 219,541	$ 37,025	$ 546,169
Bonds and Notes Payable	-	-	-	-	-	70,000	70,000
Accrued Interest	-	-	-	-	-	2,396	2,396
Due to Governmental Units	124,099	-	-	-	-	-	124,099
Due to Other Funds	1,832,032	-	457,374	325,426	99,287	226,918	2,941,037
Deferred Revenue:							
Volume of Business Tax	138,265	-	-	-	-	-	138,265
Federal Grants	-	-	-	-	-	137,535	137,535
Total Liabilities	2,180,844	-	660,529	325,426	318,828	473,874	3,959,501
Fund Balances:							
Reserve For:							
Encumbrances	64,034	-	-	-	-	-	64,034
Debt Service	-	-	-	-	-	822,025	822,025
Other Purposes	-	3,270,050	-	1,405,619	172,133	149,392	4,997,194
Unreserved (Deficit)	(1,167,633)	-	-	-	-	-	(1,167,633)
Total Fund Balances	(1,103,599)	3,270,050	-	1,405,619	172,133	971,417	4,715,620
TOTAL LIABILITIES AND FUND BALANCES	**$ 1,077,245**	**$ 3,270,050**	**$ 660,529**	**$ 1,731,045**	**$ 490,961**	**$ 1,445,291**	**$ 8,675,121**

See accompanying Notes to Basic Financial Statements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA
STATEMENT O REVENUES, EXPENDITURES AND
CHANGES IN FUND BALANCE – GOVERNMENTAL FUNDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

	General Fund	State Assignment Fund	CDBG Fund	Loans Fund	Sales Tax Fund	Other Governmental Funds	Total Funds
REVENUES							
Property Taxes	$ 333,978	$ -	$ -	$ -	$ -	$ 137,671	$ 471,649
Volume of Business Taxes	148,026	-	-	-	-	-	148,026
Sales Taxes	-	-	-	-	996,620	241,341	1,237,961
Federal Assistances	-	-	1,295,467	-	-	506,842	1,802,309
Intergovernmental	2,686,811	867,147	-	-	-	170,417	3,724,375
Licenses and Permits	216,714	-	-	-	-	-	216,714
Rent	19,397	-	-	-	-	-	19,397
Miscellaneous	216,729	-	-	-	-	10,138	226,867
Total Revenues	3,621,655	867,147	1,295,467	-	996,620	1,066,409	7,847,298
EXPENDITURES							
Current:							
Mayor and Municipal Legislature	523,891	-	-	-	-	-	523,891
General Government	1,667,739	-	-	-	-	17,836	1,685,575
Public Safety	187,169	-	-	-	-	2,008	189,177
Public Works	500,299	-	-	-	-	-	500,299
Culture and Recreation	149,480	-	-	-	-	-	149,480
Sanitation	215,628	-	-	-	-	-	215,628
Human Services and Welfare	227,386	-	-	-	198,574	314,382	740,342
Urban Development	-	646,476	1,295,467	674,217	1,561,656	306,995	4,484,811
Education	-	-	-	-	-	200,530	200,530
Debt Service:							
Pincipal	-	-	-	-	-	105,000	105,000
Interest and Other Charges	-	-	-	-	-	37,968	37,968
Total Expenditures	3,471,592	646,476	1,295,467	674,217	1,760,230	984,719	8,832,701
Excess (deficiency) of revenues over (under) expenditures and net change in fund balance	150,063	220,671	-	(674,217)	(763,610)	81,690	(985,403)
Fund Balance - Beginning as Restated (Note19)	(1,253,662)	3,049,379	-	2,079,836	935,743	889,727	5,701,023
Fund Balances - Ending	**$ (1,103,599)**	**$ 3,270,050**	**$ -**	**$ 1,405,619**	**$ 172,133**	**$ 971,417**	**$ 4,715,620**

See accompanying Notes to Basic Financial Statements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA
RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET
TO THE STATEMENT OF NET ASSETS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

Total Fund Balances – Governmental Funds		**$ 4,715,620**

Amounts reported for Governmental Activities in the Statement of Net Assets 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:

Capital Assets	$ 11,951,490	
Accumulated Depreciation	(3,538,624)	
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	(3,091,000)	
Compensated Absences	(316,665)	
Claims & Judgments	(109,518)	
Law 42	(2,302,535)	
LIMS	(5,772)	
Law146	(7,543)	
CRIM Settlement	(40,339)	
Total Long-Term Liabilities		(5,873,372)
Total Net Assets of Governmental Activities		**$7,255,114**

See accompanying Notes to Basic Financial Statements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA
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, 2010

Net Change in Fund Balances – Total Governmental Funds		**$ (985,403)**
Amounts reported for Governmental Activities in the Statement of Activities are different because:		
Repayment of debt proceeds 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.		105,000
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 Compensated Absences	87,510	
Decrease in Law 42	48,246	
Decrease in LIMS	3,576	
Decrease in Law 146	343	
Decrease in Treasury Department Debt	5,568	
Total Additional Expenditures		145,243
Change in Net Assets of Governmental Activities		**$ (735,160)**

See accompanying Notes to Basic Financial Statements.

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 Law No. 81 of August 30, 1991, as amended, known as the *Autonomous Municipality Act of the Commonwealth of Puerto Rico (Law No. 81)*.

The Municipality's governmental system consists of executive and legislative branches. The Constitution of the Commonwealth of Puerto Rico (the "Commonwealth") provides for the separation of powers of the executive, legislative and judicial branches. A Mayor, elected every four years by the citizens, exercises the executive power of the Municipality. The legislative power is exercised by the Municipal Legislature, which consists of 4 Legislators also elected every four years. The General Justice Court System of the Commonwealth, which has jurisdiction over the Municipality, exercises the judiciary power.

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

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, GASB issued Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments* (GASB No. 34). This statement established new financial reporting requirements for state and local governments. On July 1, 2002, the Municipality adopted the provisions of GASB No. 34 as well as other statements referred to below.

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, 2010, 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.

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

The 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.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The required supplementary information, which consists of a management discussion and analysis (MD&A), is information presented along with, but separate from, the Municipality's basic financial statements. The MD&A is a narrative report that introduces the accompanying basic financial statements and provides an analytical overview of the Municipality's financial activities for the year ended June 30, 2010, based on the Municipality's knowledge of the transactions, events and conditions reflected in the basic financial statements. The MD&A also highlights certain key fiscal policies that control the Municipality's operations.

As previously mentioned, on July 1, 2002, other statements and interpretations were also adopted in conjunction and simultaneously with GASB No. 34. Those statements and interpretations are: (1) GASB Statement No. 33 – *Accounting and Financial Reporting for Nonexchange Transactions*, (2) GASB Statement No. 37 – *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments: Omnibus*, (3) GASB Statement No. 38 – *Certain Financial Statement Note Disclosures* and (4) GASB Interpretation No. 6 – *Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements*.

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

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.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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 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, 2009, and the respective changes in financial position, where applicable, thereof for the fiscal year then ended.

B. Measurement Focus and Basis of Accounting

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.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

B. Measurement Focus and Basis of Accounting (Continued)

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, 2010, 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:

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

C. Financial Statement Presentation (Continued)

- **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.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

C. Financial Statement Presentation (Continued)

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 funds:

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 this assignments is the development of projects on communities, not-for-profit organizations and indirect assignment to persons of low and moderate income.

CDBG Fund – CDBG Fund is used to account for revenues derived from the Department of Housing and Urban Development, related to Community Development Block Grants – State Program.

Loans Fund – This is the fund used to account for all financial resources and transactions related to the loans for operational purposes, construction purposes and capital outlays of the Municipality, which is financed by loans from the Government Development Bank of Puerto Rico.

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.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

D. Financial Reporting Presentation

The accounts of the Municipality are organized on the basis of funds, each if which is considered a separate accounting entity. The operations of each fund are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues, and expenditures. Fund types are as follows:

General Fund – Is the general operating fund of the Municipality. It is used to account for all governmental activity, except those required to be accounted for in another fund.

Special Revenue Fund– This is the fund used to account for revenues derived from local funds, state grants or other restricted revenue sources. The uses and limitations of each special revenue fund are specified by Municipality ordinances or state statutes.

Debt Service Fund – This is the fund used to account for the accumulation of resources for and the payment of, general long-term debt principal, interest, and related costs.

Capital Projects Fund – This is the fund used to account for financial resources used for the acquisition or construction of major capital facilities. The uses and limitations of each capital projects fund are specified by Municipality ordinances or state statutes.

E. Budgetary Control

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 supplemental appropriations. 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.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

E. Budgetary Control (Continued)

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 31 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;

7. Budgetary data for the Special Revenue Fund has not been presented in the accompanying basic financial statements as such funds are budgeted over the life of the respective grant or project and not on an annual basis.

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

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

1. Encumbrances are recorded as expenditures under the budgetary basis and as a reserve of fund balances under GAAP.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

E. Budgetary Control (Continued)

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.

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 Major and Non Major 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.

F. 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.

Under the laws and regulations of the Commonwealth, public funds deposited by the Municipality in commercial banks must be fully collateralized for the amounts deposited in excess of the federal depository insurance generally provided by the Federal Deposit Insurance Corporation (FDIC). All securities pledged as collateral are held by agents designated by the Commonwealth's Secretary of the Treasury, but not in the Municipality's name.

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.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

F. Cash, Cash Equivalent and Investment (Continued)

Cash balance recognized in the Debt Service Fund is restricted for the payment of the Municipality's obligations, and others are restricted for specific projects, such as the acquisition or construction of permanent improvements. The 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.

G. Receivables

Receivable are stated net 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.

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.

I. Long-Term Obligations

The liabilities reported in the government-wide financial statements included general and special obligation bonds and notes, and other long-term liabilities, such as vacation, sick leave, litigation, long-term liabilities to other governmental entities.

In the fund financial statements, governmental fund types recognize bond issuances cost, during the current period. The face amount of debt issued is reported as other financing sources, while bond issuance costs, whether or not withheld from the actual debt proceeds received, are reported as expenditures.

J. 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.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

J. Compensated Absences (continued)

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.

The following is a summary of changes in the balance of Compensated Absences for the fiscal year ended June 30, 2010.

BALANCE JULY 1, 2009	NEW ISSUES	RETIREMENTS AND CURRENT MATURATES	BALANCE JUNE 30, 2010	CURRENT PORTION	LONG-TERM PORTION
$404,175	$ -	$87,510	$316,665	$23,213	$293,452

K. Insurance

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

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

L. Interfund Transactions

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

- **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.

- **Interfund transfers** – Represent flows of assets (permanent reallocation of financial resources among governmental funds) without equivalent flows of assets in return and without a requirement for repayment. Transfers are reported as other financing uses in the governmental fund making transfers and as other financing sources in the governmental fund receiving transfers.

- **Interfund reimbursements** – Represent repayments from the governmental fund responsible for particular expenditures or expenses to the governmental fund that initially paid for them.

M. Reservations of Fund Balance – Governmental Funds

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

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

- **Debt Service Fund** – Represents net assets available to finance future debt service payments. 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.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

M. Reservations of Fund Balance – Governmental Funds (continued)

- **Other Purposes** – Represents net assets available for specific use and/or legally segregated for other specific future use.

N. 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.

O. 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.

P. Accounting for Pension Costs

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

The Municipality accounts for pension costs from the standpoint of a participant in a multiple-employer cost-sharing plan. Accordingly, pension costs recognized in the accompanying basic financial statements are equal to the statutorily required contributions, with a liability recorded for any unpaid required contributions.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Q. Risk Financing

The Municipality carries commercial insurance to cover casualty, theft, tort claims and other losses. Insurance policies are negotiated by the Puerto Rico Treasury Department and costs are allocated among all the Municipalities of Puerto Rico.

Cost of insurance allocated to the Municipality and deducted from the gross property tax collections by the Municipal Revenue Collection Center ("CRIM") for the year ended June 30, 2010 amounted to $83,761. The current insurance policies have not been cancelled or terminated. The CRIM also deducted $56,797 for workers compensation insurance covering all municipal employees.

R. Future Adoption of Accounting Pronouncements

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

- GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions.* This statement changes the classification and terminology of fund balances and amends the definitions of the different types of governmental funds. This statement is effective for periods beginning after June 15, 2010;

- GASB Concepts Statements No. 5, *Service Efforts and Accomplishments – an Amendment of GASB Concepts Statements No. 2.* This statement provides a framework to be used by the GASB in considering guidance for reporting SEA by state and local governmental entities and amends terminology and other information in GASB:CS-2. ;

The Municipality's management has concluded that the future adoption of these GASB Statements do not have any significant impact on the Municipality's basic financial statements.

S. Subsequent events:

Management has evaluated subsequent events through February 7, 2011, the date the financial statements were evaluated to be issued.

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.

The Municipality's bank balances in commercial banks of $571,913 in the General Fund, $882,398 in the State Assignment Fund, $102,297 in the CDBG Fund and the $490,961 in the Sales Tax fund were fully collateralized at June 30, 2010. In the Other Governmental Funds there were deposits with commercial banks of $255,388 that were fully collateralized.

The deposits at GDB of $1,731,045 in the Loans Fund and $954,128 in the Other Governmental Fund, are unsecured and uncollateralized, as no collateral is required to be carried by governmental banks.

NOTE 3 – RECEIVABLES

A. Federal Grants Receivable

Federal grants receivable in the CDBG fund and in Other Governmental Funds represent expenditures incurred not yet reimbursed by the federal agencies or the pass-through grantors. Following is a detail of the federal grants receivable:

Description	Amount
Community Development Block Grant – State Program	$ 558,232
Child Care Development Block Grant	39,676
Special Programs for the Aging Title III-Part B	11,776
American Recovery and Re-investment Act Grants	4,485
Total	**$ 614,169**

NOTE 3 – RECEIVABLES (CONTINUED)

B. State Government Receivables

State government receivables in Other Governmental Funds represent expenditures incurred not yet reimbursed by the state agencies. Following is a detail of the state government receivables:

Governmental Entity	Amount
Puerto Rico Port Authority	$ 4,618
State Department of Labor and Human Resources – Law 52	127,167
Total	**$131,785**

C. Due From Other Funds

Interfund receivables and payables at June 30, 2009 are summarized as follows:

Receivable Fund	Payable Fund	Purpose	Amount
General Fund	CDBG Funds	Payroll and related accruals paid and not reimbursed	$ 187,355
General Fund	Sales Tax Fund	To cover operating expenditures	99,287
General Fund	Sales Tax Fund	Payroll and related accruals paid and not reimbursed	218,690
State Assignment Fund	General Fund	Loans between funds	1,779,361
State Assignment Fund	CDBG Funds	Loans between funds	270,019
State Assignment Fund	Other Governmental Funds	Loans between funds	8,228
State Assignment Fund	Loans Fund	Loans between funds	325,426
Other Governmental Funds	General Fund	Cash pool in the same bank account and reimbursable expenditures	52,671
Total			**$2,941,037**

NOTE 4 – CAPITAL ASSETS

Capital assets; those with an estimated useful live of one year or more from the time of acquisition by the Municipality and a cost of $25 or more, are primarily funded through the issuance of long-term bonds and loans. A summary of capital assets and changes occurring in 2010, including those changes pursuant to the implementation of GASB Statement No. 34, follows (Land and construction in progress are not subject to depreciation):

Governmental Activities	Balance July 1, 2009	Additions	Retirements / Reclassifications	Balance June 1, 2009
Capital asset, not being depreciated:				
Land	$ 3,366,886	$ -	$ -	$ 3,366,886
Construction in progress	-	-	-	-
Total capital assets not being depreciated	3,366,886	-	-	3,366,886
Capital assets, being depreciated:				
Buildings	6,285,605	-	-	6,285,605
Machinery and equipment	672,604	-	-	672,604
Motor vehicles	1,626,395	-	-	1,626,395
Total capital assets being depreciated	8,584,604	-	-	8,584,604
Less accumulated depreciation for:				
Buildings	(1,439,153)	-	-	(1,439,153)
Machinery and equipment	(670,869)	-	-	(670,869)
Motor vehicles	(1,428,602)	-	-	(1,428,602)
Total accumulated depreciation	(3,538,624)	-	-	(3,538,624)
Total capital assets being depreciated, net	5,045,980	-	-	5,045,980
Governmental activities capital assets, net	$ 8,412,866	$ -	$ -	$ 8,412,866

NOTE 4 – CAPITAL ASSETS (CONTINUED)

Depreciation expenses has not been charged to governmental functions/programs.

GASB Statement No. 34 requires to retroactively applying the requirements to major general infrastructure assets within at least four (4) years of the adoption of this pronouncement, which is not later than June 30, 2007. The Municipality has not complied with this requirement.

NOTE 5 – ACCOUNTS PAYABLE AND ACCRUED EXPENSES LIABILITIES

Accounts payable and accrued expenses liabilities in governmental fund financial statements represent expenditures incurred during fiscal year 2009-2010, and not paid by the Municipality at June 30, 2010. Following is a detail of these accounts payable and accrued liabilities:

Major Governmental Funds	Accounts Payable	Accrued Liabilities	Total
General Fund	$ 40,335	$ 46,113	$ 86,448
CDBG Fund	203,155	-	203,155
Sales Tax Fund	219,541	-	219,541
Other Governmental Funds	37,025	-	37,025
Total	**$ 500,056**	**$ 46,113**	**$ 546,169**

NOTE 6 – DUE TO OTHER GOVERNMENTAL UNITS

As of June 30, 2010, balance due to other governmental units consists of the following:

Governmental Agency	Amount
Puerto Rico Aqueduct and Sewer Authority	$ 1,981
State Department of Treasury	118,231
General Service Administration	3,887
Total	**$ 124,099**

NOTE 7 – DEFERRED REVENUES

A. **Volume of business tax** – The deferred revenues of $138,265 in the General Fund relates to volume of business tax collected in fiscal year 2009-2010 that will be earned in fiscal year 2010-2011.

B. **Federal Grants** – The deferred revenues presented in the head start fund and in other governmental funds represents the portion of federal grants received for which qualifying expenditures have not been incurred. Deferred revenues from the federal government are as follows:

Program Description	Amount
Child Care Food Program	$ 44,989
Public Assistance Grants	66,728
American Recovery and Re-investment Grants	25,818
Total	**$ 137,535**

NOTE 8 – GENERAL LONG-TERM DEBTS

Long-term liability activity for the year ended June 30, 2010, was as follows:

Description	Beginning Balance, as restated	Borrowings or Additions	Payments or Deductions	Ending Balance	Due Within One Year
Bonds and Notes Payable	$3,196,000	$ -	$105,000	$3,091,000	$1,031,000
Property Tax Advances – Treasury Department	5,568	-	5,568	-	-
Property Tax Debt – Law 42	2,350,781	-	48,246	2,302,535	51,277
Compensated absences	404,175	-	87,510	316,665	23,213
LIMS Repayment Plan	9,348	-	3,576	5,772	3,772
Property Tax Debt – Law 146	7,886	-	343	7,543	343
Claims and Judgments	109,518	-	-	109,518	-
CRIM Settlement 2008-2009	40,339	-	40,339	-	-
Total	**$6,123,615**	**$ -**	**$250,243**	**$5,873,372**	**$1,109,605**

NOTE 8 – GENERAL LONG-TERM DEBTS (CONTINUED)

A. GENERAL OBLIGATIONS BONDS AND NOTES

The Municipality issues general and special obligation bonds and notes, principally, to provide funds for the acquisition and construction of major capital facilities, to pay debt incurred in prior years, and to cover the expenditures of a special event. Bonds and notes payables as of June 30, 2010, are comprised of the following individual issues:

DESCRIPTION	AMOUNT
$220,000, Series 2005, for capital outlay purposes, payable in a installment of $35,000; at July 1, 2011 interest at 4.62% due semiannual.	$ 35,000
$220,000, Series 2006, for capital outlay purposes, payable in two annual installments of $35,000, through July 1, 2012, interest at 6% due semiannual.	70,000
$926,000, Series 2006, for capital outlay purposes, payable in July 1, 2010, excluding interest at 4.50%	926,000
$2,125,000, Series 2009, for construction purposes, payable in annual installments ranging from $35,000 to $175,000, through July 1, 2033; interest at 7.5% due semiannual.	2,060,000
Total General Obligations – Bonds	**$3,091,000**

These bonds, except by the $2,125,000 bond, are payable from the special ad valorem property tax of 2.00% which is restricted for debt service and retained by the Government Development Bank for Puerto Rico for such purposes. Bond amounting $2,125,000 is payable with the Sales Tax resources which is restricted for debt services, and the Government Development Bank for Puerto Rico retains the payment of principal and interest.

NOTE 8 – GENERAL LONG-TERM DEBTS (CONTINUED)

B. BONDS AND NOTES AMORTIZATION

The annual requirements to amortize the general obligations outstanding as of June 30, 2010 are as follows:

Year Ending June 30,	Principal payment	Interest payment	Total
2011	$1,031,000	$ 160,317	$1,091,317
2012	75,000	153,975	228,975
2013	40,000	148,875	188,875
2014	45,000	145,875	190,875
2015	50,000	142,500	192,500
2016-2020	300,000	652,000	952,000
2021-2025	430,000	521,249	951,249
2026-2030	625,000	333,750	958,750
2031-2035	495,000	75,750	570,750
Total	**$3,091,000**	**$2,334,291**	**$5,425,291**

C. PROPERTY TAX DEBT – LAW 42

The Municipality entered into a repayment agreement with the Government Development Bank for Puerto Rico (GDB) and the CRIM, to pay off the excess of property tax advances through fiscal year 2000 and 2001. The CRIM retains the payment from the property tax advances of the Municipality. The amounts retained by the CRIM are remitted to GDB on July 1 of each year through July 1, 2032. The outstanding balance of the note payable to the CRIM at June 30, 2010 amounted to $2,302,535.

D. COMPENSATED ABSENCES

The government-wide statement of net assets includes $316,665 of accrued sick leave benefits, and accrued vacation benefits, representing the Municipality's commitment to fund such costs from future operations.

E. LIMS REPAYMENT PLAN

The Municipality entered into a financing agreement with the CRIM for the payment of the Municipality's share of the cost of an information management system, acquired by the CRIM on behalf of all municipalities, for the management of a digital database of taxpayer's properties located in Puerto Rico. The outstanding balance of the note payable to the CRIM at June 30, 2010 amounted to $5,772.

NOTE 8 – GENERAL LONG-TERM DEBTS (CONTINUED)

F. PROPERTY TAX DEBT – LAW 146

On September 24, 2002, the CRIM, on behalf of the municipalities of Puerto Rico, entered into a financing agreement with GDB pursuant to the provisions of Law No. 146 of October 11, 2001. The purpose of this financing agreement was to extinguish in advance certain bonds payable issued by the Public Finance Corporation, a subsidiary of the GDB, which were originally issued to pay certain property tax receivables owned by the municipalities of Puerto Rico through 1996. The outstanding balance of the note payable to the CRIM at June 30, 2010 amounted to $7,543.

G. CRIM Settlements

Fiscal year final settlements – For the fiscal year ended on June 30, 2010 the CRIM notify to the Municipality that the preliminary settlement of property tax advances versus actual collections through fiscal year 2009 result in an overpayment to the Municipality of $40,339.

H. CLAIMS AND JUDGMENTS

Liabilities of $109,518 reported in the statement of net assets represent the balance owed for claims and judgments related to a construction contractors of the Municipality at June 30, 2010.

I. 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 is required to report 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, 2010.

NOTE 9 – DEBT RETIREMENT

Revenues of the debt service fund consist 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. In addition, the debt service fund includes the sale tax redemption funds.

NOTE 9 – DEBT RETIREMENT (CONTINUED)

These property taxes are accumulated by the Municipal Revenue Collection Center in costs of the general obligations bonds issued by the Municipality. Payments are made to the Governmental Development Bank of the Commonwealth of Puerto Rico from such accumulated funds by the Municipal Revenue Collection Center of Puerto Rico.

The Sale Tax as accumulated by P.R. Department of Treasury and payments are made to the Governmental Development Bank.

NOTE 10 – PROPERTY TAXES

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

Personal property taxes are self-assessed by taxpayers every year generally using the book value of personal property assets owned by the taxpayer at January 1 (assessment date) and reporting such taxable value through a personal property tax return filed on May 15 subsequent to the assessment date. The total personal property tax rate in force at June 30, 2010 was 6.08% (of which taxpayers pay 5.25% and 1.03% is reimbursed by the Department of Treasury).

Real property taxes are assessed by CRIM. The assessment on real property is made every January 1 and is based on estimated current values of the property deflated to 1957 market prices. The total real property tax rate in force at June 30, 2010 was 8.08% (of which 7.25% is paid by taxpayers and 1.03% is also reimbursed by the Department of Treasury).

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

CRIM is responsible for the billing and collections of real and personal property taxes on behalf of the Municipality. Prior to the beginning of each fiscal year, CRIM informs the Municipality of the estimated amount of property tax expected to be collected for the ensuing fiscal year. Throughout the year, CRIM advances funds to the Municipality based on the initial estimated collections. CRIM is required by law to prepare a settlement statement on a fiscal year basis, whereby a comparison is made between the amounts advanced to the Municipality and amounts actually collected from taxpayers.

This settlement has to be completed on a preliminary basis not later than each December 31. If CRIM remits to the Municipality property tax advances, which are less than the property tax actually collected, an additional property tax receivable is recorded at June 30. However, if advances exceed the amount actually collected by CRIM, an intergovernmental payable is recorded at June 30.

NOTE 10 – PROPERTY TAXES (CONTINUED)

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

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

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

- Thirty five percent (35%) of its net earnings (defined as the excess of revenues over expenses less an amount earmarked for the Fund for Rent and Home Improvement Subsidy Program for the Low-Income Qualifying Elderly) is earmarked to the municipalities of the Commonwealth, of which a maximum of $26 million, on an annual basis, is distributed to the Municipal Equalization Fund held by CRIM to cover operating expenses and permanent improvements of the municipalities.

- An additional amount not exceeding $16 million, on an annual basis, is distributed to the Municipal Equalization Fund, provided it is within the 35% corresponding to the municipalities of the Commonwealth. When the accumulated municipal appropriations from the municipalities' Puerto Rico Health Reform are covered up to June 30, 1997, these resources will be assigned to the Health Insurance Administration, a component unit of the Commonwealth.

NOTE 11 – VOLUME OF BUSINESS TAXES

The Municipality is authorized by Law No. 81 to impose and collect municipal license taxes on all trade or business activities operated by any natural or legal person within the territorial area of Culebra. This is a self-assessed tax generally based on the business volume measured by gross sales. The Municipality establishes the applicable tax rates. At June 30, 2010, the municipal tax rates imposed by the Municipality were 1.50% for financing institutions and 0.50% for other types of taxpayers. Any taxpayers that have been granted with partial tax exemptions under any of the incentive tax laws of the Commonwealth ultimately pay municipal license taxes at reduced tax rates, generally between 60% and 90% under standard rates.

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

Taxpayers with a sales volume of $3 million or more must include audited financial statements with their tax returns. The tax can be paid by the taxpayer in two equal installments due on July 15 and January 15, subsequent to the filing of the declaration.

NOTE 11 – VOLUME OF BUSINESS TAXES (CONTINUED)

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

Any municipal license taxes collected in advance (that is, pertaining to a future fiscal year) are recorded as deferred revenues in the GWFS and the GFFS (See Note 9).

NOTE 12 – SALES TAXES

On July 4, 2006, the Legislature of the Commonwealth of Puerto Rico approved Act No. 117 ("Act 117") which amends the Puerto Rico Internal Revenue Code of 1994 to provide for a sale and use tax of 5.5% to be imposed by the Commonwealth Government. Act 117 also authorizes each municipal government to impose a municipal sale and use tax of 1.5%. This municipal sales and use tax has in general the same tax base and limitations (except for unprocessed foods) as those provided by the Commonwealth's sales and use tax.

Section 6189 of the Puerto Rico Internal Revenue Code of 1994, as amended, authorizes the Municipalities in Puerto Rico to impose a sales and use tax to consumers. This tax must be imposed in conformity with the base, exemptions and limitations contained Subtitle BB of the Code. The Municipal Sales Tax is specifically imposed over all sales transactions of taxable items and combined transactions (as defined by the municipal internal regulation) taken place within municipal limits. The Municipal Tax is also specifically imposed over the purchase price for the use, storage or consumption of taxable transactions (as defined by the municipal internal regulation) taken place within municipal limits.

The Municipal Legislature approved the imposition of the municipal sales and use tax, effective on July 1, 2006. Individuals, organizations and entities subject to collect the municipal sales and use tax must file a tax return to the Municipality. Tax is due each 10th day of each month based on tax collected in the preceding month. The Municipal Ordinance does not impose specific restrictions or limitations on the use of the municipal sales and use tax resources. Resources are recorded in the general fund of the Municipality.

NOTE 13 – 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 State Assignment, Sales Tax and Loans Funds.

NOTE 14 – 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 a maximum of 10% of their monthly salary, and will invested in an account which will either: (a) earn a fixed rate based on the two-year Constant Maturity Treasury Note or, (b) earn a rate equal to 75% of the return of the System's investment portfolio (net of management fees), or (c) earn a combination of both alternatives. If at time of retirement accumulated benefits amount to $10,000 or less may elect to receive a lump sum distribution up to the accumulated benefits. Under the new program the retirement age is reduced from 65 to 60 for those employees who joined the current plan on or after April 1, 1990.

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

NOTE 14 – EMPLOYEE'S RETIREMENT PLAN (CONTINUED)

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

- The present value of the future pension payments was computed by using a discount of 9%.
- 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:

YEARS OF SERVICE	PARTICIPANT'S AGE	PENSION BENEFITS
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 employees and employer contributions to the above mentioned plans during the year ended June 30, 2010 amounted to approximately $89,687 and $101,154 respectively. The above represented 100% of the required contribution for the year.

Contributions in 2006 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.

NOTE 14 – EMPLOYEE'S RETIREMENT PLAN (CONTINUED)

The total pension expenditures recorded in the category of administration for the Fiscal Year Ended June 30, 2010 was approximately $101,154. 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, 2010. The P.R. Retirement Plan Administration provides additional information of the ERS. They issue a public 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, P.R. 00940.

NOTE 15 – 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. With respect to pending litigation, the Municipality has reported liabilities of $109,518 in the government wide statement of net assets.

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

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 counsels with the information currently available can not determine the final outcome of these proceeding. However, it has been the Municipality's experience that such actions are settled for amounts substantially less than the claim amounts.

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 16 – ACCOUNTING CHANGES AND RESTATEMENTS

A. GOVERNMENTAL FUND FINANCIAL STATEMENTS

The following restatements have been made in the governmental fund financial statements, which are reported as an adjustment to the beginning fund balances:

Description	General Fund	State Assignment Fund
Fund balance, beginning	$(1,179,249)	$3,000,151
Adjustment to accounts receivables not supported in prior year	(74,413)	49,228
Fund balance, beginning as restated	**$(1,253,662)**	**$3,049,379**

B. GOVERNMENTAL WIDE FINANCIAL STATEMENTS

The following restatements have been made in the governmental wide financial statements, which are reported as an adjustment to the beginning net assets:

Description	Total
Net assets, beginning	$8,015,460
Adjustment to accounts receivables not supported in prior year	(25,185)
Net assets, beginning as restated	**$7,990,275**

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA
BUDGETARY COMPARISON SCHEDULE- GENERAL FUND
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

	Budgeted Amounts		Actual Amounts (Budgetary Basis) (See Note A)	Variance with Final Budget Positive (Negative)
	Original	Final		
REVENUES:				
Property taxes	$ 333,978	$ 333,978	$ 333,978	$ -
Volume of Business Taxes	156,206	156,206	148,026	(8,180)
Intergovernmental Revenues	2,661,800	2,661,800	2,686,811	25,011
Licenses, permits and other local taxes	492,298	492,298	216,714	(275,584)
Rent of Property	23,932	23,932	19,397	(4,535)
Miscellaneous	561,049	561,049	215,672	(345,377)
Total revenues	4,229,263	4,229,263	3,620,598	(608,665)
EXPENDITURES, ENCUMBRANCES AND OTHER FINANCING USES:				
Current:				
Mayor and Municipal Legislature	619,563	627,074	531,570	95,504
General government	2,113,907	2,068,719	1,517,385	551,334
Public safety	201,963	216,031	188,753	27,278
Public works	563,207	589,333	502,741	86,592
Culture and Recreation	190,680	187,230	149,821	37,409
Health and Sanitation	267,295	268,298	215,628	52,670
Human Service and Welfare	272,648	272,578	227,617	44,961
Total expenditures, encumbrances and other financing uses	4,229,263	4,229,263	3,333,515	895,748
EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES, ENCUMBRANCES AND OTHER FINANCING SOURCES (USES)	$ -	$ -	$ 287,083	$ 287,083

NOTE A – EXPLANATION OF DIFFERENCE BETWEEN BUDGETARY INFLOWS AND OUTFLOWS AND GAAP REVENUES AND EXPENDITURES

Explanation of Differences:

Sources/inflows of resources:	
Actual amounts (budgetary basis)"available for appropriation" from the budgetary comparison schedule	$ 3,620,598
Differences-budget to GAAP:	
Prior and current GAAP adjustments to revenues	1,057
Total revenues and other financing sources as reported on the statement of revenues, expenditures, and changes in fund balances	$ 3,621,655
Uses/outflows of resources:	
Actual amounts (budgetary basis)"total charges to appropriations" from the budgetary comparison schedule	$ 3,333,515
Differences-budget to GAAP:	
Prior Year expenditure are not outflows of budgetary resources but are expenditure for financial purposes	41,556
Encumbrances for supplies and equipment ordered but not received are reported in the year	(51,506)
the order is placed for budgetary reporting purposes	
GAAP adjustment to expenditures	148,027
Total expenditures and other financing uses as reported on the statement of revenues, expenditures, and changes in fund balances	$ 3,471,592

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2010

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
YEAR ENDED JUNE 30, 2010

	NUMBER	DISBURSEMENT
US Department of Housing and Urban Development		
Passed through:		
Municipal Service Administration:		
Community Development Block Grant	14.228	$1,168,138
ARRA - Community Development Block Grant	14.225	127,329
		1,295,467
US Department of Agriculture		
Passed through:		
PR Department of Education:		
Child and Adult Food Program	10.558	20,014
US Department of Health and Human Services		
Passes through:		
PR Department of Family:		
Child Care and Development Block Grant	93.575	171,355
ARRA – Child Care and Development Block Grant	93.713	37,025
		208,380
Special Program for the Aging Title III, Part B-93.044 Grants for Supportive Services and Senior Centers		78,697
		287,077
US Department of Homeland and Security		
Passes through:		
PR Office of Management and Budget (GAR):		
Public Assistance Grant	97.036	101,461
PR Department of Justice:		
ARRA- Homeland Security Grant Program	97.067	10,208
		111,669
		$1,714,227

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA
NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
JUNE 30, 2010

1. BASIS OF PRESENTATION:

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of Municipality of Culebra and is prepared on the modified accrual basis of accounting. Accordingly, amounts presented in the accompanying schedule agree to amounts presented in the basic financial statements.

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

Carlos R. Díaz Negrón

Certified Public Accountant

MEMBER:
American Institute of Certified Public Accountants
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REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

To The Honorable Mayor And
Municipal Legislative Body
Municipality of Culebra
Culebra, Puerto Rico

We have audited the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of Municipality of Culebra, Puerto Rico, as of and for the year ended June 30, 2010, which collectively comprise the Municipality of Culebra, Puerto Rico's basic financial statements and have issued our report thereon dated February 11, 2011. We did not express an opinion on the statement of net assets and statement of activities because the inadequacy of the accounting record of capital assets. Except as discussed in the preceding sentence, 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 Municipality of Culebra, Puerto Rico's internal control over financial reporting as a 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 Municipality of Culebra, Puerto Rico's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Municipality of Culebra, Puerto Rico's internal control over financial reporting.

A *deficiency in internal control* 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 and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING (CONTINUED)

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We identified certain deficiencies in internal control over financial reporting, described in the accompanying schedule of findings and questioned costs that we consider to be material weakness in internal control over financial reporting. Findings 01-10 to 03-10.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Municipality of Culebra, Puerto Rico's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule of findings and questioned costs as items 01-10 to 03-10

We noted certain matters that we reported to management of Municipality of Culebra, Puerto Rico, in a separate letter dated February 11, 2011.

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

CARLOS R. DIAZ NEGRON
CONTADOR PUBLICO AUTORIZADO
PUERTO RICO

February 11, 2011
Aguas Buenas, Puerto Rico

License No. 1339
Expires December 1, 2013

The stamp No. **2564413** of the Puerto Rico Society of Certified Public Accountants was affixed to the original of this report.

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

Carlos R. Díaz Negrón

Certified Public Accountant

MEMBER:
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REPORT ON COMPLIANCE WITH REQUIREMENTS
APPLICABLE TO EACH MAJOR PROGRAM AND ON INTERNAL CONTROL
OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133

To The Honorable Mayor And
Municipal Legislative Body
Municipality Of Culebra
Culebra, Puerto Rico

Compliance

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

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

REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE (CONTINUED)

As described in item 5-10 in the accompanying schedule of findings and questioned costs, Municipality of Culebra, Puerto Rico did not comply with requirement regarding Procurement and Suspensions and Debarment that are applicable to its Community Development Block Grant. Compliance whit such requirements is necessary, in our opinion, Municipality of Culebra, Puerto Rico, to comply with the requirements applicable to that program.

In our opinion, except for the non compliance described in the preceding paragraph, Municipality of Culebra, Puerto Rico, complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2010. The results of our auditing procedures also disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as items 4-10 and 6-10 to 8-10.

Internal Control Over Compliance

Management of Municipality of Culebra, Puerto Rico, is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered Municipality of Culebra, Puerto Rico'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 and to test and report on internal control over compliance in accordance with OMB Circular A-133, 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 of Culebra, Puerto Rico's internal control over compliance.

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

A *deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. We considered the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned cost as items 4-10 to 8-10 to be significant deficiencies.

REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE (CONTINUED)

Municipality of Culebra, Puerto Rico'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 of Culebra, Puerto Rico's responses and, accordingly, we express no opinion on the responses.

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

CARLOS R. DIAZ NEGRON
CONTADOR PUBLICO AUTORIZADO
PUERTO RICO

February 11, 2011
Aguas Buenas, Puerto Rico

License No. 1339
Expire December 1, 2013

The stamp No. **2564414** of the Puerto Rico Society of Certified Public Accountants was affixed to the original of this report.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2010

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2010

SECTION I - SUMMARY OF AUDITOR'S RESULTS

Financial Statements

Type of auditor's report issued	**Unqualified**	
Internal control over financial reporting:		
• Material weakness identified?	_X_ yes	___ no
• Significant deficiency identified that is not considered to be material weaknesses?	___ yes	_X_ no
Noncompliance material to financial statement noted?	_X_ yes	___ no

Federal Awards

Internal control over major programs:		
• Material weakness identified?	___ yes	_X_ no
• Significant deficiency identified that are not considered to be material weakness	_X_ yes	___ no
Type of auditor's report issued on compliance for major programs	**Qualified**	
Any audit findings disclosed that are required to be reported in accordance with section 510(a) of Circular A-133	_X_ yes	___ no

Identification of major programs:

CFA Number(s)	**Name of Federal Program**
14.228	Community Development Block Grants

Dollar threshold used to distinguish between type A and type B programs:	$300,000	
Audit qualified as low-risk audited?	___ yes	_X_ no

SECTION II - FINANCIAL STATEMENT FINDINGS

Finding No. 1-10 - Municipal Solid Waste Landfill GASB 18

The estimated liability and the related disclosure presented in the financial statement related to costs of closure and postclosure of the Municipal solid waste landfill is not based on actual engineering studies. Therefore, we were unable to obtain a reliable base on which those estimates were based. Management believes that the effect in the June 30, 2010 financial statements is not material. However, as years going by the accrual will be material and the amount must be based on reliable sources.

We recommend performing the engineering studies to determine the factors necessary to calculate the amount to be accrued for cost closure and postclosure care. These costs include the following:

- The cost of equipment expected to be installed and facilities expected to be constructed near or after the date the landfill stops accepting waste and during the postclosure period. Such equipment might include gas monitoring and collection systems, storm water management systems, and groundwater monitoring wells.

- The cost of final cover (i.e., capping) expected to be applied near or after the closure date.

- The cost of monitoring and maintaining the expected usable landfill area during the postclosure period.

The amount to be accrued each period should be determined using a depletion approach and should be based on the percentage of capacity used during the period.

SECTION II – FINANCIAL STATEMENT FINDINGS

Finding No. 2 – 10 – Property, Plant and Equipment

Compliance Requirement:

Significant deficiencies over property, plant and equipment

Condition:

The Municipality has not maintained complete and adequate records in order to obtain sufficient, competent evidential matter with respect to the capital assets reported in 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 determinable. This finding is repeated form prior years.

Criteria:

Chapter XI, 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 Statement No. 34 requires that all capital assets, including infrastructure, must be presented in the Statement of Net Assets and that assets must be depreciated during its useful life.

Cause:

Competent and sufficient evidential matter related to the capital assets was not available to support the value, completeness and ownership of these capital assets.

Effect:

The Municipality's Government Wide Financial Statements do no present fairly, the financial position of the governmental activities, and the change in financial position of the municipality.

Recommendation:

We recommend that the Municipality should continue the compilation of documents to support the value, completeness and ownership of its capital assets, to comply with the requirements of the GASB No. 34.

SECTION II – FINANCIAL STATEMENT FINDINGS

Finding No. 3 – 10 – Accounting Records

Category:

Internal controls

Category:

Accounting System

Condition:

The accounting system and manuals used by the Municipality to account and register the financial transactions during the fiscal year do not provide for the summarization of transactions that permit the preparation of Municipality's financial statements in conformity with the accounting principles generally accepted in the United States of America (GAAP). This finding is repeated from prior year.

Criteria:

According to Article 8.01(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 system, 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 in accordance, generally accepted accounting principles and the requirements established by the Governmental Accounting Standard Board.

Cause:

Municipality's accounting system and financial reports are subject to State's agencies requirements whish does not allow nor provide the municipality with the necessary tools capable of recapturing the financial information and provide financial statements.

SECTION II – FINANCIAL STATEMENT FINDINGS

Finding No. 3 – 10 (continued)

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 effect the Municipality ability to measure the financial and non-financial performance of programs and activities; adequately safeguard significant assets and properly record various transactions; and hider 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.

Recommendation:

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

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Finding No. 4 – 10 – Equipment and Real Property Management

Category:

CFDA 1428 Community Development Bock Grant/Small Cities

Requirement:

Compliance and Internal Control

Noncompliance:

Equipment and Real Property Management

Conditions:

The Municipality does not have a property register that includes all the required information; it only includes the property number and its description.

Criteria:

Subpart C, 24 CFR 85.32 (d)(1), states that property records must be maintained and its shall includes: a description of the property, serial number of other identification number, the source of property, percentage of Federal participation in the property, the location, use and condition of the property, any ultimate disposition data including the date of disposal and sales princes of property. 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.

Cause:

The Municipality does not maintain the appropriate information on the real property records to assure that is in accordance with the federal regulation.

Effect:

The Municipality is not in compliance with Subpart C, 24 CFR 85.32 (d) (1).

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS (CONTINUED)

Finding No. 4 – 10 (continued)

Recommendation:

The Municipality should revise and update its property records in accordance with the federal regulation.

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS (CONTINUED)

Finding No. 5-10 – Procurement and Suspension and Debarment

Federal Program

CFDA – 14.228 Community Development Block Grant

Compliance requirement:

Procurement and Suspension and Debarment

Category:

Compliance and Internal Control

Condition:

As part of our audit procedures we examined 14 disbursements to test the compliance with the Procurement and Suspension and Debarment requirement for Community Development Block Grant program. In 10 of the 14 disbursements amounting $919,712.44 the Municipality did not comply with Suspension and Debarment requirement and in one disbursement amounting to $27,900 the Municipality did not comply with the procurement requirement.

Criteria:

Procurement:

States, and governmental subrecipients of States, shall use the same State policies and procedures used for procurements from non-Federal funds. They also shall ensure that every purchase order or other contract includes any clauses required by Federal statutes and executive orders and their implementing regulations.

Local governments and Indian tribal governments which are not subrecipients of States will use their own procurement procedures provided that they conform to applicable Federal law and regulations and standards identified in the A-102 Common Rule.

All non-Federal entities shall follow Federal laws and implementing regulations applicable to procurements, as noted in Federal agency implementation of the A-102 Common Rule and OMB Circular A-110.

SECTION III. - FEDERAL AWARDS FINDINGS AND QUESTIONED COSTS (CONTINUED)

Finding No. 5-10 – Procurement and Suspension and Debarment

Criteria (continued):

Suspension and Debarment:

2 CFR part 180 states that non-federal entities are prohibited from contracting with or making subawards under covered transactions to parties that are suspended or debarred or whose principals are suspended or debarred. Covered transactions include those procurement contracts for goods and services awarded under a nonprocurement transaction (e.g., grant or cooperative agreement) that are expected to equal or exceed $25,000 or meet certain other specified criteria. CFR section 180.220 of the government-wide nonprocurement debarment and suspension guidance contains those additional limited circumstances. All nonprocurement transactions (i.e., subawards to subrecipients), irrespective of award amount, are considered covered transactions.

When a non-federal entity enters into a covered transaction with an entity at a lower tier, the non-federal entity must verify that the entity is not suspended or debarred or otherwise excluded. This verification may be accomplished by checking the Excluded Parties List System (EPLS) maintained by the General Services Administration (GSA), collecting a certification from the entity, or adding a clause or condition to the covered transaction with that entity.

Effect:

The Municipality could be exposed to administrative action by the grantor.

Questioned cost:

$27,900

Recommendation:

We recommend that the Municipality establishes an adequate internal control system to ascertain compliance with the Procurement and Suspension and Debarment requirement.

SECTION III. - FEDERAL AWARDS FINDINGS AND QUESTIONED COSTS (CONTINUED)

Finding No. 6-10 – Davis Bacon Act

Federal Program

CFDA - 14.228 Community Development Block Grant

Compliance requirement:

Davis – Bacon Act

Category:

Compliance and internal control

Condition:

As part of our audit procedures we tested 14 disbursements to test the compliance with the Davis-Bacon Act for Public Assistance Grants Program. In 2 of the 8 the contractors did not submit the payrolls to the Municipality for examination.

Criteria:

Section 40 USC 3141-3144, 346 and 347 state that when required by the Davis Bacon Act, the Department of labor's (DOL) government wide implementation of the Davis-Bacon Act, or by Federal program legislation, all labor and mechanics employed by contractors or subcontractors to work on construction contracts in excess of $2,000 financed by Federal Assistance Fund must be paid wages not less than those established for the locality of the project (prevailing wage rate) by de DOL.

Non-federal entities shall include in their construction contracts subject to the Davis-Bacon Act a requirement that the contractor or subcontractor comply with the requirements of the Davis-Bacon Act and the DOL regulations (29 CFR part 5, "Labor Standards Provisions Applicable to Contacts Governing Federally Financed and Assisted Construction"). This includes a requirement for the contractor or subcontractor to submit to the non-Federal entity weekly, for each week in which any contract work is performed, a copy of the payroll and a statement of compliance (certified payrolls) (29 CFR sections 5.5 and 5.6). This reporting is often done using Optional Form WH-347 which includes the required statement of compliance (OMB No. 1215-0149).

Effect:

The Municipality could be exposed to administrative action by the grantor.

SECTION III. - FEDERAL AWARDS FINDINGS AND QUESTIONED COSTS (CONTINUED)

Finding No. 6-10 – Davis Bacon Act

Questioned cost:

None

Recommendation:

We recommend that the Municipality establishes and adequate internal control system to ascertain compliance with Davis-Bacon Act.

SECTION III. - FEDERAL AWARDS FINDINGS AND QUESTIONED COSTS (CONTINUED)

Finding No. 7-10 – Reporting

Federal Program

CFDA - 14.228 Community Development Block Grant

Compliance requirement:

Reporting

Category:

Compliance and internal control

Condition:

The Municipality did not provided us to examination the quartely report of January to March 2010.

Criteria:

Memorandum Circular OCAM – 1994 -09 require that:

a) The quartely reports should be received in the agency the last day of the subsequent month to the quarter end.

Effect:

The Municipality could be exposed to administrative action by the grantor.

Questioned cost:

None

Recommendation:

We recommend that the Municipality establishes and adequate internal control system to ascertain compliance with Davis-Bacon Act.

SECTION III. - FEDERAL AWARDS FINDINGS AND QUESTIONED COSTS (CONTINUED)

Finding No. 08-10 – Cash Management

Federal Program

CFDA - 14.228 Community Development Block Grant

Compliance requirement:

Cash Management

Category:

Compliance/internal control

Condition:

The Municipality does not maintain a individual depositary account to ARRA funds.

Criteria:

Memorandum Circular OCAM – 2009 -21 requires that:

b) Opening a different bank account to the CDBG funds form the deposit of the funds assigned for ARRA funds.

Effect:

The Municipality could be exposed to administrative action by the grantor.

Questioned cost:

None

Recommendation:

We recommend that the Municipality establishes and adequate internal control system to ascertain compliance with Davis-Bacon Act.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CULEBRA

EXHIBIT – I

CORRECTIVE ACTION PLAN
FOR YEAR ENDED1+09 JUNE 30, 2010

March 17, 2011

Municipality of Culebra
Mangement Responses
Single Audit 2009-2010

Finding 1-10

The Municipality will make an evaluation with key employees of the Municipality and the director of the Public Works Department, of the maximum space and the available space of the Municipality's solid waste landfill at June 30, 2011. Once we collect this information we will calculate the liability of the closure and postclosure care costs of the landfill. In addition, we will request quotations from external consultants to help us in the technical issues related with the landfill's available space.

Responsible Person: Public Works Director
Implementation Date: June, 2011

Finding 2-10

The Property Division of the Municipality is updating its capital assets inventory. We established schedules to perform periodical physical inventories of Municipality's capital assets to update the property accounting records. Also we are considering, request quotations from external consultants to help us in the application of the GASB Statement 34.

Responsible Person: Finance Department Director
Implementation Date: June, 2012

Finding 3-10

We engage annually with our external consultant, a certified public accountant, to prepare the government fund and government wide financial statements. Those financial statements are prepare with the cash basis accounting records of the Municipality and are converted to the modified accrual and accrual basis of accounting. We will continue with this practice until we acquire accounting software with a reasonable cost.

Responsible Person: Finance Department Director
Implementation Date: June, 2012

Finding 4-10

The Federal Programs Director in coordination with the Property Division of the Municipality were instructed to update the CDBG's capital assets subsidiary ledger in order to comply with the 24 CFR, Subpart C, Section 85.32 (d) (1).

Responsible Person: Federal Programs Director/ Finance Department Director
Implementation Date: July, 2011

Finding 5-10

We gave instructions to include a step in our procurement procedures to verify through the electronic version available on the internet whether or not the contractors are on the excluded party list of the Federal Government. Also, we will revise our contract model, to include all the clauses required by the Federal statutes that are missing. In addition, we will continue strengthening our internal control procedures by documenting adequately our acquisition process.

Responsible Person: Contract Division Director/ Federal Programs Director
Implementation Date: April, 2011

Finding 6-10

We gave instructions to the responsible employee of the need to obtain the contractor's payrolls related to all construction projects, paid with Federal funds. In addition, the Municipality will assure that the contractor's payrolls were properly documented and the employee's wages were in accordance to the Department of Labor regulations.

Responsible Person: Federal Programs Director
Implementation Date: April, 2011

Finding 7-10

The Mayor gave instructions to the Federal Programs Director, to find the quarterly report that is missing. In addition, the Municipality will continue strengthening the internal controls over the recordkeeping of the quarterly reports of the CDBG Program.

Responsible Person: Federal Programs Director
Implementation Date: Immediately

Finding 8-10

The ARRA CDBG funds were fully expended within the current CDBG account. This situation will be prevented for futures grants.

Responsible Person: Federal Programs Director
Implementation Date: Not Applicable