



Accountants &
business advisers

SINGLE AUDIT

**COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA**

JUNE 30, 2011

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INDEPENDENT AUDITOR'S REPORT

To the Honorable Mayor and
Members of the Municipal Legislature
Commonwealth of Puerto Rico
Municipality of Carolina
Carolina, Puerto Rico

We have audited the accompanying basic financial statements of the governmental activities, each major fund and the aggregate remaining fund information of the Commonwealth of Puerto Rico, Municipality of Carolina as of and for the fiscal years ended June 30, 2011, which collectively comprise the Municipality's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Municipality's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in the Government Auditing Standards, issued by the Comptroller General of the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the 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.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the governmental activities, each major fund, and the aggregate remaining governmental fund information of the Commonwealth of Puerto Rico, Municipality of Carolina, as of June 30, 2011, and the changes in financial position, where applicable, thereof for the fiscal years then ended in conformity with accounting principles generally accepted in the United States of America.

To the Honorable Mayor and
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Municipality of Carolina
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In accordance with Government Auditing Standards, we have also issued our report dated February 3, 2012 on our consideration of the Municipality's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grants agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and budgetary comparison information on pages 4 through 24 and 85 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.

To the Honorable Mayor and
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Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Commonwealth of Puerto Rico, Municipality of Carolina's basic financial statements. The 14.871 Housing Choice Voucher balance sheet and, program revenue and expense summaries on pages 86 through 87 are presented for purposes of additional analysis and are not a required part of the basic financial statements. The schedule of expenditures of federal awards on pages 92 through 93 is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations, and is also not a required part of the basic financial statements. The 14.871 Housing Choice Voucher summaries and the schedule of expenditures of federal awards are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the basic financial statements as a whole.

*PKF, LLP*

License No. 22
Expires December 1, 2013

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA

MANAGEMENT'S DISCUSSION AND ANALYSIS
FISCAL YEAR ENDED JUNE 30, 2011

As management of the Municipality of Carolina (the Municipality), we offer readers the following discussion and analysis of the Municipality's financial activities reported in the accompanying basic financial statements for the fiscal year ended June 30, 2011. We encourage readers to consider the information presented here in conjunction with additional information that we have furnished in the accompanying basic financial statements.

During fiscal year ended June 30, 2002, the Municipality implemented the new required financial reporting standards established by Statement No. 34, *Basic Financial Statements and Management Discussion and Analysis for the State and Local Governments*, issued by the Government Accounting Standards Board (commonly known as GASB 34). According to this statement, significant required changes in content and structure have been made in the accompanying Municipality's basic financial statements as of and for the fiscal year ended June 30, 2011, which make the accompanying basic financial statements not easily comparable to the Municipality's general purpose financial statements issued in prior years.

This Management's Discussion and Analysis (MD&A) is prepared as a result of the requirement of GASB 34, and it has been designed accordingly with the following goals:

- a) Assist the reader in focusing on significant financial issues,
- b) Provide an overview of the Municipality's financial activity,
- c) Identify changes in the Municipality's financial position (its ability to address the next and subsequent year challenges),
- d) Identify any material deviations from the financial plan (the approved budget), and
- e) Identify individual fund issues or concerns.

Since the MD&A is designed to focus on the current year activities, resulting changes and currently known facts, please read it in conjunction with the accompanying basic financial statements.

FINANCIAL HIGHLIGHTS

Government-Wide Highlights:

- The Municipality's assets exceeded its liabilities (net assets) by \$1,717,214,953 at June 30, 2011, for an increase of \$3,791,102 as compared with last fiscal year. Of this amount \$26,857,795 are unrestricted. Net assets may be used to meet the Municipality's current operations.
- The Municipality's assets increased from \$2,146,690,296 at June 30, 2010 to \$2,158,633,301 at June 30, 2011, for an increase of \$11,943,005.
- The liabilities of the Municipality increased from \$433,266,445 at June 30, 2010 to \$441,418,348 at June 30, 2011, for an increase of \$8,151,903.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)
FISCAL YEAR ENDED JUNE 30, 2011

- The revenues of the Municipality increased from \$189,129,113 for the fiscal year ended June 30, 2010 to \$189,546,439 for the fiscal year ended June 30, 2011, for an increase of \$417,326.
- The Municipality's expenses increased from \$159,294,795 for the fiscal year ended June 30, 2010 to \$187,877,980 for the fiscal year ended June 30, 2011, for an increase of \$28,583,185.

Governmental Funds Highlights:

- The total fund balances of governmental funds amounted to \$168,985,765 at June 30, 2011, decreased by \$21,222,813 (excess of revenues and other financing sources over expenditures and other financing uses) during fiscal year ended June 30, 2011.
- The total assets of governmental funds decreased from \$276,912,829 at June 30, 2010 to \$258,853,212 at June 30, 2011, for a decrease of \$18,059,617.
- The governmental fund's total liabilities increased from \$86,704,251 at June 30, 2010 to \$89,867,447 at June 30, 2011, for an increase of \$3,163,196.
- The total revenues of governmental funds decreased from \$189,129,113 for the fiscal year ended June 30, 2010 to \$188,984,646 for the fiscal year ended June 30, 2011, for a decrease of \$144,467.
- The governmental fund's total expenditures decreased from \$237,996,018 for the fiscal year ended June 30, 2010 to \$236,366,578 for the fiscal year ended June 30, 2011, for a decrease of \$1,629,440.
- Other financing sources (uses), net of governmental funds decreased from \$60,105,000 for the fiscal year ended June 30, 2010 to \$23,395,000 for the fiscal year ended June 30, 2011, for a decrease of \$36,710,000.

OVERVIEW OF THE BASIC FINANCIAL STATEMENTS

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

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)
FISCAL YEAR ENDED JUNE 30, 2011

This narrative represents an overview and analysis of the financial statements of the Municipality for the fiscal year ended June 30, 2011. Because this MD&A is designed to focus on the current year activities, resulting changes and currently known facts, we encourage readers to consider the information presented in this MD&A in conjunction with the additional information furnished in the accompanying basic financial statements. The Municipality's basic financial statements include three components: 1) the government-wide financial statements (GWFS), 2) governmental fund financial statements (GFFS), and 3) notes to the basic financial statements (NBFS).

This report also contains additional required supplementary information (budgetary schedule) in addition to the basic financial statements themselves. These components are described below.

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

a) Government-Wide Financial Statements

The government wide financial statements (GWSF) are composed of: (1) the statements of net assets (SNA) and (2) the statement of activities (SA). These financial statements can be found immediately following this MD&A. GWFS are designed to provide readers with a broad overview of the Municipality's operations as a whole in a manner similar to private-sector business. These statements provide short-term and long-term information about the Municipality's financial position, which assist the Municipality's management to determine the economic condition at June 30, 2011. The GWFS present the financial position of the Municipality from the economic resources measurement focus using the accrual basis of accounting.

Statement of Net Assets

The purpose of SNA is to attempt to report all assets owned and all liabilities owed by the Municipality. The Municipality reports of all of its assets when it acquires ownership over the assets and reports all of its liabilities when they are incurred. For example, the Municipality reports buildings and infrastructure as assets, even though they are not available to pay the obligations incurred by the Municipality. On the other hand, the Municipality reports liabilities, such as claims and judgments or municipal solid waste landfill closure and post-closure care costs, even though these liabilities might not be paid until several fiscal years into the future.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)
FISCAL YEAR ENDED JUNE 30, 2011

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

Statement of Activities

The SA presents information showing how the Municipality's net assets changed during the fiscal year ended June 30, 2011, by presenting all of the Municipality's revenues and expenses. As previously discussed, the items reported in SA are measured in a manner similar to the approach used by a commercial enterprise in that revenues are recognized when earned or established criteria are satisfied and expenses are recorded when incurred by the Municipality.

Consequently, revenues are reported even when they may not be collected for several months after the end of the fiscal year and expenses are recorded even though they may not have used cash during the current year.

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

The focus of SA is on the net cost of various activities provided by the Municipality. The statement begins with a column that identifies the cost of each of the Municipality's major functions. Another column identifies the revenues that are specifically related to the classified governmental functions.

The difference between the expenses and revenues related to specific functions/programs identifies the extent to which each function of the Municipality draws from general revenues or is self-financing through fees, intergovernmental aid and other sources of resources. This statement also presents a comparison between direct expenses and program revenues for each function of the Municipality. GWFS and GFFS present all of the Municipality's governmental activities, which are supported mostly by taxes and intergovernmental revenues (such as federal and state grants and contributions).

COMMONWEALTH OF PUERTO RICO
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MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)
FISCAL YEAR ENDED JUNE 30, 2011

The SA is intended to summarize and simplify the user's analysis of the costs of governmental services. The governmental activities reflect basic services, including public safety, public works and transportation, solid waste disposal and sanitation, recreation and sports, education, public housing and building, recreation and sports, health, economic development activities and general government services. This statement also presents a comparison between direct expenses and program revenues for each function of the Municipality.

b) Governmental Fund Financial Statements

The GFFS are composed of: 1) balance sheet-governmental funds and 2) statement of revenues, expenditures and changes in fund balances-governmental funds. These financial statements report the financial position and results of operations of the Municipality's governmental funds, with an emphasis on the Municipality's major governmental funds.

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

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

The government fund financial statements provide a detailed short-term view of the Municipality's finances that assist in determining whether there will be adequate financial resources available to meet the current needs of the Municipality, that is to say, evaluating the Municipality's near-term financing requirements. For financial reporting purposes, the Municipality classifies its governmental funds within the following types: (1) general fund, (2) debt service fund, (3) capital project fund, (4) economic development fund and (5) workforce investment fund. Each major fund is presented in a separate column in the governmental funds balance sheet and the governmental funds statements of revenues, expenditures and changes in fund balances.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)
FISCAL YEAR ENDED JUNE 30, 2011

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

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

The Municipality has five major governmental funds. Each major fund is presented in a separate column in the governmental funds' balance sheet and the governmental funds' statement of revenues, expenditures and changes in fund balances. The five major governmental funds are: (1) general fund, (2) debt service fund, (3) permanent improvements bonds fund, (4) economic development fund and (5) workforce investment fund.

The differences of results between governmental activities and governmental funds are explained in a reconciliation schedule following each governmental fund financial statement.

c) Notes to Basic Financial Statements

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

d) Required Supplementary Information

The basic financial statements are followed by a section of required supplementary information consisting of a budgetary comparison between actual operating results with the original budget and the final amended budget for the general fund.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)
FISCAL YEAR ENDED JUNE 30, 2011

Financial Analysis of Government-Wide Financial Statements

The Municipality's overall financial position and operations for the last two fiscal years are summarized as follows, based on the information included in the accompanying GWFS:

Comparative Condensed Statement of Net Assets
Governmental Activities
Fiscal Years Ended June 30,

	<u>2011</u>	<u>2010</u>
Assets:		
Current assets	\$ 251,132,583	\$ 270,136,078
Noncurrent assets:		
Capital assets, net	1,905,972,136	1,875,032,801
Other noncurrent assets	<u>1,528,582</u>	<u>1,521,417</u>
Total assets	<u>2,158,633,301</u>	<u>2,146,690,296</u>
Liabilities:		
Current liabilities	52,837,901	56,692,563
Long-term liabilities due within one year	32,325,038	19,908,013
Noncurrent liabilities:		
Long-term liabilities due after one year	<u>356,255,409</u>	<u>356,665,869</u>
Total liabilities	<u>441,418,348</u>	<u>433,266,445</u>
Net assets:		
Invested in capital assets, net of related debt	1,557,596,146	1,533,084,820
Restricted	132,761,012	144,986,316
Unrestricted	<u>26,857,795</u>	<u>35,352,715</u>
Total net assets	<u>\$ 1,717,214,953</u>	<u>\$ 1,713,423,851</u>

As noted earlier, net assets may serve over time as useful indicator of the Municipality's financial position. In the case of the Municipality, net assets (excess of assets over liabilities) amounted to \$1,717,214,953 at June 30, 2011.

The Municipality's current assets amounting to \$251,132,583 are mainly composed of restricted cash (\$137,852,523), unrestricted cash and certificates of deposits (\$72,330,336), federal grants receivables (\$27,616,040), property taxes receivable (\$3,847,551) and municipal license taxes receivable (\$3,573,362).

COMMONWEALTH OF PUERTO RICO
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MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)
FISCAL YEAR ENDED JUNE 30, 2011

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

The short-term investments in certificates of deposit are unrestricted and available to meet operational needs and obligations with citizens and creditors. Restricted property taxes receivable represent resources set aside to redeem the bonds of the Municipality in minimum annual or biannual principal and interest payments.

The Municipality's non-current assets, amounting to \$1,907,500,718 at June 30, 2011, are substantially composed of capital assets, with a cost basis of \$2,016,682,481, which are reported net of accumulated depreciation, and amortization of \$110,710,345.

At June 30, 2011, the Municipality's current liabilities amounting to \$85,162,939 are mainly composed of unearned revenues (\$30,343,897), the portions due within one year of bonds and notes payable (\$19,071,100), accounts payables and accrued liabilities (\$16,374,164) and due to other government agencies (\$6,433,181). Unearned revenues principally consist of municipal license taxes. As noted in the condensed statements of net assets, the Municipality's current assets exceeded current liabilities by \$165,969,644 for a current ratio (current assets to current liabilities) of 2.95 to 1.

The Municipality's noncurrent liabilities, amounting to \$356,255,409 at June 30, 2011, are mainly composed of portions due after one year of bonds and notes payable (\$329,304,890), compensated absences (\$11,814,673), interest due for account sold (\$6,349,644), governmental agencies payables (\$3,689,977), estimated liability for the municipal solid waste landfill closure and post closure care costs (\$2,568,700) and accrued legal claims (\$2,527,525).

The largest portions of the Municipality's net assets are invested in capital assets net of their related debt which amount to \$1,557,596,146. The Municipality's net assets are also composed of net assets amounting to \$132,761,012 that are restricted for (1) future debt service payments and (2) the future acquisition or construction of capital assets. In addition, the Municipality's net assets are reported net of an unrestricted net asset of \$26,857,795.

The portion of the Municipality's net assets invested in capital assets, such as land, buildings, equipment and infrastructure (roads, improvements and other immovable assets), less any outstanding related debt used to acquire those assets, are used by the Municipality to provide services to its citizens. Consequentially, these assets are not available for future spending. Although the Municipality's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)
FISCAL YEAR ENDED JUNE 30, 2011

The restricted net assets represent resources that are subject to external restrictions on how they may be used. The remaining balance of unrestricted net assets may be used to meet the Municipality's ongoing obligations to residents and creditors. Internally imposed designations of resources are not presented as restricted net assets.

Comparative Condensed Statement of Activities
Governmental Activities
Fiscal Years Ended June 30,

	2011	2010
Program Revenues:		
Operating grants and contributions	\$ 26,988,629	\$ 29,972,092
Capital grants and contributions	1,430,279	2,380,933
Charges for services	1,901,950	2,111,541
Total program revenues	30,320,858	34,464,566
General Revenues:		
Property taxes	81,060,593	70,821,319
Municipal license taxes	31,767,564	35,150,899
Sales taxes	20,486,968	21,103,090
Construction excise and permits	6,475,308	6,374,536
Intergovernmental grant	15,452,369	17,144,153
Other general revenues	3,982,779	4,070,550
Total general revenue	159,225,581	154,664,547
Total revenues	189,546,439	189,129,113
Program expenses:		
General government	42,846,416	37,044,843
Public safety	16,302,905	12,928,584
Public works, streets and transportation	42,321,809	45,129,493
Sanitation	19,371,724	13,640,145
Health	7,885,802	7,885,802
Recreation and sports	6,439,321	2,610,088
Education and training	13,946,864	9,589,842
Housing and buildings	14,301,279	9,365,218
Economics development	4,369,065	2,732,155
Welfare	5,569,777	4,729,405
Employment opportunities	2,728,131	3,697,151
Interest on long-term obligations	11,794,887	9,942,069
Total expenses	187,877,980	159,294,795
Increase in net assets	1,668,459	29,834,318
Net assets, at beginning of fiscal year	1,713,423,851	1,698,174,125
Prior period adjustments	2,122,643	(14,584,592)
Net assets, at beginning of fiscal year (restated)	1,715,546,494	1,683,589,533
Net assets, at end of fiscal year	\$ 1,717,214,953	\$ 1,713,423,851

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)
FISCAL YEAR ENDED JUNE 30, 2011

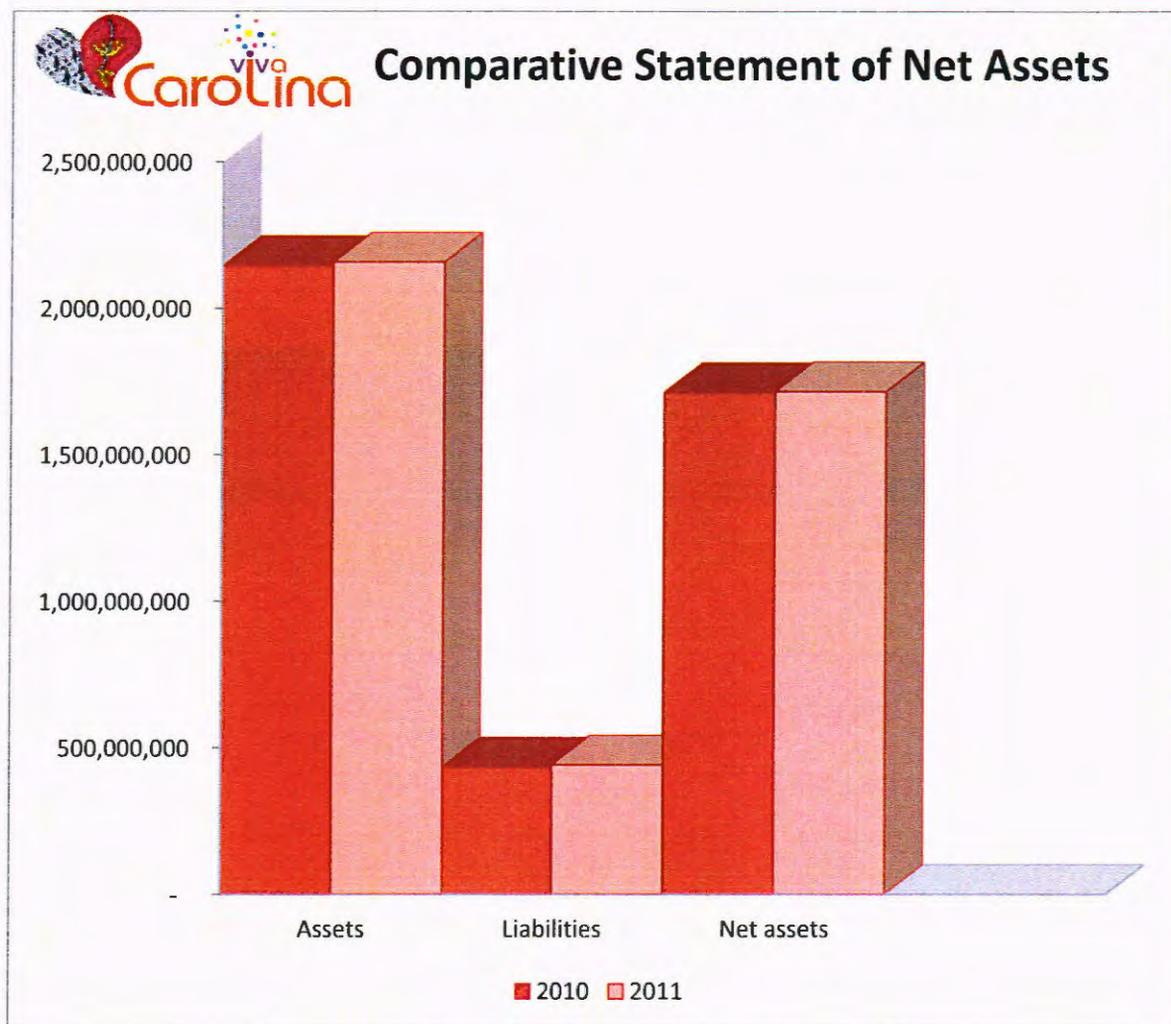
The total revenues of the Municipality increased from \$189,129,113 for the fiscal year ended June 30, 2010 to \$189,546,439 for the fiscal year ended June 30, 2011, for an increase of \$417,326. Of this amount, \$139,790,433 (74%) came from property taxes, municipal license, sales taxes and construction excise and permits, while \$28,418,908 came from capital and operating grants and contributions and \$1,901,950 (1%) came from charges for services. The most significant fluctuations among the current fiscal year revenues and those of the prior fiscal year were as follows:

- Total program revenues (Operating grants and contributions, capital grants and charge for service) decreased by \$4,143,708 during the fiscal year.
- Property taxes increased by \$10,239,724 during the fiscal year.
- Municipal license, sales taxes and intergovernmental grants decreased by \$3,383,335, \$616,122 and \$1,691,784, respectively as compared with last fiscal year.
- The Municipality's expenses cover a wide range of services. During fiscal year 2010-11, the Municipality's total expenses increased from \$159,294,795 for the fiscal year ended June 30, 2010 to \$187,877,980 for the fiscal year ended June 30, 2011, for an increase of \$28,583,185.
- The largest expenses were related to capital improvements to streets, public works and transportation (\$42,321,809) and general administrating and operating costs (\$42,846,416), which were classified as "general government".
- Public works, streets and transportation expenses decreased by \$2,807,684, while public safety, sanitation, recreation and sports, education, public housing and economic development, increased by \$3,374,321, \$5,731,579, \$3,829,233, \$4,357,022, \$4,936,061 and \$1,636,910, respectively as compared with last fiscal year.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)
FISCAL YEAR ENDED JUNE 30, 2011

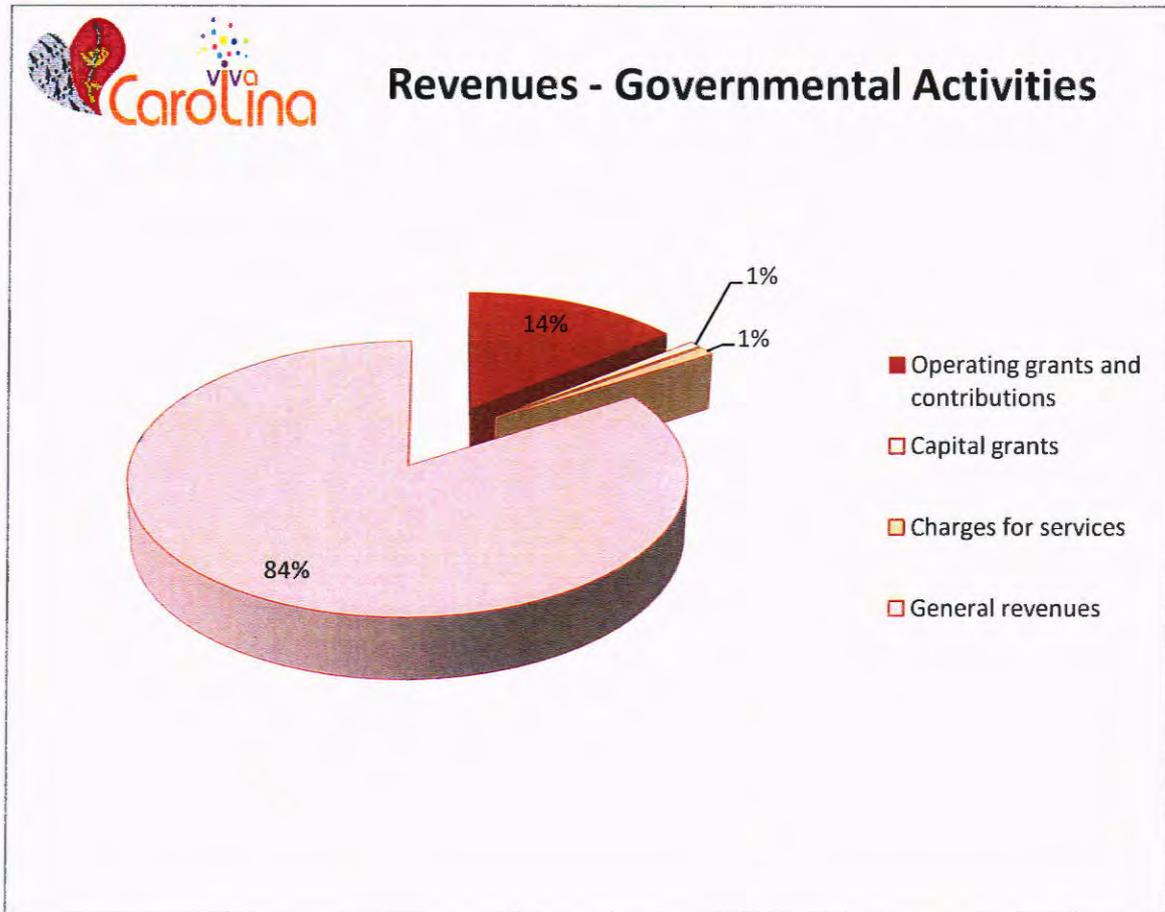
The following table presents the comparative statements of net assets for the fiscal years ended June 30, 2010 and 2011:



COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)
FISCAL YEAR ENDED JUNE 30, 2011

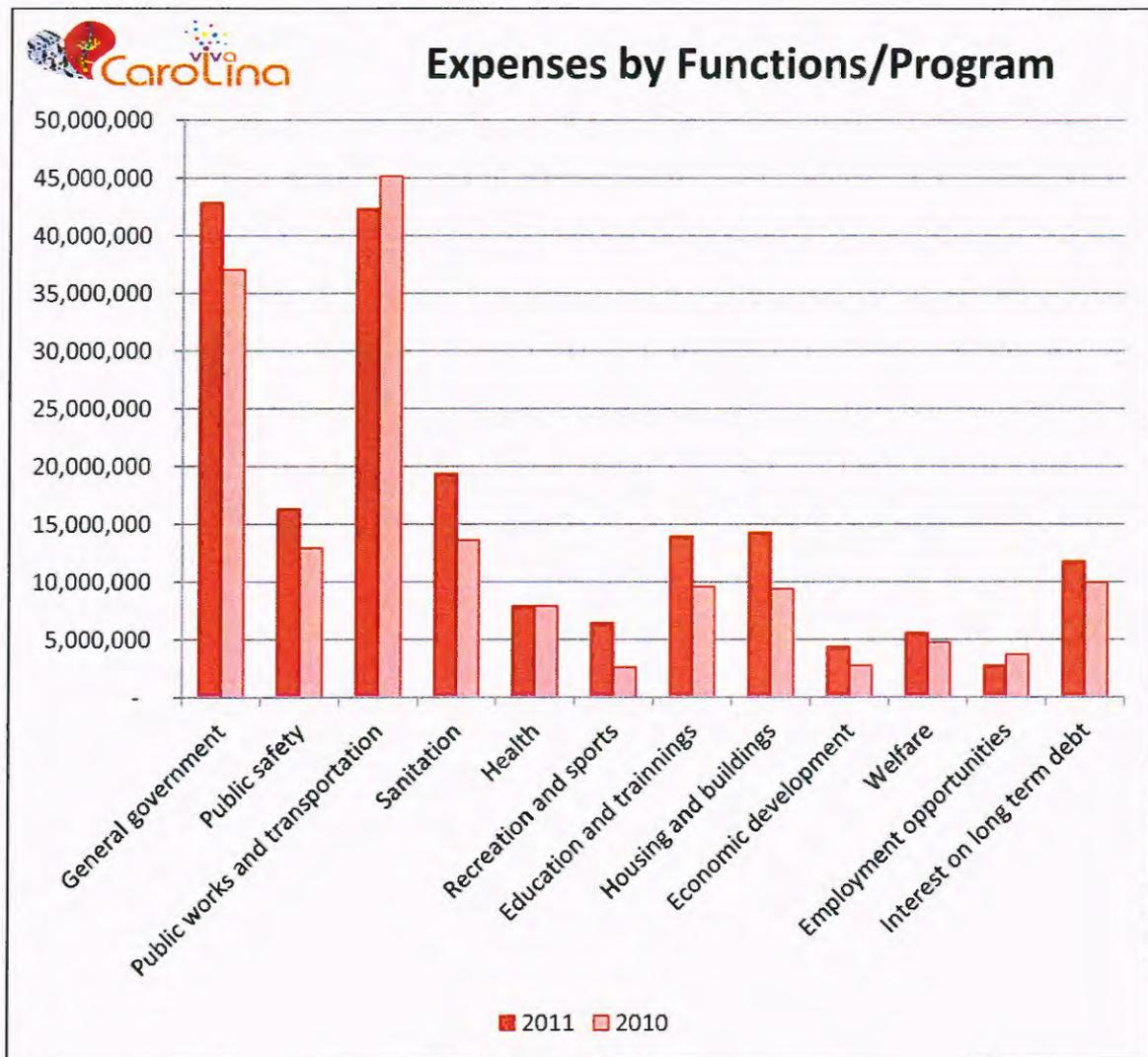
The following table presents the composition of revenues for the fiscal years ended June 30, 2011:



COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)
FISCAL YEAR ENDED JUNE 30, 2011

The following table presents the composition of expenses for the fiscal years ended June 30, 2011 and 2010:



COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)
FISCAL YEAR ENDED JUNE 30, 2011

Financial Analysis of Governmental Funds Financial Statements

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

At the end of the current fiscal year, Municipality's governmental funds reported a total fund balance of \$168,985,765, a decrease of \$21,222,813 as compared with last fiscal year. The following is a condensed comparative presentation of the Municipality's balance sheet of the governmental funds:

Comparative Condensed Balance Sheet
Governmental Funds
Fiscal Years Ended June 30,

	<u>2011</u>	<u>2010</u>
Assets:		
Total assets - major governmental funds	\$ 231,468,813	\$ 251,989,788
Total assets - other governmental funds	<u>27,384,399</u>	<u>24,923,041</u>
Total assets	<u>258,853,212</u>	<u>276,912,829</u>
Liabilities:		
Total liabilities - major governmental funds	76,949,829	76,028,578
Total liabilities - other governmental funds	<u>12,917,618</u>	<u>10,675,673</u>
Total liabilities	<u>89,867,447</u>	<u>86,704,251</u>
Fund balances:		
Restricted	111,413,234	100,907,150
Committed	55,717,940	86,044,012
Unrestricted	<u>1,854,591</u>	<u>3,257,416</u>
Total fund balance	<u>\$ 168,985,765</u>	<u>\$ 190,208,578</u>

At June 30, 2011, the total assets of governmental funds decreased by \$18,059,617 in comparison with the prior fiscal year principally for: (1) the decrease on investments in cash and certificates of deposits of \$24,877,484, (2) the increase in property taxes receivables (\$1,139,219), (3) a net increase in due from other funds (\$1,139,219), (4) a net increase in intergovernmental and federal grants (\$1,279,436) and (5) a net increase in other receivables (\$2,466,047).

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)
FISCAL YEAR ENDED JUNE 30, 2011

At June 30, 2011, the total liabilities of governmental funds increased by \$3,163,196 in comparison with the prior fiscal year principally for: (1) an increase of \$5,257,974 in deferred revenues, (2) a net increase of \$2,187,453 in matured bonds and interest payables, (3) a net decrease in due to intergovernmental agencies of \$2,941,995 and (4) a net decrease in accounts payables and accrued liabilities of \$1,134,852.

At the end of the current fiscal year, total unassigned fund balances of the governmental funds amounted to \$1,854,591, while total fund balance reached \$168,985,765. The following is a summarized financial analysis of the Municipality's Major funds as reported in the balance sheet:

General Fund (GF) – The GF's assets are mainly composed of unrestricted cash and certificate of deposits (\$71,760,322), due from other funds (\$4,423,781), municipal license taxes receivables (\$3,573,362) and sales taxes receivables (\$1,897,406). GF's liabilities are mainly composed of deferred municipal license taxes (\$30,343,897), due to government's agencies (\$6,321,042), accounts payable and accrued liabilities (\$6,942,913), and due to other funds (\$1,746,515).

Debt Service Fund (DSF) – The DSF's assets consist mainly of restricted cash with fiscal agent (\$56,216,257) and restricted property tax receivable (\$3,847,551). DSF's liabilities are mainly composed of matured bonds and notes principal payable (\$14,315,000), matured interest due and payable (\$4,110,294) and deferred revenues (\$3,479,053).

Capital Project Fund (CPF) – The CPF's assets are mainly composed of unrestricted and restricted cash (\$70,328,159), due from contractors (\$2,343,271), and due from other funds (\$813,810). CPF's liabilities are mainly composed of accounts payable (\$6,602,022).

Economic Development Fund (EDF) – The EDF's assets are mainly composed of unrestricted and restricted cash (\$7,650,000) and federal grants receivables (\$6,725,055). EDF's liabilities are mainly composed of accounts payables and short-term loans to other funds (\$1,149,673).

Workforce Investment Act Fund (WIAF) – The WIAF's assets consist mainly of federal grants receivables (\$238,294). WIAF's liabilities are mainly composed of accounts payables and accrued liabilities (\$213,975).

Other Governmental Fund (OGF) – The OGF's total assets are mainly composed of restricted cash (\$4,225,981), federal grants receivable (\$20,652,691) and due from other funds (\$2,000,552). The OGF's liabilities are principally composed of due to other funds (\$4,076,655), deferred federal revenues (\$5,619,000) and accounts payables and accrued liabilities (\$2,405,833).

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)
FISCAL YEAR ENDED JUNE 30, 2011

Comparative Condensed Statement of Revenues, Expenditures and
Changes in Fund Balances - Governmental Funds
Fiscal Years Ended June 30,

	<u>2011</u>	<u>2010</u>
Revenues:		
Total revenues - major governmental funds	\$ 167,702,077	\$ 167,021,169
Total revenues - other governmental funds	<u>21,282,569</u>	<u>22,107,944</u>
Total revenues	<u>188,984,646</u>	<u>189,129,113</u>
Expenditures		
Total expenditures - major governmental funds	214,638,784	220,869,603
Total expenditures - other governmental funds	<u>21,727,794</u>	<u>17,126,415</u>
Total expenditures	<u>236,366,578</u>	<u>237,996,018</u>
Excess of revenues over (expenditures)	(47,381,932)	(48,866,905)
Other financing sources (uses), net:		
Proceeds from debt issuance - major funds	23,395,000	60,105,000
Transfer from other funds - major funds	19,354,886	15,450,168
Transfer from other funds - other funds	1,513,196	1,163,522
Transfer to other funds - major funds	(20,153,683)	(15,917,958)
Transfer to other funds - other funds	<u>(714,399)</u>	<u>(695,732)</u>
Total other financing sources (uses), net	<u>23,395,000</u>	<u>60,105,000</u>
Net changes in fund balance	(23,986,932)	11,238,095
Fund balances, at beginning of fiscal year	190,208,578	173,785,743
Prior period adjustments	<u>2,764,119</u>	<u>5,184,740</u>
Fund balances, at beginning of fiscal year (restated)	<u>192,972,697</u>	<u>178,970,483</u>
Fund balances, at ending of fiscal year	<u>\$ 168,985,765</u>	<u>\$ 190,208,578</u>

The Municipality's total revenues decreased from \$189,129,113 for the fiscal year ended June 30, 2010 to \$188,984,646 for the fiscal year ended June 30, 2011, for a decrease of \$144,467. Of this amount, \$137,919,775(73%) came from property taxes, municipal license taxes, sales taxes and constriction excise and permits, while \$41,877,236 (22%) came from intergovernmental and federal grants. The most significant fluctuations among the current fiscal year revenues and those of the prior fiscal year were as follows:

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)
FISCAL YEAR ENDED JUNE 30, 2011

- Property taxes increased by \$9,550,499.
- Municipal licenses taxes and construction excise and permits decreased by \$3,383,335, and \$1,081,111, respectively.
- Intergovernmental contributions and federal grants decreased by \$2,956,258 and \$4,204,356, respectively as compared with last fiscal year.
- The Municipality's expenses cover a wide range of services. The largest expenses were related to capital improvements to streets, public works and transportation (\$45.1 million) and general administrating and operating costs (\$37 million), which were classified as "general government".
- During fiscal year 2010-11, the Municipality's total expenditures decreased from \$237,996,018 for the fiscal year ended June 30, 2010 to \$236,366,578 for the fiscal year ended June 30, 2011, for a decrease of \$1,629,440.

The following is a summarized financial analysis of the Municipality's major funds as reported in the statements of revenues, expenditures and changes in fund balances:

General Fund (GF)- The GF's revenues amounting to \$128,436,515 are mainly composed of property taxes (\$52,514,405), municipal license taxes (\$31,767,564), sales taxes (\$17,819,501), construction excise and permits (\$5,293,425), intergovernmental grants and contributions (\$13,866,897) and interest income (\$1,882,133).

The GF's expenditures amounting to \$129,898,931 are mainly composed of general administrative and operational costs (\$50,013,402), public safety operations (\$19,262,426), solid waste disposal, landfill operations and sanitation services (\$21,449,859), public works, transportation and improvements to streets (\$10,383,496) and health services (\$7,885,802). The most significant fluctuation between the current fiscal year expenditures and those of the prior fiscal year occurred in the public works and transportation and general government, for a decreased of \$5,921,776 and \$3,175,047, respectively. Otherwise, sanitation operations and recreation and sports expenditures reflect an increase of \$5,144,587 and \$1,726,074, respectively as compared with prior fiscal year.

Debt Service Fund (DSF) – The DSF's revenues consist mainly of restricted property taxes (\$27,857,413), restricted sales taxes (\$2,667,467) and operating transfer in for debt payment (\$7,622,312). The DSF's expenditures consist mainly of matured principal payments (\$18,127,617) and matured interest payments on loans (\$11,794,887).

Capital Project Fund (CPF) – The CPF's revenues are mainly composed of proceeds from debt issuance (\$23,395,000) and intergovernmental grants and contributions (\$1,430,279). The CPF's expenditures decreased from \$50,322,739 for the fiscal year ended June 30, 2010 to \$46,604,209 for the fiscal year ended June 30, 2011. Those expenditures were related to capital outlays which capitalized on government wide financial statements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)
FISCAL YEAR ENDED JUNE 30, 2011

Economic Development Fund (EDF) – The EDF's revenues and expenditures are mainly composed of federal grants (\$4,200,112) and economic development projects (\$5,162,194).

Workforce Investment Act Fund (WIAF) – The WIAF's revenues and expenditures consist mainly of federal grants (\$2,208,032) and direct benefits of employment opportunities to citizens (\$3,050,946).

Other Governmental Fund (OGF) – The OGF's total revenues are mainly composed of federal grants (\$20,142,362). The OGF's total expenditures are mainly composed of education (\$9,949,947), public housing projects (\$6,153,140), public works and transportation (\$2,871,493).

Capital Assets

The accompanying statement of net assets reported total gross Municipality's capital assets, at cost, amounting to \$2,016,682,481, of which \$531,476,436 represents buildings, infrastructure and improvements and \$124,306,139 relates to construction and infrastructure in progress at June 30, 2011. The accumulated depreciation of capital assets amounted to \$110,710,345, of which \$93,841,286 is related to buildings, infrastructure and improvements at June 30, 2011. This investment in capital assets includes buildings, infrastructure, land, machinery and equipments, park facilities, motor vehicles, construction in progress, landfill facilities, recycle plant and other capital assets. Infrastructure assets are items that are normally immovable and of value only to the municipal government, such as roads, bridges, streets and sidewalks, drainage systems, lighting systems, and similar items.

Actual costs incurred to purchase or construct capital assets were \$43,702,723 for the year ended June 30, 2011. Depreciation and amortization charges for the year ended totaled \$12,244,066. The Municipality finances a significant portion of its construction activities through bond issuances and state and federal grants. The proceeds from bond issuances designated for construction activities are committed in its entirety for such purpose and cannot be used for any other purposes. Major capital assets additions during fiscal year include:

- ❖ Purchase new vehicles for public works and municipal public transportation
- ❖ Capital improvements on roads and construction of buildings and other municipalities facilities
- ❖ Improvements to landfill and recreational facilities
- ❖ Specialized school infrastructure for excelling students in sciences, languages and technologies
- ❖ Acquisition of land for developments projects
- ❖ Purchase of equipment, furniture and fixtures

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)
FISCAL YEAR ENDED JUNE 30, 2011

Major additions to construction and infrastructure in progress (disbursements of more than \$580,000) as of June 30, 2011 are as follows:

<u>Project</u>	<u>Amount</u>
Museo y Parque del Niño	\$ 10,818,125
Mejoras ave. Roberto Clemente	3,300,805
Parque Acuático Aquasol-Balneario	2,620,361
Mejoras ave. Isla Verde	2,533,433
Museo de Historia y Arte de Carolina	1,833,820
Construcción sistema pluvial Villamar	1,413,955
Museo y Galería Los Gigantes	1,224,755
Mejoras antigua casa alcaldía	590,049
Mejoras sistema pluvial Felicita De León	<u>587,013</u>
 Total major capital additions for the fiscal year ended June 30, 2011	 <u>\$ 24,922,316</u>

Debt Administration

The laws and regulations of the Commonwealth of Puerto Rico have established a limitation for the issuance of general obligation bonds and notes for the payment of which the good faith, credit and taxing power of each municipality may be pledged.

The applicable laws and regulations also require that in order for a municipality to be able to issue additional general obligation bonds and notes, such municipality must have sufficient "payment capacity". Act No. 64 provides that a municipality has sufficient "payment capacity" to incur additional general obligation debt if the deposits in such Municipality's Redemption Fund and the annual amounts collected with respect to such Municipality's Special Additional Tax, as projected by the Government Development Bank for Puerto Rico, will be sufficient to service to maturity the Municipality's outstanding general obligation debt and the additional proposed general obligation debt ("payment capacity").

The Municipality is required under applicable laws and regulations to levy the Special Additional Tax in such amounts as shall be required for the payment of its general obligation municipal bonds and notes. In addition, principal and interest on all general obligation municipal bonds and notes issued in anticipation of the issuance of general obligation bonds issued by the Municipality constitute a first lien on the Municipality's Basic Tax revenues. Accordingly, the Municipality's Basic Tax revenues would be available to make debt service payments on general obligation municipal bonds and notes to the extent that the Special Additional Tax levied by the Municipality, together with moneys deposit in the Municipality's Redemption Fund.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)
FISCAL YEAR ENDED JUNE 30, 2011

Budgetary Highlights

The original budget of the general fund (operating fund) for the fiscal year ended June 30, 2011 amounted to \$98,748,188. Over the course of the fiscal year, the Municipality revised the general fund budget in order to include increases in revenues that were identified during course of the fiscal year based on current developments that positively affected the Municipality's finances. Generally, the Municipal Legislature authorized budget amendments for the following activities: 1) amendments made to adjust the estimates that are used to prepare the original budget ordinance once exact information is available; 2) amendments made to recognize new funding amounts from external sources, such as Federal Grants and State Grants; and 3) increases in appropriations that became necessary to maintain services.

During the current fiscal year, the original budget was revised to recognize an increase of \$4,703,782 in total budgeted revenues, to reach the total revised budget amount of \$103,451,970. Of this amount \$1,055,038 was from unreserved resources (readjustments) from prior years. Increases in budgeted expenditures were also made since the laws and regulations of the Commonwealth mandate a balanced budget. At June 30, 2011, the Municipality's total revised budget for all governmental funds was \$302.9 million.

The total actual revenues (budgetary basis) of the general fund for the fiscal year ended June 30, 2011 were \$102,905,338, which is \$546,632 (.53%) less than the budgeted revenues. The total variance was primarily attributed to decrease on property taxes of \$748,202, miscellaneous revenues decrease of \$98,431 and interest on deposits and investment decrease of \$521,670. On the other hand, during fiscal year 2010-11 the municipal license taxes increase by \$758,856.

The total actual expenditures (budgetary basis) of the general fund for the fiscal year ended June 30, 2011 were \$103,129,675, which is \$322,295 less than the budgeted expenditures. The favorable variance in expenditures was principally due to cost reduction initiative implemented by the Municipality, which emphasized in reducing general and administrative costs while increasing direct services to citizens.

Economic Factors and Next Year Budget

The Municipality provides a full range of services including public works, education, public safety, public housing, health, community development, culture, recreation and other administrative services. The municipality has a wide industrial base which includes the International Airport, hotels, large pharmaceuticals, wholesalers, retail stores, financial institutions, restaurants, among others. The Municipality has an unemployment rate of approximately of 12%, which is lower than the state average of 16% as of June 30, 2011.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)
FISCAL YEAR ENDED JUNE 30, 2011

The Municipality relies primarily on property taxes, municipal license taxes and sales taxes, as well as, federal and state grants to carry out its governmental activities. Historically, property and municipal license taxes have been very predictable with increases or decreases not generally exceeding ten percent. Federal grant revenues may vary if new grants are available but revenue is also very predictable.

Those factors were considered when preparing the Municipality's budget for the 2010-2011 fiscal year. There were no significant changes between the budgets for fiscal year 2009-2010 and the budgets for fiscal year 2010-2011.

Contacting the Municipality's Financial Management

The Municipality's financial statements are designed to provide a general overview of the Municipality's finances for all Carolina residents, taxpayers, customers, investors, and creditors. This financial report seeks to demonstrate the Municipality's accountability for the money it receives. Questions concerning any of the information provided in this report or request for additional information should be addressed to: Municipality of Carolina, Office of Mayor, P.O. Box 8, Carolina, Puerto Rico, 00986-0008.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA

Statement of Net Assets
June 30, 2011

ASSETS

Current assets:	
Cash and cash equivalents	\$ 89,467,174
Cash with fiscal agent	120,715,685
Municipal license taxes receivable	3,573,362
Sales taxes receivable	1,897,406
Due from other governments	999,468
Federal grants receivable	27,616,040
Property taxes receivable	3,847,551
Other receivables	<u>3,015,897</u>
Total current assets	<u>251,132,583</u>
Noncurrent assets:	
Capital assets, net	1,905,972,136
Bond issue costs	<u>1,528,582</u>
Total noncurrent assets	<u>1,907,500,718</u>
Total assets	<u>2,158,633,301</u>

LIABILITIES

Current liabilities:	
Bonds and notes payable	19,071,100
Accounts payable and accrued liabilities	16,374,164
Accrued legal claims	164,451
Accrued compensated absences	1,648,615
Interest payable	4,110,294
Due to other governments	6,433,181
LIMS refinancing debt	364,069
Interest due for accounts sold	317,482
Due to federal agency	716,686
Deferred municipal licenses taxes	30,343,897
Deferred federal revenue	<u>5,619,000</u>
Total current liabilities	<u>\$ 85,162,939</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA

Statement of Net Assets (continued)
June 30, 2011

Noncurrent liabilities, net of current portions:	
Bonds and notes payable	329,304,890
Landfill obligations	2,568,700
Due to other governments	3,689,977
Interest due for accounts sold	6,349,644
Accrued legal claims	2,527,525
Accrued compensated absences	<u>11,814,673</u>
Total noncurrent liabilities	<u>356,255,409</u>
	<u>441,418,348</u>
Total liabilities	
NET ASSETS	
Invested in capital assets, net of related debt	1,557,596,146
Restricted for:	
Economic development projects	13,771,082
Capital projects	66,649,571
Debt service	37,873,578
Other purposes	14,466,781
Unrestricted	<u>26,857,795</u>
Total net assets	<u>\$ 1,717,214,953</u>

See notes to financial statements

COMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA

Statement of Activities
For the Fiscal Year Ended June 30, 2011

<u>Functions and Programs</u>	<u>Expenses</u>	<u>Charges for services</u>	<u>Operating grants and contributions</u>	<u>Capital grants and contributions</u>	<u>Net (expenses) revenue and changes in net assets</u>
Governmental activities:					
General government	\$ 42,846,416	\$ 1,161,012	\$ -	\$ -	\$ (41,685,404)
Public safety	16,302,905	-	-	-	(16,302,905)
Public work, streets and transportatio	42,321,809	-	-	1,430,279	(40,891,530)
Sanitation	19,371,724	726,354	-	-	(18,645,370)
Health	7,885,802	-	-	-	(7,885,802)
Recreation and sports	6,439,321	-	-	-	(6,439,321)
Education and training	13,946,864	-	-	-	(13,946,864)
Housing	14,301,279	-	20,142,362	-	5,841,083
Economic development	4,369,065	14,584	4,638,235	-	283,754
Welfare	5,569,777	-	-	-	(5,569,777)
Employment opportunities	2,728,131	-	2,208,032	-	(520,099)
Interest	11,794,887	-	-	-	(11,794,887)
Total governmental activities	<u>187,877,980</u>	<u>1,901,950</u>	<u>26,988,629</u>	<u>1,430,279</u>	<u>(157,557,122)</u>
General revenues:					
					81,060,593
					31,767,564
					20,486,968
					6,475,308
					2,351,969
					15,452,369
					1,630,810
					<u>159,225,581</u>
					1,668,459
					<u>1,713,423,851</u>
					2,122,643
					<u>1,715,546,494</u>
					<u>\$ 1,717,214,953</u>

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA

Balance Sheet - Governmental Funds
June 30, 2011

	General	Debt Service	Capital Projects	Economic Development	Workforce Investment	Other Governmental	Total Governmental
ASSETS							
Cash and certificates of deposit	\$ 71,760,130	\$ -	\$ 5,828,923	\$ 7,650,000	\$ 2,140	\$ 4,225,981	\$ 89,467,174
Cash with fiscal agent	192	56,216,257	64,499,236	-	-	-	120,715,685
Municipal license taxes receivable	3,573,362	-	-	-	-	-	3,573,362
Sales taxes receivable	1,897,406	-	-	-	-	-	1,897,406
Due from other governments	292,615	-	572,981	36,495	-	97,377	999,468
Federal grants receivable	-	-	-	6,725,055	238,294	20,652,691	27,616,040
Due from other funds	4,423,781	-	813,810	617,790	-	2,000,552	7,855,933
Property taxes receivable	-	3,847,551	-	-	-	-	3,847,551
Other receivables	93,888	-	2,343,271	32,667	2,969	407,798	2,880,593
Total assets	\$ 82,041,374	\$ 60,063,808	\$ 74,058,221	\$ 15,062,007	\$ 243,403	27,384,399	\$ 258,853,212

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA

Balance Sheet Governmental Funds (continued)
June 30, 2011

	General	Debt Service	Capital Projects	Economic Development	Workforce Investment	Other Governmental	Total Governmental
LIABILITIES AND FUND BALANCES							
Liabilities:							
Accounts payable and accrued liabilities	\$ 6,942,913	\$ -	\$ 6,602,022	\$ 209,421	\$ 213,975	\$ 2,405,833	\$ 16,374,164
Bonds and notes payable	-	14,315,000	-	-	-	-	14,315,000
Interest payable	-	4,110,294	-	-	-	-	4,110,294
Due to other governments	6,321,042	-	-	-	20,595	-	6,341,637
Due to other funds	1,746,515	285,883	806,628	940,252	-	4,076,655	7,855,933
Due to federal agency	-	-	-	-	-	716,686	716,686
Deferred municipal license	30,343,897	-	-	-	-	-	30,343,897
Deferred federal revenue	-	-	-	-	-	5,619,000	5,619,000
Other deferred revenue	471,087	3,479,053	-	141,252	-	99,444	4,190,836
Total liabilities	45,825,454	22,190,230	7,408,650	1,290,925	234,570	12,917,618	89,867,447
Fund balances:							
Restricted	18,430,807	37,873,578	34,735,740	9,762,750	8,833	10,601,526	111,413,234
Committed	15,930,522	-	31,913,831	4,008,332	-	3,865,255	55,717,940
Unassigned	1,854,591	-	-	-	-	-	1,854,591
Total fund balances	36,215,920	37,873,578	66,649,571	13,771,082	8,833	14,466,781	168,985,765
Total liabilities and fund balances	\$ 82,041,374	\$ 60,063,808	\$ 74,058,221	\$ 15,062,007	\$ 243,403	\$ 27,384,399	\$ 258,853,212

See notes to financial statements

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA

Reconciliation of the Balance Sheet to the Statement of
Net Assets - Governmental Funds
Fiscal Year Ended June 30, 2011

Total fund balance of governmental fund	\$ 168,985,765
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 not reported in the funds	1,905,972,136
Bond issue costs of governmental activities are not financial resources and not reported as assets in the funds	1,528,582
Other economic resources used in governmental activities are not financial resources and not reported as revenue in the funds	4,326,140
Other long-term liabilities, such as accrued compensated absences, litigations, LIMS debt, interest of accounts sold current year and other contingencies are not available to pay for expenditures and therefore not reported in the funds	(29,536,680)
General obligation bonds, special and federal loans are not due and payable in the current period and therefore not reported in the funds	<u>(334,060,990)</u>
Total net assets of governmental activities	<u>\$ 1,717,214,953</u>

See notes to financial statements

COMMONWEALTH OF PUERTO RICO
Municipality of Carolina
Statement of Revenues, Expenditures and Changes in Fund Balances
Governmental Funds
Fiscal Year Ended June 30, 2011

	General	Debt Service	Capital Projects	Economic Development	Workforce Investment	Other Governmental	Total Governmental
Revenues :							
Property Taxes	\$ 52,514,405	\$ 27,857,413	\$ -	\$ -	\$ -	\$ -	\$ 80,371,818
Municipal license taxes	31,767,564	-	-	-	-	-	31,767,564
Sales taxes	17,819,501	2,667,467	-	-	-	-	20,486,968
Construction excise permits	6,468,284	-	-	-	-	7,024	6,475,308
Federal grants	-	-	-	4,200,112	2,208,032	20,142,362	26,550,506
Interest income	1,882,133	5,056	302,680	14,1816	-	20,284	2,351,969
Intergovernmental	15,422,815	-	1,430,279	-	-	29,554	16,882,648
Landfill	726,354	-	-	-	-	-	726,354
Rent	1,161,012	-	-	438,123	-	126,982	1,726,117
Other	674,447	-	-	14,584	-	956,363	1,645,394
Total revenues	128,436,515	30,529,936	1,732,959	4,794,635	2,208,032	21,282,569	188,984,646
Expenditures:							
General government	50,013,402	-	611,067	-	-	-	50,624,469
Public safety	19,262,426	-	-	-	-	-	19,262,426
Public work, streets and transportation	10,383,496	-	36,749,638	-	-	2,871,493	50,004,627
Sanitation	21,449,859	-	1,438,479	-	-	-	22,888,338
Health	7,885,802	-	-	-	-	-	7,885,802
Recreation and sports	4,975,166	-	1,321,742	-	-	1,311,365	7,608,273
Education and training	5,403,078	-	1,125,659	-	-	9,949,947	16,478,684
Housing	5,386,676	-	5,357,624	-	-	6,153,138	16,897,438
Economic development	-	-	-	5,162,194	-	-	5,162,194
Welfare	5,139,026	-	-	-	-	1,441,851	6,580,877
Employment opportunity	-	-	-	-	3,050,946	-	3,050,946
Debt service payments	-	29,922,504	-	-	-	-	29,922,504
Total expenditures	129,898,931	29,922,504	46,604,209	5,162,194	3,050,946	21,727,794	236,366,578
Other financing sources (uses) :							
Proceeds from debt issuance	-	-	23,395,000	-	-	-	23,395,000
Operating transfer in	1,278,929	7,622,312	10,276,202	177,443	-	1,513,196	20,868,082
Operating transfer out	(15,948,390)	-	(2,381,861)	(1,823,432)	-	(714,399)	(20,868,082)
Other financing sources (uses)	(14,669,461)	7,622,312	31,289,341	(1,645,989)	-	798,797	23,395,000
Excess (deficiency) of revenues and other financing sources over expenditures and other financing uses	(16,131,877)	8,229,744	(13,581,909)	(2,013,548)	(842,914)	353,572	(23,986,932)
Fund balances at beginning of fiscal year (as previously reported)	48,944,615	29,643,834	80,644,569	15,784,630	943,562	14,247,368	190,208,578
Prior period adjustments	3,403,182	-	(413,089)	-	(91,815)	(134,159)	2,764,119
Fund balances at beginning of fiscal year (as restated)	52,347,797	29,643,834	80,231,480	15,784,630	851,747	14,113,209	192,972,697
Fund balances at end of fiscal year	\$ 36,215,920	\$ 37,873,578	\$ 66,649,571	\$ 13,771,082	\$ 8,833	\$ 14,466,781	\$ 168,985,765

See notes to financial statements

OK May 19/04/2012

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA

Reconciliation of the Statement of Revenues, Expenditures and
Changes in Fund Balances of Governmental Funds
to the Statement of Activities
For the Fiscal Year Ended June 30, 2011

(Deficiency) of revenues and other financing sources over expenditures and other financing uses - total governmental funds	\$ (23,986,932)
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Amounts reported in the statement of activities are different because:

Governmental funds report capital outlays as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives as depreciation expense. This is the amount by which capital outlays exceeded depreciation in the current period.	31,458,657
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Revenues in the statement of activities that do not provide current financial resources are not reported as revenues in the funds.	688,776
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Repayment of debt principal is an expenditure in the governmental funds, but the repayment reduces long term liabilities in the statement of net assets.	18,127,617
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Proceeds from debt issuance are other financing sources in the governmental funds but such proceeds increase long term liabilities in the statement of net assets.	(23,395,000)
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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 the governmental funds.	<u>(1,224,659)</u>
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Change in net assets of governmental activities	<u>\$ 1,668,459</u>
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See notes to financial statements

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA

NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2011

Note 1 - Governmental Entity and Summary of Significant Accounting Policies

Government Background Information

The Municipality of Carolina (the Municipality) is a local municipal government constituted on 1857 in the Commonwealth of Puerto Rico (the Commonwealth). The Municipality has full legislative, fiscal and all other governmental powers and responsibilities expressly assigned by the Public Act No. 81 of August 30, 1991, as amended, known as *Autonomous Municipalities Act of the Commonwealth of Puerto Rico* (Act No. 81). The Municipality is one of seventy-eight municipalities legally separated from the Commonwealth's government.

The laws and regulations of the Commonwealth provide for separation of powers of the executive, legislative, judicial branches of the Commonwealth and the municipalities. However, the Municipality's governmental system consists of executive and legislative branches only. The executive power of the Municipality is exercised by a Mayor, who is elected every four years in the general elections of Puerto Rico. The legislative power of the Municipality is exercised by the Municipal Legislature, which is also elected every four years. The judiciary power is exercised by the General Justice Court System of the Commonwealth, which has jurisdiction over the Municipality.

The Municipality assumes either partial or full responsibility for providing services to its citizens related to public housing, welfare, public safety, health, sanitation, education, culture, recreation, urban and economic developments, employment opportunities, public transportation and many other fiscal, general and administrative services.

Financial Reporting Model

The accompanying basic financial statements present the financial position and the results of operations of the Municipality as a whole and its various governmental funds as of and for the fiscal year ended June 30, 2011, in conformity with accounting principles generally accepted in the United States of America (GAAP), as prescribed by the Governmental Accounting Standards Board (GASB).

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

Government Wide Financial Statements ("GWFS") – The accompanying GWFS is a set of financial statements composed of: (1) a statement of net assets and (2) a statement of activities. These statements report financial information for the Municipality as a whole.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA

NOTES TO FINANCIAL STATEMENTS (continued)
JUNE 30, 2011

The GWFS are aimed at presenting a broad overview of the Municipality's finances by focusing on operational accountability through reporting the financial position and results of operations of the Municipality as a whole using methods that are similar to those used by most private business.

The focus of GWFS is on the operational accountability of the Municipality as a single economic unit and not on compliance with budgets, regulatory requirements or on the use of available or currently expendable financial resources (referred to as fiscal accountability). Operational accountability is the Municipality's responsibility to report to the extent to which it has met its operating objectives efficiently and effectively, using all resources available for that purpose. It focuses on the Municipality's principal operating objective, which is to provide services to its citizens.

The accompanying statement of net assets provides short-term and long-term information about the Municipality's financial position, by presenting all the Municipality's assets and liabilities, with the difference between these two items reported as "net assets" (equity) and or net liabilities. This statement assists management in assessing the level of services that can be provided by the Municipality in the future and its ability to meet its obligations as they become due. In addition, this statement reports the extent to which the Municipality has invested in capital assets and discloses legal and contractual restrictions on resources.

Net assets are reported in the accompanying statement of net assets within the following three categories:

- Invested in Capital Assets, Net of Related Debt – This net asset category 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. For the purposes of determining the outstanding debt attributed to capital assets, the total long-term debt related to the acquisition, construction or improvement of capital assets has been reduced by any related unspent debt proceeds and any unamortized debt issuance costs.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA

NOTES TO FINANCIAL STATEMENTS (continued)
JUNE 30, 2011

- **Restricted Net Assets** – This net asset category consists of net resources restricted by external parties (such as creditors, grantors, contributors, laws or regulations of other governments, etc.), or net assets for which constraints are imposed by constitutionally provisions or enabling legislation. Enabling legislation consists of legislation that authorizes the Municipality to assess, levy, charges or otherwise mandate payment of resources (from external resources providers) and establishes restrictions if it includes a legally enforceable that those resources be used only for the specific purposes stipulated in the legislation.

The classification of restricted net assets identifies resources that have been received or earned by the Municipality with an explicit understanding between the Municipality and the resources providers that the resources would be used for specific purposes. Grants, contributions and donations are often given under those kinds of conditions. Bond indentures also often limit the use of bond proceeds to specific purposes.

Internally imposed designations of resources, including earmarking, are not presented as restricted net assets. These designations consist of management's plans for the use of resources, which are subject to change at the discretion of the Municipal Legislature.

The Municipality has reported the following types of restricted net assets in the accompanying statement of net assets:

- (1) *Economic Development Projects* – Represent net resources available from federal grants and loans provided by the U.S. Department of Housing and Urban Development (HUD), which have been set aside to cover different activities related to economic developments projects. Generally, these are used to provide multipurpose services, construction or improvements of certain capital assets.
 - (2) *Capital Projects* – Represent net resources available to finance the acquisition, construction or improvement of major capital assets under contracts and other commitments.
 - (3) *Debt Services* – Represent net resources available to cover future debt service payments of bonds and notes payable.
 - (4) *Other Governmental Activities* – Represent net resources available from certain federal and state grants, which have been set aside to carry out several programs.
- **Unrestricted Net Assets** – This net asset category consists of net assets which do not met the definition of the two preceding categories. Unrestricted net assets often are designed 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.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA

NOTES TO FINANCIAL STATEMENTS (continued)
JUNE 30, 2011

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

The accompanying statement of activities presents the Municipality's result of operations by showing, how the Municipality's net assets changed during the year ended June 30, 2011, using a net (expense) revenue format. This statement presents the cost of each function/program as well as the extent to which each of the Municipality's functions, programs or other services either contributes to or draws from the Municipality's general revenues (such as property taxes, municipal license taxes, construction excise taxes, etc.)

A function/program describes a group of activities that are aimed at accomplishing a major service or regulatory responsibility. The functions/programs reported in the accompanying basic financial statements are: (1) general government, (2) public safety, (3) public works, streets and transportation, (4) sanitation, (5) health, (6) recreation and sports, (7) education, (8) housing and buildings, (9) economic development, (10) welfare and (11) employment opportunities.

The statement of activities demonstrates the degree to which *program revenues* offset *direct expenses* of a given function/program or segments. Direct expenses are those that are clearly identifiable with a specific function, segment or operational unit. This statement reports revenues in two broad categories: (1) program revenues and (2) general revenues.

Program revenues are generated directly from a program itself or may come from parties outside the Municipality's taxpayers or citizens. In the statement of activities, program revenues reduce the costs (expenses) of the function/program to arrive at the net cost of the function/program that must be financed from the Municipality's general revenues. The accompanying statement of activities separately reports the following categories of program revenues:

(1) Charges for Services - These revenues generally consist of exchange or exchange-like transactions involving charges to customers or applicants, who purchase, use or directly from goods, services or privileges provided, or are otherwise directly affected by the services. These revenues include fees charged for specific services, charges for licenses and permits and fines and forfeitures, among others.

(2) Operating and Capital Grants and Contributions – These revenue consist of transactions that are either mandatory or voluntary non-exchange transactions with other governments, organizations, or individuals that restrict the resources for use in a particular program. Operating grants and contributions consist of resources that are required to be used to finance the costs of operating a specific program or can be used either for operating or capital purposes of a specific program. Capital grants and contributions consist of revenues or resources that are restricted for a capital purposes – to purchase, construct or renovate capital assets associated with a specific program. Restricted operating and capital grants and contributions are program revenues because they are specifically attributable to a program and reduce the net expense of that program to the Municipality. They are reported net of estimated uncollectible amounts.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA

NOTES TO FINANCIAL STATEMENTS (continued)
JUNE 30, 2011

General revenues are default category for revenues. It includes all revenues and gains that do not meet the definition of program revenues. Property taxes, municipal license taxes, sales taxes and construction excise taxes are reported as general revenues. All other nontax revenues (including unrestricted interest on deposit and investments, grants and contributions not restricted for specific programs and miscellaneous revenues) that do not meet the definition of program revenues are classified as general revenues. Resources that are dedicated internally by the Municipality are reported as general revenues rather than as program revenues. All general revenues are reported net of estimated uncollectible amounts, which are recorded as reduction of revenues rather than as expenses.

The general government function/program reported in the accompanying statement of activities includes expenses that are, in essence, indirect or costs of other functions/programs of the Municipality. Even through some of these costs have been charged to certain funds in the GFFS as indirect costs allocations permitted under some federal programs, the Municipality has reported these indirect costs as direct expenses of the general government function. Accordingly, the Municipality does not allocate general government (indirect) costs to other functions.

The effects of all interfund governmental activities (revenues, expenditures and other financing sources/uses among governmental funds) have been removed from the accompanying statements of net assets. The Municipality classifies all of its activities as governmental activities in the accompanying Government Wide Financial Statements. These are activities generally financed through taxes, intergovernmental grants and other non-exchange revenues that can be used to support the Municipality's programs or services. These governmental activities are also generally reported in the Governmental Fund Financial Statements.

The Municipality has no significant operations or activities that: (1) are financed and operated primarily in a manner similar to private business enterprises, where the costs of providing goods or services to the general public is financed primarily through user charges, or (2) are fiduciary in nature, which are those in which the Municipality would be holding or managing net assets for specific individuals or other external parties in accordance with trust agreements or other custodial arrangements. As a result, no business-type nor fiduciary activities are reported in the accompanying GWFS. All Municipalities' operations are classified as governmental activities for financial reporting purposes.

Governmental Fund Financial Statements ("GFFS") – is a set of financial statements composed of: (1) a balance sheet and (2) a statement of revenues, expenditures and changes in fund balances - governmental funds.

A fund is a fiscal and accounting entity consisting of a self-balancing set of accounts used to record assets, liabilities and residual equities, deficits or balances and changes therein, which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with GAAP and/or special regulations, restrictions or limitations.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA

NOTES TO FINANCIAL STATEMENTS (continued)
JUNE 30, 2011

These financial statements report the financial position and results of operations of the Municipality's governmental funds by presenting sources, uses and balances of current financial resources. GFFS focus primarily on: (1) the Municipality's major governmental funds, (2) the fiscal accountability and (3) the individual parts of the Municipality's government. The accompanying GFFS segregates governmental funds according to their intended purpose and are used to aid management in demonstrating compliance with legal, financial and contractual provisions. The minimum numbers of funds is maintained consistent with legal and self-imposed managerial requirements established by the Municipality.

The Municipality reports its governmental funds within the following categories:

- *General Fund* – the general fund is the primary operational fund used to account for all financial resources and governmental activities of the Municipality, except for financial resources required to be accounted for in another funds. It is presumed that the Municipality's activities have been reported in the general fund except for transactions for which one of the following compelling reasons has required the use of another fund: (1) legal requirements, (2) GAAP requirements or (3) the demands of sound financial administration requiring the use of a fund other than the general fund.
- *Debt Service Fund* – the debt service fund is used to account for the accumulation of resources for the payment of, principal and interest for: (1) bonds payable for which debt service payments are legally mandated to be accounted for in a debt service fund and (2) general long-term debt for which the Municipality is being accumulating financial resources in advance, to pay principal and interest payments maturing in future years (such bonds payable and notes payable). Long-term debt's principal and accrued interest due on July 1 of the following fiscal year are accounted for as liabilities in the debt service fund at June 30, if resources are available at June 30 for its payments.

The outstanding balance of general long-term debt for which debt service payments do not involve the advance accumulation of resources (such as accrued compensated absences, accrued claims and judgments, advances to CRIM, and the estimated liability for municipal solid waste landfill closure and post closure maintenance costs) are only accounted for in the accompanying statements of net assets.

- *Capital Projects Funds* – the capital project funds is used to account for the financial resources used for the acquisition, construction or improvement of major capital facilities and other assets. Significant capital outlays financed from proceeds of general obligation, public improvements or special obligation bonds are also accounted in the capital project funds.

The use of the capital projects funds has been reserved only for major capital acquisitions, construction or improvement activities that would distort financial resources trend data if not reported separately from other Municipality's operating activities. Periodic purchases of minor capital assets (such as furniture, office equipment, vehicles and other minor capital assets or improvements) have been reported in the governmental fund which financial resources were used for the payment.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA

NOTES TO FINANCIAL STATEMENTS (continued)
JUNE 30, 2011

- *Economic Development Funds* – the economic development fund is used to account for the financial resources required for the economic development activities of the Municipality. Financing is provided primarily from federal grants and loans, and local special assignments contributions.
- *Workforce Investment Fund* – the workforce investment fund account for the financial federal grant for the operations of the Employment Opportunity Municipal Agency. This municipal unit is an entity organized by the Municipality as requested by the Governor of Puerto Rico, in accordance with section 116 of the Workforce Investment Act (WIA) and section 2.001 of the Autonomous Municipal Law of Puerto Rico. The entity was designated as Service Delivery Area (SDA) according to the provision of the WIA of 1998, set forth in section 116 and the federal regulation as issued by the U.S. Secretary of Labor for the implementation of WIA. The SDA purpose is to establish programs to provide remedial education, training and employment assistance to economically disadvantages youth and adults, and persons facing multiple barriers to employment and dislocated workers.

Notes to Basic Financial Statements – A set of notes that provides information that is essential to the user's understanding of the basic financial statements.

Required Supplementary Information (other than MD&A) – A set of reports and information reported along with, but separate from, the basic financial statements of the Municipality, such as: (1) Budgetary Comparison Schedule – General Fund, and (2) the Notes to Budgetary Comparison Schedule.

Financial Reporting Entity

The accompanying basic financial statements include all departments and municipal operations units that are under the legal and administrative control of the Mayor and the Municipal Legislature, and whose financial resources are under the legal custody and control of the Municipality's Director of Finance and Budget, as prescribed by Act No. 81.

According to GAAP, the financial reporting entity for the Municipality consists of: (1) the primary government, which is composed of all municipal departments and units under the legal and administrative control of the Mayor and the Municipal Legislature, and (2) all component units. In evaluating how to define the Municipality for financial reporting purposes, the Municipality's management has addressed all potential entities and organizations that may be considered component units according to the criteria set forth by Statement No. 14, *The Financial Reporting Entity*, as amended by Statement No. 39, *Determining Whether Certain Organizations are Component Units*, both issued by the Governmental Accounting Standards Board.

GAAP defines component units as those entities that: (1) are legally separate organizations for which the Municipality's elected officials are financially accountable, and (2) other organizations for which the nature and significance of their relationship with the Municipality are such that exclusion of their financial statements from those of the Municipality would cause the Municipality's basic financial statements to be misleading or incomplete.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA

NOTES TO FINANCIAL STATEMENTS (continued)
JUNE 30, 2011

Financially accountability exists if the Municipality appoints a voting majority of the organization's governing body, and if either one of the following conditions exist: (1) the Municipality can impose its will on the organization or (2) the potential for the organization to provide specific financial benefits to, or impose specific financial burdens on, the Municipality.

On July 1, 2003, the Municipality adopted the provisions of GASB Statement No. 39, *Determining Whether Certain Organizations are Component Units - an Amended of GASB Statement No. 14* (GASB No. 39). GASB No. 39, states that certain organizations for which the primary government (the Municipality) is not financially accountable should be reported as component units based in the nature and significance of their relationship with the primary government, including their ongoing financial support of the primary government and its other component units.

According to GASB No. 39, a legally separate, tax-exempt organization should be reported as a discretely presented component unit of a reporting entity if all of the following criteria are met:

- a. The economic resources received or held by the separate organization are entirely or almost entirely for the direct benefit of the primary government, its component units, or its constituents.
- b. The primary government, or its component units, is entitled to, or has the ability to otherwise access, a majority of the economic resources received or held by the separate organization.
- c. The economic resources received or held by an individual organization that the specific primary government, or its component units, is entitled to, or has the ability to otherwise access, are significant to that primary government.

In addition, GASB No. 39 states that other organizations should be evaluated as potential component units if they are closely related to, or financially integrated with, the primary government. Such types of entities may be presented as either blended or discretely presented component units, depending upon how they meet the criteria for each specified in GASB No. 14.

The Municipality's management has concluded that, based on the aforementioned criteria, there is one legally non-profit separate entity, *Corporación Carolina Beisbol Gigantes, Inc.*, considered component unit of the Municipality according to GAAP for the fiscal year ended June 30, 2011.

According to Act. No. 81, the Municipality is authorized to establish a non-profit corporation for certain economic development activities. The purpose of this entity is to administer and operate a professional baseball team in the Puerto Rico winter baseball league.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA

NOTES TO FINANCIAL STATEMENTS (continued)
JUNE 30, 2011

Measurement Focus and Basis of Accounting

The accompanying basic financial statements of the Municipality are prepared in accordance with the generally accepted accounting principles in the United States of America (U.S. GAAP). The Municipality's reporting entity applies all relevant Government Accounting Standards Board (GASB) pronouncements and applicable Financial Accounting Standards Board (FASB) pronouncements and Accounting Principles Board (APB) opinions issued on or before November 30, 1989, unless they conflict with GASB pronouncements. The Municipality's reporting entity does not apply FASB pronouncements or APB opinions issued after November 30, 1989.

Two different measurement focuses have been applied in the accompanying basic financial statements: (1) the flow of current financial resources and (2) the flow of economic resources. Basis of accounting refers to when transactions have been recognized in the accompanying basic financial statements. GAAP provides for the use of two different bases of accounting, which have been in the accompanying basic financial statements: (1) the accrual basis and (2) the modified accrual basis.

Government Wide Financial Statements (GWFS)

The accompanying GWFS are reported using the economic resources measurement focus and the accrual basis of accounting. Accordingly, revenues are generally recorded when earned and expenses are generally recorded when a liability is incurred, regardless of the timing of related cash flows.

Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met. All significant interfund activities have been eliminated from these GWFS.

All revenues, expenses, gains, losses, assets and liabilities resulting from exchange and exchange-like transactions are generally recorded when the exchange takes place. In exchange transactions, each party to the transaction receives and gives up essentially equal values. An exchange-like transaction is one in which there is an identifiable exchange and the values exchanged, though related, may not be quite the same. Nevertheless, the exchange characteristics of the exchange-like transaction are strong enough to justify treating it as an exchange for accounting purposes (examples include fees for licenses and permits, charges for services and miscellaneous revenues, which are recorded as revenues when collected because they are generally not measurable until actually received).

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA

NOTES TO FINANCIAL STATEMENTS (continued)
JUNE 30, 2011

All revenues, expenses, gains, losses and assets resulting from non-exchange transactions are recorded using the criteria set forth by GASB Statement No. 33, *Accounting and Financial Reporting for Non-exchange Transactions* (GASB No. 33). GASB No. 33 established accounting and reporting standards for non-exchange transactions involving cash and financial or capital resources (for example, most taxes, grants and private donations). In a non-exchange transaction, the Municipality gives (or receives) value without directly receiving (or giving) equal value in return. This is different from an exchange transaction, in which each party receives and gives up essentially equal values. According to GASB No. 33, the Municipality groups its non-exchange transactions into the following four classes in the accompanying basic financial statements: (a) derived tax revenues, (b) imposed non-exchange revenues, (c) government mandated non-exchange transactions and (d) voluntary non-exchange transactions.

In the case of derived tax revenue transactions, which result from assessments the Municipality places on exchange transactions, receivables and revenues are recorded when the underlying exchange has occurred. Imposed non-exchange revenue transactions (such as property taxes and municipal license taxes), which result from assessments made by the Municipality on nongovernmental entities, including individuals, other than assessments on exchange transactions, receivables are generally recorded in the period when an enforceable legal claim has arisen. Property taxes and municipal license are generally recorded as revenues (net of amounts considered not collectible) in the fiscal year when resources are required to be used for the first fiscal year that the use of the resources is permitted.

Government-mandated non-exchange transactions (such as grants and contributions) result when a government at one level (such as the federal or state government) provides resources to the Municipality and the provider government requires the Municipality to use those resources for a specific purpose or purposes established in the provider's enabling legislation. In these type of transactions, receivables and revenues are generally recorded when all eligibility requirements imposed by the provider have been met. For the majority of grants, the Municipality must expend resources on the specific purpose or project before the provider reimburses any amounts. Therefore, revenue is generally recognized as qualifying reimbursable expenditures are incurred.

Voluntary non-exchange transactions (such as donations and certain grants and entitlements) result from legislative or contractual agreements, other than exchanges, willingly entered into by two or more parties.

As discussed above, in these types of transactions, receivables and revenues are generally accounted for in the same manner as government-mandated non-exchange transactions. Events that are neither exchange nor non-exchange transactions are recorded when it is probable that a loss has been incurred and the amount of loss is reasonably estimable.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA

NOTES TO FINANCIAL STATEMENTS (continued)
JUNE 30, 2011

Receipts of any type of revenue sources collected in advance for use in the following fiscal year are recorded as deferred revenues. According to GASB No. 34, all general capital assets and the un-matured long-term liabilities are recorded only in the accompanying statement of net assets. The measurement focus and the basis of accounting used in the accompanying GWFS differ significantly from the measurement focus and basis of accounting used in the preparation of the accompanying GFFS. Therefore, the accompanying GFFS include reconciliations, as detailed in the accompanying table of contents, to better identify the relationship between the GWFS and the GFFS.

The accompanying GFFS are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Accordingly, the accompanying statement of revenues, expenditures and changes in fund balances – governmental funds, reports changes in the amount of financial resources available in the near future as a result of transactions and events of the fiscal year reported.

Therefore, revenues are generally recognized as soon as they are both measurable and available. Revenues are considered available when they are collectible within the current fiscal year or soon enough thereafter to pay liabilities of the current fiscal year. For this purpose, the Municipality considers most revenues available if collected within 90 days after June 30, 2011, except for property taxes for which the availability period is 60 days. Revenue sources not meeting this availability criterion or collected in advance are recorded as deferred revenues at June 30, 2011.

The principal revenue sources considered susceptible to accrual include property taxes, municipal license taxes, intergovernmental grants and contributions, interest on deposits and investments, charges for services and certain miscellaneous revenues. These principal revenue sources meet both measurability and availability criteria in the accompanying GFFS, except for amounts recorded as deferred revenues.

In a manner similar to the GWFS, but subject to and limited by the availability criteria discussed above, all revenues, expenses, gains, losses, assets and liabilities resulting from exchange and exchange-like transactions are also generally recorded when the exchange takes place. Accordingly, fees for licenses and permits, charges for services and miscellaneous revenues are recorded as revenues when collected because they are generally not measurable until actually received.

In the accompanying GFFS, expenditures and related liabilities are generally recorded in the accounting period in which the liability is incurred, except for:

(1) Principal and interest on bonds and notes payable are recorded when they mature (when payment is due), except for principal and interest due on July 1 of the following fiscal year, which are recorded as governmental fund liabilities when resources are available in the debt service funds (generally, June 30); and

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(2) Compensated absences (vacation and sick leave), obligations under capital leases, estimated liability for municipal solid waste landfill closure and post-closure care costs, amounts subject to judgments under litigation and other long-term obligations, are recorded only when they mature (when payment is due) in the accompanying government-wide financial statements; and

(3) Other accrued liabilities not due and payable or not normally expected to be liquidated in full and in a timely manner with available and expendable financial resources is recorded in the accompanying statement of net assets. Such liabilities are recorded in the governmental funds when they mature.

All revenues, expenses, gains, losses and assets resulting from non-exchange transactions are recorded in a similar manner to the GWFS, using the previously discussed criteria set forth by GASB No. 33 for non-exchange transactions, but subject to and limited by the availability criteria discussed above. Accordingly, property tax and municipal license tax receivables are also generally recorded in the fiscal year when an enforceable legal claim has arisen while property tax and municipal license tax revenues (net of amounts considered not collectible) are also generally recorded in the fiscal year when resources are required to be used for the first fiscal year that the use of the resources is permitted. Receivables and revenues from federal and state grants and contributions, donations and entitlements are also generally recorded when all eligibility requirements imposed by the provider have been met (generally, as qualifying reimbursable expenditures are incurred). Interest on deposits and investments are recorded when earned only if collected within 90 days after the fiscal year-end since these revenues would be considered both measurable and available.

Pursuant to the provisions of GASB Interpretation No. 6, *Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements* (GASB No. 6), the Municipality generally accrues a governmental fund liability and expenditure in the period in which the government incurs the liability, to the extent that these liabilities are normally expected to be liquidated in a timely manner and in full with current available financial resources. GASB No. 6 modified the recognition criteria for certain expenditures and liabilities reported under the modified accrual basis of accounting prior to GASB No. 34 and clarified a number of situations in which the Municipality should distinguish between governmental fund liabilities and general long-term liabilities.

Therefore, the accompanying balance sheet – governmental funds only reflects assets that will be converted into cash to satisfy current liabilities. Long-term assets and those assets that will not be converted into cash to satisfy current liabilities are not accounted for in the accompanying balance sheet – governmental funds.

At the same time, long-term liabilities (generally, those un-matured that will not require the use of current financial resources to pay them) are not accounted for in the accompanying balance sheet – governmental funds.

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The measurement focus of the GFFS is on decreases of net financial resources (expenditures) rather than expenses. Most expenditures are measurable and are recorded when the related governmental fund liability is incurred. Allocation of costs, such as depreciation and amortization, are recorded in the accompanying statement of activities, but are not recorded in the accompanying GFFS.

Major and Non major Funds

The focus of the GFFS is on major governmental funds, which generally represent the Municipality's most important funds. Under the provisions of GASB 34, the Municipality is required to segregate governmental funds between major and non-major categories within the GFFS. For financial reporting purposes, major individual governmental funds are reported in separate columns in the GFFS, while data from all non-major governmental funds are aggregated into a single column (reported as other governmental funds).

At minimum a fund is considered major if: (1) is the primary operating fund of the Municipality (i.e. the general fund) or; (2) meets both of the following criteria:

- (a) Total assets, liabilities, revenues, or expenditures/expenses of that individual governmental or enterprise fund are at least 10 percent of the corresponding element total for all funds of that category or type; and,
- (b) Total assets, liabilities, revenues or expenditures/expenses of the individual governmental or enterprise fund are at least 5 percent of the corresponding total for all governmental and enterprise funds combined.
- (c) Any other fund that the government's officials believe is particular important to financial statements users.

For the purposes of applying the aforementioned major fund criteria, no eliminations of interfund balances have been made. Total revenues for these purposes means all revenues, including operating and non-operating revenues (net of allowances for uncollectible accounts), except for other financing sources. Total expenditures for these purposes, means all expenditures, including operating and non-operating expenditures, except for other financing uses.

Based on the above-mentioned criteria, the Municipality's general fund, the debt service fund, the capital project fund, the economic development fund and the workforce investment fund are the Municipality's major governmental funds for the fiscal year ended June 30, 2011, and accordingly, have been reported as major funds in the accompanying GFFS. All other governmental funds of the Municipality are considered Non major for financial reporting purposes.

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Budgetary Control

According to Act No. 81, the Mayor and its Administrative Cabinet prepare annual budgets each fiscal year for the Municipality's general fund and debt service fund. Such legally adopted budgets are based on expected expenditures by program and estimated resources by source.

The annual budgets are developed using elements of performance-based program budgeting and zero-based budgeting and include estimates of revenues and other resources for the ensuing fiscal year under laws and regulations existing at the time the budgets are prepared.

The Mayor must submit, for the fiscal year commencing on the next July 1, an annual budgetary resolution project to the Commissioner of Municipal Affairs of the Commonwealth (the Commissioner) and the Municipal Legislature no later than May 10 and May 15, respectively. The Commissioner preliminary verifies that the annual budgetary resolution project complies with all the applicable laws and regulations and may provide comments and suggestions to the Mayor on or before June 13.

The annual budgets may be updated for any estimate revisions as well as fiscal year-end encumbrances and may include any additional information requested by the Municipal Legislature. The Mayor may request subsequent amendments to the approved budgets, which are subject to the approval of the Municipal Legislature.

The Municipality's Department of Finance has the responsibility to ensure that budgetary spending control is maintained. For day-to-day management control purposes, expenditures plus encumbrances may not exceed budgeted amounts at the expenditure-type level of each cost center (activity within a program within a fund). The Mayor may transfer unencumbered appropriations within programs within funds. The Municipal Legislature may transfer amounts among programs within and among funds.

Under the laws and regulations of the Commonwealth, the appropriations made for any fiscal year shall not exceed the total revenue, including available surplus, estimated for said fiscal year unless the imposition of taxes sufficient to cover said appropriations is provided.

Statutory (Budgetary) Accounting

The Municipality's budget is adopted in accordance with a statutory basis of accounting, which is not in accordance with GAAP. According to the budgetary basis of accounting, revenue is generally recorded when cash is received. Short-term and long-term borrowings may be used to finance budgetary excess of expenditures over revenues.

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Under the statutory basis of accounting, the Municipality uses encumbrance accounting to record the full amount of purchase orders, contracts and other commitments of appropriated resources as deductions from the appropriation prior to actual expenditure. In the governmental funds, encumbrance accounting is a significant aspect of budgetary control. Expenditures are generally recorded when the related expenditure is incurred or encumbered. Available appropriations and encumbrances are established to lapse one year after the end of the fiscal year. Amounts required to settle claims and judgments against the Municipality, and certain other liabilities, are not recognized until they are encumbered or otherwise processed for payment.

Encumbrances outstanding at year-end are reported as a reservation of fund balance and they constitute neither expenditures, nor liabilities. Other appropriations, mainly capital projects appropriations, are continuing accounts for which the Municipal Legislature has authorized that an unspent balance from the prior year be carried forward and made available for current spending.

The accompanying statement of revenue and expenditure – budget and actual – budgetary basis - general fund, provides information about the general fund's original budget, its amendments and the actual results of operations of such governmental fund under the budgetary basis of accounting for the fiscal year ended June 30, 2011.

Unrestricted and Restricted Deposits

The Municipality is allowed to invest its available resources in bank accounts, certificate of deposit and other bank obligations, with commercial banks qualified as a depository of public funds by the Puerto Rico Treasury Department or in instruments of the Government Development Bank (GDB) for Puerto Rico. Under the laws and regulations of the Commonwealth, public funds deposited by the Municipality in commercial banks must be fully collateralized by the Federal Deposits Insurance Corporation (FDIC).

The Municipality's deposits are composed of: (1) cash on hand, (2) demand deposits in commercial banks and GDB and (3) cash and cash equivalents in commercial banks. Cash and cash equivalents consist of certificate of deposit with original maturities of three months or less, which amounted to \$210,182,859 at June 30, 2011. The Municipality follows the practice of pooling cash. The balance in the pooled cash account is available to meet current operating requirements and any excess is invested in certificates of deposits with commercial banks.

Certain cash and cash equivalents set aside by the general fund, the debt service fund, the capital project fund, the economic development fund, workforce investment fund and other nonmajor fund are classified as temporarily restricted assets since their use is limited for: (a) the compliance with the debt service requirements of bonds and notes payable as established in the respective debt agreements, (b) the funding of construction and permanent improvements projects, and (c) the funding of federal and state sponsored programs. Restricted cash and cash equivalents amounted to \$137,852,523 at June 30, 2011 (see note 3).

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Cash and cash equivalents recorded in general fund, amounting to \$5,612,590, consist of restricted cash to finance specific commitments and activities. Cash held with fiscal agent recorded in the debt service funds, amounting to \$56,216,257, represent additional property tax collections retained by the Municipal Revenue Collection Center (CRIM) a municipal agency (not a component unit of the Commonwealth of Puerto Rico or of the Municipality) and additional portion of sales taxes collected and distributed by Puerto Rico Treasury Department and deposited in GDB. Such cash balances are restricted for the payment of the Municipality's debt service, as established by law. Cash with fiscal agent recorded in the capital project fund, amounting to \$64,499,236, represent unspent proceeds of bonds and notes and the balance of interest and noninterest bearing accounts which is restricted for the acquisition, construction or improvements of major capital assets.

Cash and cash equivalents recorded in economic development fund, workforce investment fund and other governmental fund, represent mainly restricted cash balance of interest and noninterest-bearing accounts to finance the operations of state and federal funded programs.

Receivables and Payables

Activity between funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as either "due to/from other funds" (i.e. the current portion of interfund loans). Tax receivables in the general fund represent amounts owed by taxpayers principally for individual and corporate municipal license taxes, sales taxes and landfill, among others.

A portion of these tax receivables is recognized when they become measurable and available based on actual collections during the 60 days following the fiscal year-ended related to tax returns due before year-ended. Tax receivables also include amounts owed by taxpayers from taxable years prior to June 30, 2011, estimated to be collectible but not currently available, as a result of the adoption of GASB 33. Accounts receivable are stated net of estimated allowances for uncollectible accounts, which are determined, based upon past collection experience, historical trends, current economic conditions and the periodic aging of accounts receivable.

Intergovernmental receivables and federal grants receivable mainly represents owed to the Municipality by the Commonwealth or the federal government of the United States of America for: (1) intergovernmental grants, (2) for reimbursement of expenditures incurred pursuant to federally funded programs, respectively. In the accompanying GWFS, receivables consist principally of all revenues earned at year-ended and not yet received.

Nonexchange transactions collectible but not available are deferred in the accompanying GFFS in accordance with the modified accrual basis of accounting, but not deferred in the accompanying government-wide statements in accordance with the accrual basis of accounting. Interest income is recorded when earned only if collected within 60 days after year-ended since they would be considered both measurable and available. Allowances for uncollectible accounts receivables are based upon historical trends and the periodic aging of accounts receivables.

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Inventories and Prepaid Expenses

Inventories consist of materials and supplies held for consumption. Generally, inventories and prepaid expenses are valued at cost and predominantly on the first-in, first-out basis. Governmental fund inventories and prepaid expenses are recorded as expenditures (consumption method) when purchased rather than capitalized as an asset. However, inventories and prepaid expenses are not recorded in the accompanying government wide-statement of net assets since amount are not material.

Deferred Charges

Deferred charges in the accompanying statement of net assets consist of bond issuance costs, net of accumulated amortization. Deferred charges are amortized over the term of the related debt using the straight-line method. In the accompanying GFFS, bond issuance costs are recognized in the current period as expenditure, whether or not withheld from the actual debt proceeds received. Debt issue costs amounted to \$145,000 at June 30, 2011 involve legal and accounting fees incurred in the new debt issuance of \$23,395,000 in the fiscal year 2010-11. This amount was recorded as expenditures in the accompanying GFFS.

Total amortized debt issue costs are reported in the statement of net assets, as non-current assets and amounted to \$1,528,582 by current and prior debt issuances.

Interfund Transactions

Permanent reallocations of resources between the Municipality's funds are classified as interfund transfers. The Municipality has the following types of transactions recorded among funds in the accompanying fund financial statements:

- (1) *Operating Transfers* – Legally required transfers that are reported when incurred as operations transfer-in by the recipient and as operating transfer-out by the disbursing fund.
- (2) *Intra-entity Transactions* – Transfers between the funds of the primary government are reported as inter-fund transfer with receivables and payables presented as amounts due to and due from other funds.

For the purposes of the accompanying government-wide statement of activities, all interfund transfers between individual governmental funds have been eliminated.

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Insurance

The Municipality purchase commercial insurance covering its public facilities and equipment, primarily to provide protection in case of casualty, theft, tort claims, disaster and other losses. Also, principal officials of the Municipality are covered under various surety insurance. The Commonwealth, through its Department of Treasury, pays the insurance premiums on behalf of the Municipality and then is reimbursed each year through monthly equal payments. The current insurance policies have not been canceled or terminated. For worker's compensation and disability insurance, the Municipality obtains insurance coverage through the State Insurance Fund Corporation (a component unit of the Commonwealth) and the Occupational Disability Fund (which is a trust administrated by the Department of Labor and Human Resources of the Commonwealth).

Capital Assets

The accounting and reporting treatment applied to the capital assets associated with a fund are determined by its measurement focus.

Capital assets are long-lived assets of the Municipality as a whole, such as land, land improvements, easements, buildings, structures and building improvements, vehicles, machinery and equipment, furniture and fixtures arts works, Construction in progress and infrastructure, and other assets that are used in the operations of the Municipality and that have initial useful lives extending beyond a single reporting period (fiscal year). Infrastructure assets are generally stationary in nature and include roads, bridges, streets and sidewalks, drainage systems and other similar assets.

In the accompanying government-wide statement of net assets, all individual capital assets over threshold amount of \$300 or more at the date of acquisition, construction or improvement and with useful lives extending beyond one year, have been capitalized and depreciated. All assets with individual costs under \$300 or with useful lives not exceeding one year, are charged directly to expense in the government wide statement of activities. In the governmental funds, all capital assets are recorded as expenditures.

In the statement of net assets, all capital assets are recorded at their historical cost or estimated cost if actual is unavailable, except for donated capital assets, which are recorded at their estimated fair value at the date of donation. Estimated historical cost based on deflated current costs were used to value a significant portion of the infrastructure constructed or acquired prior to June 30, 2001 and certain lands, buildings, structures and building improvements. The method used to deflate the currents costs with an approximate price index was used only in the case of certain items for which the historical cost documentation was not available. Actual historical costs were used to value the infrastructure acquired or constructed after June 30, 2001 as well as, construction in progress, machinery and equipment and licensed vehicles acquired prior or after such date.

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Major outlays for capital assets and improvements are capitalized in the statement of net asset as projects are constructed. The costs of normal maintenance and repairs that do not add value to the asset or materially extend capital asset lives are not capitalized. Otherwise, improvements and other capital outlays that significantly extended the useful life of an asset are capitalized.

Depreciation and amortization expense of capital assets is recorded as a direct expense of the function/program in the government-wide statement of activities. Depreciable capital assets are generally depreciated or amortized over their estimated useful lives under the straight-line method, except for machinery and equipment held under capital leases, which is depreciated over the shorter of its estimated useful life or the lease term. The estimated useful lives of major capital asset categories are:

Infrastructure	60 years
Buildings	50 years
Buildings improvements	20 to 40 years
Furniture and fixtures	10 years
Machinery and equipment	5 to 10 years
Motor vehicles	4 to 10 years

The Municipality assigned a 10% residual value on most capital assets. There is no depreciation recorded for land and construction in progress. Capital assets are recorded as expenditures in the acquiring fund for the purposes of the accompanying statement of revenues, expenditures and changed in fund balances – governmental funds.

The Municipality has adopted GASB No. 42, Accounting for impairment of capital assets and for insurance recoveries. This statement establishes accounting and financial reporting standard for impairment of capital assets.

Deferred Revenues

The Municipality reports deferred revenue on its governmental fund financial statement-balance sheet, when potential revenue does not meet both the “measurable” and “available” criteria for revenue recognition in the current period (unavailable revenue). Available is defined as due (or past due) at June 30, and collected within 60 days thereafter to pay obligations due at June 30. Deferred revenue also arises when the Municipality receives resources before it has a legal claim to them (unearned revenue). In subsequent periods, when the revenue recognition criterion is met, or when the Municipality has a legal claim to the resources, the liability for deferred revenue is removed and revenue is recognized. Deferred revenue at the government-wide level arises only when the Municipality receives resources before it has a legal claim to them.

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Compensated Absences

Compensated absences are accounted for under the provisions of Statement No. 16, *Accounting for Compensated Absences*, issued by GASB (GASB No. 16). Compensated absences include paid time off made available to employees in connection with vacation and sick leaves and, compensatory time. According to GASB 16, the liability for compensated absences recorded in the accompanying government-wide statement of net assets is limited to leave that: (1) is attributable to services already rendered on or before June 30, 2011, and (2) is not contingent on a specific event (such as illness) that is outside the control of the Municipality and the employee. Compensated absences that relate to future services or are contingent on a specific event outside the control of the employer or the employee are accounted for in the period when those services are rendered or those events take place.

The liability for compensated absences, include salary-related costs, which are directly and incrementally related to the amount of salary paid to the employee (such as employer's share of Social Security and Medicare taxes, and employer contributions to retirement system). The vacation policy of the Municipality provides for the accumulation of regular vacations leave at a rate of 2.5 days per month (30 days per year) and sick leave at a rate of 1.5 days per month (18 per year).

Employees also, accumulate compensatory time at a rate of 1.5 times the overtime worked. Employees accumulate compensatory time at a rate of 1.5 times the overtime worked. Vacation leave may be accumulated up to a maximum of 60 days and sick leave up to a maximum of 90 days.

The Municipality is required to pay excess sick leave over 90 days on or before March 31 of the accumulated excess at December 31 of prior year. In the case of compensatory time, the excess of 240 hours is paid to employees each year, if not consumed. In the event of employee resignation, the employee is paid for accumulated vacations days up to the maximum allowed. Upon termination of employment, an employee receives compensation for all accumulated unpaid regular vacation leave at the current rate.

In the case of regular sick leave, if the employee terminates his or her employment with the Municipality before reaching 10 years of services, such regular sick leave is not paid to the employee. After 10 years of services any regular sick leave balance is paid to the employee. Accumulated vacation time is fully vested to the employees at any time.

The liability for compensated absences has been calculated using the vesting method, in which sick leave amounts for both employees who currently are eligible to receive termination payments and other employees who are expected to become eligible in the future to receive such payments upon termination are included. At June 30, 2011, the Municipality has recorded a liability for compensated absences amounting to \$13,463,288 in the accompanying government-wide statement of net assets.

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Post Employment Benefits

The Municipality is required to cover annually the 3% increase (cost of living allowance) in the retirement plan of its retirees employees. Substantially all of the employees may become eligible for these benefits if they reach normal retirement age while working for the Municipality. For the fiscal year ended June 30, 2011, post employment benefits paid amounted to \$979,769. These benefits are recorded as expenditures when paid in the accompanying government-wide statement of activities and statement of revenues, expenditures and change in fund balances.

Claims and Judgment

The estimated amount of the liability for claims and judgments, which is due on demand, such as from adjudicated or settled claims, is recorded in the accompanying government-wide statement of activities and statement of revenues, expenditures and change in fund balances.

Long-term Debt

The long-term liabilities reported in the accompanying statements of net assets include the Municipality's bonds payable, notes payable, bond anticipation notes, obligations under capital leases, accrued compensated absences, estimated liability for municipal solid waste landfill closure and post-closure care costs and accrued legal claims and judgments.

All long-term liabilities to be repaid from governmental resources is reported as liabilities in the government-wide statements of net assets, except for principal and interest payment on long-term obligations due on July 1 of the following fiscal year, which is recorded in the GFFS when resources are available in the debt service fund (generally at June 30). The face amount of debt issued is reported as other financing sources when issued.

In the GWFS debt issuance costs are reported as deferred charges, which are amortized under the straight-line method over the life of the debt, while in the GFFS such costs are recognized as expenditures during the current period.

Non-interest bearing notes payable are accounted for under the provisions of Opinion No. 21, Interest on Receivables and Payables, issued by the Accounting Principles Board (APB No. 21). According to APB No. 21, the Municipality has recorded such notes at present value with an imputed interest rate that approximates the rate that would have been used, using the same terms and conditions, if it had been negotiated by an independent lender.

In the accompanying statement of net assets, such notes payable are reported net of the applicable unamortized discount, which is the difference between the present value and the face amount of the notes. The discount is amortized over the life of the notes using the effective interest method. Amortization of the notes discount is recorded as part of interest expense in the statement of activities. In the GFFS, notes discount is recognized as other financing uses during the current period.

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Fund Balances

In February 2009, GASB issues its Statements No. 54, "*Fund Balance Reporting and Governmental Fund Type Definitions*" (GASB No. 54). The objective of this Statement is to enhance the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied and by clarifying the existing governmental fund type definitions. This Statement establishes fund balance classifications that comprise a hierarchy based primarily on the extent to which a government is bound to observe constraints imposed upon the use of the resources reported in governmental funds.

Pursuant to the provisions of GASB 54, the fund balances amounts are reported as nonspendable, restricted, committed, assigned and unassigned, based on the relative strength of the constraints that control how specific amounts can be spent, as described follows:

- *Nonspendable* - This fund balance category includes amounts that cannot be spent because they are not in spendable form, or legally or contractually required to be maintained intact. The "not in spendable form" criterion includes items that are not expected to be converted to cash, included but not limited to inventories, prepaid items long-term balances of loans and notes receivable.
- *Restricted* - This fund balance category includes amounts that are restricted for specific purpose, when constraints placed on the use of resources are either externally imposed by creditors, grantors, contributors, or laws or regulations of other governments or is imposed by law through constitutional provisions or enabling legislation (Municipality ordinances).

Enabling legislation authorizes the Municipality to assess, levy, charge, or otherwise mandates payment of resources (from external resource providers) and includes a legally enforceable requirement that those resources be used only for the specific purposes stipulated in the legislation.

Legal enforceability means that the Municipality can be compelled by an external party- such as citizens, public interest groups, or the judiciary to use resources created by enabling legislation only for the purposes specified by the legislation.

- *Committed* - This fund balance classification includes amounts that can only be used for specific purposes pursuant to constraints imposed by the highest level of decision-making authority.

Those committed amounts cannot be used for other purposes unless the intended use removes or changes the specified use by taking the same type of formal action it employed to previously commit those amounts. In contrast to fund balance that is restricted by enabling legislation, committed fund balance classification may be redeployed for other purposes with appropriate due process.

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Constraints imposed on the use of committed amounts are imposed by the State or Municipal legislature separate from the authorization to raise the underlying revenue; therefore, compliance with these constraints are not considered to be legally enforceable. Committed fund balance also incorporates contractual obligations to the extent that existing resources in the fund have been specifically committed for use in satisfying those contractual requirements.

- *Assigned* - This fund balance classification includes amounts that are constrained by the government's intent to be used by the Municipality for specific purposes, but do not meet the criteria to be classified as restricted or committed. In governmental funds other than the general fund, assigned fund balance represents the remaining amount that is not restricted or committed. In the General Fund, assigned amounts represent intended uses established by a Municipality official to whom the government has delegated that authority by Municipality Charter or ordinance.
- *Unassigned* - Unassigned fund balance is the residual classification for the general fund. It represents the fund balance that has not been assigned to other funds and not been restricted, committed or assigned for specific purposes with the general fund.

The Municipality applies restricted resources first when expenditures are incurred for purposes for which either restricted or unrestricted (committed, assigned, and unassigned) amounts are available. Similarly, within unrestricted fund balance, committed amounts are reduced first followed by assigned, and then unassigned amounts when expenditures are incurred for purposes for which amounts in any of the unrestricted fund balance classifications could be used. At June 30, 2011, the accompanying fund financial statements reported fund balances as restricted, committed, assigned and unassigned.

Municipal Solid Waste Landfill Closure and Post-closure Care Costs

Municipal solid waste landfill closure and post-closure care costs are accounted for under the provisions of Statement No. 18, *Accounting for Municipal Solid Waste Landfill Closure and Post-closure Care Costs*, issued by GASB (GASB No. 18).

The estimated liability for municipal solid waste landfill closure and post-closure care costs (including monitoring and maintenance) includes an estimate of all costs to be incurred near or after the close of the Municipality's solid waste landfill. In the government-wide statement of net assets, this liability is recognized under the accrual basis of accounting over the useful life of the landfill, even though such costs will only be incurred near or after the close of the landfill. The estimates of closing and post-closing costs include: (1) the cost of equipment and/or facilities that will be acquired near the time the landfill stops accepting waste or after for the purposes of post-closure care and monitoring, (2) the cost of applying the final cover and (3) the cost of post-closure maintenance and monitoring.

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These cost estimates are made using current costs (costs that would be incurred if these services had been obtained during the current period) allocated in the accompanying statement of net assets based on the landfill capacity used through June 30, 2011. The liability is adjusted annually to reflect the effects of inflation, advances in technology, changes in regulations or similar changes. Any changes in the estimated total current costs occur before the landfill stops accepting solid waste are reported in the period of the changes and an adjustment is made to the calculation, which is accounted for prospectively as a change in accounting estimate.

Changes in the estimated total current costs for landfill closure and post-closure care costs may also occur after the date that the landfill stops accepting solid waste. These changes may include changes due to inflation (or deflation), changes in technology, changes in closure and post-closure care requirements, corrections of errors in estimation and changes in the extent of environmental remediation that is required. Changes in these estimates would be reported in the period in which the change is probable and reasonably estimable.

In the GFFS, municipal solid waste landfill closure and post-closure care costs are recorded in the accounting period in which they are due under the modified accrual basis of accounting.

Use of Estimates

The preparation of basic financial statements in conformity with accounting principles generally accepted in the United States of America requires the Municipality's management to make significant estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the basic financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Note 2 - Stewardship, Compliance, and Accountability

The Municipality's general fund is the only governmental fund for which an annual budget is legally adopted. The Municipality's elected Mayor is legally required to prepare and submit to the elected Municipal Legislature an annual balanced budget for the ensuing fiscal year. The annual budget is prepared by the Municipality's Department of Finance, and takes into consideration the advice provided by all municipal department and divisions. The appropriation made for any fiscal year shall not exceed the total revenues, including available surplus, estimated for said fiscal year, unless the imposition of taxes sufficient to cover said appropriations is provided by law.

The annual budget, which is developed utilizing elements of performance-based program budgeting, includes an estimate of revenues and other financing resources of the ensuing fiscal year under: (1) laws existing at the time the budget is submitted; and (2) municipal legislative measures proposed by the Mayor and submitted with the proposed budget, as well as the Mayor's recommendations as to appropriations that in his judgment are necessary, convenient, and in conformity with the four-year governmental plan adopted by the Municipality.

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The Municipal Legislature may amend the budget submitted by the Mayor but not increase any items so far to cause a deficit without imposing taxes or identifying other sources of revenue to cover such deficit. Upon approval by the Municipal Legislature, the budget is referred to the Mayor who may decrease or eliminate any line item but not increase or insert any new line item in the budget. The Mayor may also veto the budget in its entirety and return it to the Municipal Legislature with his objections. If a budget is not adopted prior to the end of the fiscal year, the annual budget for the preceding fiscal year, as approved by the Legislature and the Mayor, is automatically renewed for the ensuing fiscal year until the Municipal Legislative and the mayor approve a new budget. This permits the Municipality to continue making payments for its operations and other purposes until the new budget is approved.

The Municipality's annual budget is prepared on the budgetary basis of accounting, which is not in accordance with GAAP. Accordingly, for budgetary purposes the Municipality uses encumbrance accounting. The encumbrances (principally purchase orders and contracts) are considered expenditures when commitment is made. For GAAP reporting purposes, encumbrances outstanding at year-ended reported as reservations of budgetary appropriations and GAAP fund balances and do not constitute expenditures or liabilities on a GAAP basis because the commitments of the general fund at the end of fiscal year will lapse to the following fiscal year. In addition, the Municipal Legislature may direct that certain revenues be retained and made available for spending within a specific appropriation account. Generally, expenditures may not exceed the level of spending authorized for an individual department or division of the Municipality.

The Municipality follows these procedures, which are in accordance with the Autonomous Municipal Law for Municipalities of Puerto Rico (Law No. 81, as amended), in establishing the budgetary data reflected in the accompanying Budgetary Comparison Schedule – General Fund:

- 1) On or prior to May 15, the Mayor submits to the Municipal Legislature a proposed budget for the fiscal year commencing the following July 1st. The proposed budget includes estimated expenditures and their financing sources.

The Municipality's general fund is the only governmental fund for which an annual budget is legally adopted. The Municipality's elected Mayor is legally required to prepare and submit to the elected Municipal Legislature an annual balanced budget for the ensuing fiscal year. The annual budget is prepared by the Municipality's Department of Finance, and takes into consideration the advice provided by all municipal department and divisions.

The appropriation made for any fiscal year shall not exceed the total revenues, including available surplus, estimated for said fiscal year, unless the imposition of taxes sufficient to cover said appropriations is provided by law.

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NOTES TO FINANCIAL STATEMENTS (continued)
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The annual budget, which is developed utilizing elements of performance-based program budgeting, includes an estimate of revenues and other financing resources of the ensuing fiscal year under: (1) laws existing at the time the budget is submitted; and (2) municipal legislative measures proposed by the Mayor and submitted with the proposed budget, as well as the Mayor's recommendations as to appropriations that in his judgment are necessary, convenient, and in conformity with the four-year governmental plan adopted by the Municipality.

The Municipal Legislature may amend the budget submitted by the Mayor but not increase any items so far to cause a deficit without imposing taxes or identifying other sources of revenue to cover such deficit. Upon approval by the Municipal Legislature, the budget is referred to the Mayor who may decrease or eliminate any line item but not increase or insert any new line item in the budget. The Mayor may also veto the budget in its entirety and return it to the Municipal Legislature with his objections. If a budget is not adopted prior to the end of the fiscal year, the annual budget for the preceding fiscal year, as approved by the Legislature and the Mayor, is automatically renewed for the ensuing fiscal year until the Municipal Legislative and the mayor approve a new budget. This permits the Municipality to continue making payments for its operations and other purposes until the new budget is approved.

The Municipality's annual budget is prepared on the budgetary basis of accounting, which is not in accordance with GAAP. Accordingly, for budgetary purposes the Municipality uses encumbrance accounting. The encumbrances (principally purchase orders and contracts) are considered expenditures when commitment is made. For GAAP reporting purposes, encumbrances outstanding at year-ended reported as reservations of budgetary appropriations and GAAP fund balances and do not constitute expenditures or liabilities on a GAAP basis because the commitments of the general fund at the end of fiscal year will lapse to the following fiscal year. In addition, the Municipal Legislature may direct that certain revenues be retained and made available for spending within a specific appropriation account. Generally, expenditures may not exceed the level of spending authorized for an individual department or division of the Municipality.

The Municipality follows these procedures, which are in accordance with the Autonomous Municipal Law for Municipalities of Puerto Rico (Law No. 81, as amended), in establishing the budgetary data reflected in the accompanying Budgetary Comparison Schedule – General Fund:

- 1) On or prior to May 15, the Mayor submits to the Municipal Legislature a proposed budget for the fiscal year commencing the following July 1st. The proposed budget includes estimated expenditures and their financing sources.
- 2) The budget document is available for public inspection prior to its approval by the Municipal Legislature.

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NOTES TO FINANCIAL STATEMENTS (continued)
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- 3) Prior to July 1st, the annual budget is legally enacted through passage of the annual appropriation ordinance.
- 4) Subsequent to the enactment to the annual appropriation ordinance, the Municipal Legislature has the authority to make adjustments to the budget. Adjustments made during fiscal year June 30, 2011 amounted to \$1,055,038 are reflected in the budget information as readjustments from prior years included in the General Fund's budgetary basis.

The Municipality's Finance Department has the responsibility to ensure that budgetary spending control is maintained on an individual department or division basis. The Finance Department may transfer part or all of any encumbered balance within a department to another department subject to approval.

Budgetary control is exercised through the Municipality's accounting system. This system ensures that encumbrances or expenditures are not processed if they exceed the department or division's total available spending authorization, which is considered its budget. The legal level of budgetary control is at the individual department level for the general fund expenditures, principal and interest due for the year for the debt service fund, and by bond or note authorization for capital expenditures.

Since the budgetary basis differs from GAAP, actual amounts for the general fund are presented in the accompanying Budgetary Comparison Schedule to enhance comparability. The principal differences are as follows:

- 1) Encumbrances are recorded as expenditures under the budgetary basis and as reservations of fund balances under GAAP basis.
- 2) The Municipality receives certain revenues as contributions from governmental entities and legislative, which are not included therein nor are the related expenditures.

Because accounting principles applied for purposes of developing data on budgetary basis differ significantly from those used to present governmental fund financial statements in conformity with GAAP, a reconciliation of differences in the deficiency of revenues and other financing sources under expenditures and other uses of financial sources for the year ended June 30, 2011 was presented for the general fund as part of the accompanying budgetary comparison schedule.

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NOTES TO FINANCIAL STATEMENTS (continued)
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The necessary adjustments to convert the result of operations of the general fund from the modified accrual basis of accounting to the budgetary basis for fiscal year June 30, 2011 are as follows:

Results of operations as per statement of revenue, expenditures and changes in fund balances	\$ (16,131,877)
Adjustments:	
Less:	
Non-budgeted revenues recorded	(27,865,144)
Current year encumbrances recognized as expenditures for budgetary basis	(2,452,263)
Add:	
Non-budgeted expenditures recorded	42,034,745
Prior year encumbrances recorded as current year expenditures for GAAP purposes	4,190,202
Excess of revenue over expenditures - budgetary basis	\$ (224,337)

The Municipality is statutorily required to satisfy the debt service requirements, regardless of whether such amounts are appropriated or not. Appropriations are enacted for certain departments and divisions. Appropriations for capital projects are made for each bond or note issue and authorization continues for the expected construction period.

Note 3 - Deposits and Investments

The Municipality maintains its deposits of cash in various commercial banks located in Puerto Rico and Governmental Development Bank for Puerto Rico (GDB) a component unit of the Commonwealth, who serves as a fiscal agent for the Municipality. Proceeds from bonds and funds related to certain grant awards are required by law to be held with GDB.

On July 1, 2004, 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.

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NOTES TO FINANCIAL STATEMENTS (continued)
JUNE 30, 2011

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

Therefore, the Municipality's management has concluded that the risk related to any possible loss related to defaults by commercial banks on the Municipality's deposits is considered low at June 30, 2011.

Interest Rate Risk – This is the risk that changes in interest rates of debt investments will adversely affect the fair value of an investment. The Municipality manages its exposure to declines in fair values by: (1) not including debt investments in its investment portfolio at June 30, 2011, (2) limiting the weighted average maturity of its investments to three months or less and (3) keeping most of its bank deposits in interest bearing accounts generating interest at prevailing market rates. The Municipality's investments in certificates of deposits are recorded at cost, which approximates their fair value. Therefore, the Municipality's management has concluded that at June 30, 2011, the interest rate risk associated with the Municipality's cash and cash equivalents is considered low.

Custodial Credit Risk – In the case of deposits, this is the risk that in the event of a bank failure, the Municipality's deposits may not be recovered. Pursuant to the *Statement of Investment Guidelines for the Government of the Commonwealth of Puerto Rico*, the balances deposited in commercial banks by the Municipality are insured by the Federal Deposit Insurance Corporation (FDIC) generally up to a maximum of \$250,000 per depositor. However, under the laws and regulations of the Commonwealth, public funds deposited in commercial banks must be fully collateralized for the amount deposited in excess of federal depository insurance provided by the FDIC. All securities pledged as collateral are held by an agent of the Secretary of the Treasury of the Commonwealth in the name of the Municipality. Deposits with GDB are uninsured and uncollateralized. However, no losses related to defaults by GDB on deposit transactions have been incurred by the Municipality through June 30, 2011.

Foreign Exchange Risk – The risk that changes in exchange rates will adversely affect the value of an investment or a deposit. According to the aforementioned investment guidelines, the Municipality is prevented from investing in foreign securities or any other types of investments in which foreign exchange risk exposure may be significant. Accordingly, management has concluded that the foreign exchange risk related to the Municipality's deposits is considered low at June 30, 2011.

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NOTES TO FINANCIAL STATEMENTS (continued)
JUNE 30, 2011

At June 30, 2011, the total deposits are as follows:

	Major governmental funds					Other governmental	Total governmental
	General	Debt Service	Capital project	Economic investment	Workforce investment		
Unrestricted cash and cash equivalents in commercial banks	\$ 66,147,732	\$ -	\$ 5,828,923	\$ 353,681	\$ -	\$ -	\$ 72,330,336
Total unrestricted cash	<u>66,147,732</u>	<u>-</u>	<u>5,828,923</u>	<u>353,681</u>	<u>-</u>	<u>-</u>	<u>72,330,336</u>
Restricted cash:							
Cash and cash equivalent in commercial banks	5,612,398	902,650	-	7,296,319	2,140	4,225,981	18,039,488
Cash with fiscal agent, GDB	192	55,313,607	64,499,236	-	-	-	119,813,035
Total restricted cash	<u>5,612,590</u>	<u>56,216,257</u>	<u>64,499,236</u>	<u>7,296,319</u>	<u>2,140</u>	<u>4,225,981</u>	<u>137,852,523</u>
Total deposits and investments	<u>\$ 71,760,322</u>	<u>\$ 56,216,257</u>	<u>\$ 70,328,159</u>	<u>\$ 7,650,000</u>	<u>\$ 2,140</u>	<u>\$ 4,225,981</u>	<u>\$ 210,182,859</u>

Note 4 Property Taxes

The Municipality is authorized by law to impose and collect personal and real property taxes from any natural or legal person engaged in trade or business that, at January 1 of each year: (1) is engaged in trade or business and is the owner of personal property or real property used in trade or business or (2) owns residential real property with a value in excess of \$150,000 (at 1957 market prices).

The CRIM is responsible for the assessment of all real and personal property located within the Municipality and for the levy, administration and collection of the corresponding taxes. Personal property taxes are self-assessed by taxpayers every year using the book value of personal property assets owned by the taxpayer at January 1 and reporting such taxable value through a personal property tax return filed on May 15 subsequent to the assessment date. At June 30, 2011, the total personal property tax rate in force was 8.28 % (of which taxpayers pay 8.08% and the remaining .20% is paid by the Department of Treasury of the Commonwealth, as a subsidy). Complete exemption from personal property taxes up to an assessment of \$50,000 is granted to retailers with an annual volume of net sales under \$150,000. The Department of Treasury instead of the property taxpayers becomes the source of payment in these cases.

The assessment on real property is made every January 1 and is based on estimated current values of the property deflated at 1957 market prices. At June 30, 2011, the total real property tax rate in force was 10.28% (of which 10.08% is paid by taxpayers). Real property taxes are billed by the CRIM and are due in two equal installments in July and January following the assessment date. Residential real property occupied by its owner is exempt by law from property taxes on the first \$150,000 of the assessed value (\$15,000 at 1957 market prices). For such exempt amounts, the Department of Treasury of the Commonwealth 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. In addition, veterans have additional exemption from taxes of \$5,000 of the assessed value of real property. The revenue related to the basic tax on exempt property is recorded in the general fund when collections are received from the CRIM.

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NOTES TO FINANCIAL STATEMENTS (continued)
JUNE 30, 2011

According to Act No. 81, CRIM is required to remit 1.03% of the personal and real property tax collected to the Municipality to be used for the partial funding of the debt service requirements on general obligations and notes payable of the Municipality. In addition, there is a portion of the tax rate of 3.25% of the total personal property and real property taxes collected by CRIM that is restricted for the debt service requirements of the Municipality and is retained by GDB for such purposes. Accordingly, such amount is recorded as revenues in the debt service fund when collected and reported by the CRIM.

Since the collection of property taxes from the taxpayers is under the administration of the CRIM, the Municipality recognized as expenditure the operational expenses allocated by the CRIM to the Municipality, which amounted to \$1,736,828 during the fiscal year ended June 30, 2011.

CRIM reports annually to the Municipality the estimated amount of property tax expected to be collected for the ensuing fiscal year. Throughout the fiscal year, CRIM advances funds to the Municipality based on the initial estimated collection amounts for the fiscal year. 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 the property tax amounts actually collected from taxpayers during the fiscal year.

This settlement has to be completed no later than December 31 following the fiscal year end. If CRIM remits to the Municipality property tax advances, which are less than the property tax actually collected, an intergovernmental receivable is recorded at June 30 in the Municipality's basic financial statements. However, if advances exceed the amount actually collected by CRIM, an intergovernmental payable is recorded at June 30. For the fiscal year ended June 30, 2011, the property tax collections not exceeded the advances remitted by CRIM by \$688,776, which are recorded within intergovernmental payables in the accompanying GWFS and GFFS (see note 11).

The following is a summary of the property tax advances, which resulted as an intergovernmental payable, at June 30, 2011:

Amortization through collections of property taxes by the CRIM	\$ 50,436,721
Advance received from CRIM	<u>51,125,497</u>
Due to CRIM	<u>\$ (688,776)</u>

This amount was recorded as outstanding debt in the accompanying government wide-statement of net assets and governmental fund-balance sheet.

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NOTES TO FINANCIAL STATEMENTS (continued)
JUNE 30, 2011

Furthermore, included within the total personal and real property tax rates of 8.28% and 10.28%, respectively, there is a portion of the tax rates that is recorded in the Municipality's general fund, of which a portion is restricted for the payment of: (1) the insurance premiums acquired through the Department of Treasury, (2) the principal and interest on five Municipality's general obligation bonds, (3) the monthly contributions to CRIM, which are statutorily required as the Municipality's share of CRIM's operating expenses, (4) statutory contributions to the Puerto Rico Health Services Administration (PRHSA), as the Municipality's share of the cost of the public health insurance coverage provided to qualifying low-income citizens, (5) certain notes payable to CRIM (see note 11) and, (6) certain amounts due to certain agencies and component units of the Commonwealth, which are recorded within intergovernmental payables in the accompanying GWFS and GFFS. The 0.20 percent of unrestricted personal and real property taxes paid by the Department of Treasury as a subsidy is recorded in the Municipality's general fund.

The Traditional Lottery System of the Commonwealth (the "Additional Lottery") is an operational unit reported as an enterprise fund of the Commonwealth's basic financial statements, which currently operates several betting alternatives to the citizens for Puerto Rico. The Traditional 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 5 - Municipal License Taxes And Sales And Use Taxes

Municipal License Tax

The Municipality is authorized by Act No. 81 to imposes and collect municipal volume license taxes to any natural or legal person having trade or business activities within the territory of Carolina, which are not totally or partially exempt form tax pursuant to the Industrial Incentives Act of the Commonwealth of Puerto Rico. This is a self-assessed tax based on the business volume in gross sales as shown in the tax return. The declaration filling date is ten days after the State Income Tax is filed (usually the 15th day of April of each year).

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Entities with sales volume of \$1 million or more must include rates established by the Municipality. At June 30, 2011, the municipal tax rates imposed by the Municipality were 1.50% for financing institutions and .50% for any other taxpayers. Any taxpayers, who 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 standards rates.

Each taxpayer must assess his/her corresponding municipal license tax by declaring his/her volume of business through a tax form based on the actual volume of business generated in the preceding calendar year. The tax can be paid by the taxpayer in two equal installments: (1) the first payment due in July 15, and (2) January 15 subsequent to the filing of the declaration. The first installment of the tax covers the taxable period (six months) ended December 31 subsequent to the filing date of the declaration, while the second installment of the tax covers the taxable period (six months) 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, a 5% discount is granted automatically in the tax amount due. The minimum gross revenue to file the Volume of Business Tax declaration is \$5,000 and the minimum tax payable is \$25.

Municipal license taxes collected in advance (that is, prior to June 30 but pertaining to the next fiscal year) are recorded as deferred revenues in the GWFS and the GFFS (see note 7). As of June 30 2011, the total municipal volume of business tax collected was \$26,910,835 and the receivable balance (net of the allowance for estimated uncollectible amounts) was \$3,573,362.

Municipal Sales and Use Taxes

On July 4, 2006, the Governor of Puerto Rico signed Act No. 117, known as the "*Tax Fairness Act of 2007*" (hereinafter the "Act"). Among its provisions, the Act provides for sales and uses tax of 5.5% at a Commonwealth level and authorizes the municipalities to impose sales and uses tax of 1.5% at the municipal level. On July 12, 2006, the Municipal Legislature of the Municipality of Carolina approved the Ordinance No. 03 (Series 2006-2007) based on the State Public Law No. 117 establishing a local sales and use tax of 1.5% over the sale of goods and services made within the Municipalities boundaries. Under this Ordinance, any person or legal entity doing business or making retail sales are required to register on the Municipality to obtain a retailer's Registration Certificate. The retailers are required to file monthly sales tax returns by the 10th day following the month in which the tax was collected.

On July 29, 2007, the Public Law No. 80 established that the municipalities may collect only 1% of its sales and use tax and the Puerto Rico Treasury Department (PRTD) the other 0.5%. Consequently, the Ordinance No. 15 (Series 2007-2008) was approved in order to revise the local sales and use tax of 1% at the municipal level. Resources collected would be use for construction, permanent improvements, health and public safety services, the improvements in the management of solid waste disposal and the implementation of recycling programs by the Municipality. Sales and uses taxes collections (at the municipal level of 1%) during fiscal year 2010-11 amounted to \$17,689,916.

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The tax collected by PRTD will be distributed to the municipalities in three separate funds:

1. Municipal Redemption Fund – composed of .2% of the .5% collected by the PRTD. To be used to grants loans for the exclusive benefit of the municipalities. This fund, in addition to other variables, is used to calculate the Municipality's borrowing power within a specific timeframe. The Municipality's contribution to the fund was \$2,667,467 as of June 30, 2011. This amount was recorded in the debt service fund.
2. Municipal Development Fund – composed of .2% of the .5% collected by the PRTD. To be used to establish a Municipal Development Fund to be distributed within all municipalities by formula based on total amounts collected, operational budgets and population. The amount received from this fund in the fiscal year ended June 30, 2011 was \$129,585.
3. Municipal Improvements Fund – composed of .1% of the .5% collected by the PRTD. To be distributed and assigned by the State Legislature for construction and permanent improvements projects to the municipalities. No benefit was received from this fund in the fiscal year 2010-11.

Note 6 - Interfunds Transactions

Interfund transactions at June 30, 2011 consisted of the following:

Operating Transfer

Transfer to:	Transfer from:					
	Major funds				Other governmental fund	Total governmental funds
	General Fund	Debt service fund	Capital project fund	Economic investment fund		
Major funds:						
General fund	\$ -	\$ -	\$ 754,430	\$ -	\$ 514,399	\$ 1,268,829
Debt service fund	5,976,324	-	-	1,645,988	-	7,622,312
Capital project fund	8,660,290	-	1,415,914	-	200,000	10,276,204
Economic development fund	-	-	-	177,444	-	177,444
Other funds	1,311,776	-	211,517	-	-	1,523,293
Total	\$ 15,948,390	\$ -	\$ 2,381,861	\$ 1,823,432	\$ 714,399	\$ 20,868,082

Due from / to

Due to:	Due from:					
	Major funds				Other governmental fund	Total governmental funds
	General Fund	Debt Service Fund	Capital project Fund	Economic investment fund		
Major funds:						
General fund	\$ -	\$ 285,883	\$ 383,421	\$ 424,424	\$ 3,344,701	\$ 4,438,429
Debt service fund	-	-	-	-	-	-
Capital project fund	637,673	-	193,002	-	-	830,675
Economic development fund	143	-	-	515,828	181,622	697,593
Other funds	1,108,699	-	230,205	-	550,332	1,889,236
Total	\$ 1,746,515	\$ 285,883	\$ 806,628	\$ 940,252	\$ 4,076,655	\$ 7,855,933

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Inter-funds transfer in/out reflect the transfers of resources between from one governmental fund to another without the attempt to recovering. Inter-funds receivables and payables represent the pending settlements of the aforementioned transfers, which are considered by management to be fully realizable at June 30, 2011. As mentioned earlier, the inter-fund receivables and payables and operating transfer in and out recorded in the accompanying FFS are eliminated on the GWFS.

Note 7 - Deferred Revenues

Deferred revenues recorded in the accompanying GWFS and the GFFS are as follows:

- a. General Fund - the deferred revenue of \$30,343,897 in the general fund is related to municipal license taxes collected in fiscal year 2010-11 that will be earned in fiscal year 2011-12. Otherwise, the balances of \$3,904,149 in the general fund and \$3,479,053 in the debt service fund represent the municipal license taxes, property taxes and sales taxes receivables from prior years, not collected as of June 30, 2011.
- b. Deferred federal revenue – the deferred revenues recorded in the deferred federal revenue funds of \$5,619,000 represent the portion of federal grant for which qualifying expenditures have not been incurred.

Note 8 - Intergovernmental Payable

Due to other governmental units recorded in the accompanying GWFS and GFFS consists of the following:

	Included in general fund	Included in workforce inv. fund	Total governmental funds	Included in GWFS	Total GWFS
Puerto Rico Electric Power Authority	\$ 14,1377	-	\$ 14,1377	-	\$ 14,1377
Municipal Revenue Collection Center (CRIM)	5,014,916	-	5,014,916	91,544	5,106,460
Employers Retirement System of the Government of Puerto Rico	720,643	-	720,643	-	720,643
State Insurance fund Corporation (FSE)	444,106	-	444,106	-	444,106
Human Resource Development Occupational Council	-	20,595	20,595	-	20,595
Total	\$ 6,321,042	\$ 20,595	\$ 6,341,637	\$ 91,544	\$ 6,433,181

Note 9 - Intergovernmental Revenues

Sources of intergovernmental revenue consist primarily of governmental contributions from the Commonwealth of Puerto Rico and "in lieu of tax" contribution from a "quasi-public" corporation, such as the Puerto Rico Electric Power Authority (AEE) amounting to \$1,625,326 and \$12,212,112, respectively. These intergovernmental revenues are accounted for in the general fund.

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NOTES TO FINANCIAL STATEMENTS (continued)
JUNE 30, 2011

Note 10 - Capital Assets

Capital assets activity for the year ended June 30, 2011, was as follows:

	Balance at June 30, 2010	Additions	Retirements dispositions and reclassifications	Balance at June 30, 2011
Governmental activities				
Cost basis of capital assets, not being depreciated/amortized:				
Land	\$ 1,308,929,509	5,514,107	-	\$ 1,314,443,616
Construction in progress	81,039,237	20,950,319	(624,214)	101,365,342
Infrastructure in progress	<u>15,412,003</u>	<u>6,949,965</u>	<u>(421,711)</u>	<u>22,940,797</u>
Total capital assets, not being depreciated/amortized	<u>\$ 1,406,380,749</u>	<u>\$ 33,414,391</u>	<u>\$ (1,045,385)</u>	<u>\$ 1,438,749,755</u>
Cost basis of capital asset, being depreciated/amortized:				
Buildings, infrastructure and improvements	523,915,143	6,914,164	647,129	531,476,436
Licensed vehicles, machinery, equipment furniture and fixtures	<u>43,203,188</u>	<u>3,374,168</u>	<u>(12,1066)</u>	<u>46,456,290</u>
Total capital assets, being depreciated/ amortized	<u>567,118,331</u>	<u>10,288,332</u>	<u>526,063</u>	<u>577,932,726</u>
Total cost basis of capital assets	<u>1,973,499,080</u>	<u>43,702,723</u>	<u>(519,322)</u>	<u>2,016,682,481</u>
Less: accumulated depreciation and amortization:				
Buildings, infrastructure and improvements	(85,233,444)	(8,607,842)	-	(93,841,286)
Licensed vehicles, machinery, equipment furniture and fixtures	<u>(13,232,835)</u>	<u>(3,636,224)</u>	<u>-</u>	<u>(16,869,059)</u>
Total accumulated depreciation and amortization	<u>(98,466,279)</u>	<u>(12,244,066)</u>	<u>-</u>	<u>(110,710,345)</u>
Total capital assets, net	<u>\$ 1,875,032,801</u>	<u>\$ 31,458,657</u>	<u>\$ (519,322)</u>	<u>\$ 1,905,972,136</u>

Depreciation and amortization expense for the fiscal year ended June 30, 2011 was charged to functions in the accompanying government wide statement of activities as follows:

General government	\$ 3,121,750
Public safety	1,187,815
Public works streets and transportation	3,083,528
Sanitation	1,411,406
Recreations and sports	469,163
Education and training	1,016,155
Housing and buildings	1,041,978
Economic Development	318,326
Welfare	405,809
Employment opportunity	<u>188,136</u>
Total depreciation and amortization expense	<u>\$ 12,244,066</u>

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NOTES TO FINANCIAL STATEMENTS (continued)
JUNE 30, 2011

Note 11 - Long Term Debt

The general long-term debt activity for the year ended June 30, 2011 was as follows:

	Balance at June 30, 2010	Borrowings or Additions	Payments or Deductions	Balance at June 30, 2011	Due within one year	Long term portion
Bonds and notes payables	\$ 331,007,536	23,395,000	\$ (17,176,546)	\$ 337,225,990	\$ 18,106,100	\$ 319,119,890
Federal notes payables	12,115,000	-	(965,000)	11,150,000	965,000	10,185,000
Notes payable to Crim	19,021,653	688,776	(3,882,797)	15,827,632	5,788,011	10,039,621
Compensated absences	14,228,354	951,737	(1,716,803)	13,463,288	1,648,615	11,814,673
Estimated liability for municipal solid waste land fill closure and postclosure Claims and judgments	1,261,761 4,872,840	1,306,939 -	- (2,180,864)	2,568,700 2,691,976	- 164,451	2,568,700 2,527,525
Total	\$ 382,507,144	\$ 26,342,452	\$ (25,922,010)	\$ 382,927,586	\$ 26,672,177	\$ 356,255,409

Debt Limitation

The Municipality's Legislature is legally authorized to determine the contracting of debts of the Municipality. Nevertheless, the laws and regulations of the Commonwealth also provide that:

- Direct obligations of the Municipality (evidenced principally by bonds and notes) are backed by the full faith, credit and taxing power of the Municipality; and
- Direct obligations are not to be issued if the amount of the principal of, and interest on, such bonds and notes (and on all such bonds and notes issued thereafter) which are payable in any fiscal year, together with any amount paid by the Municipality in the preceding fiscal year on accounts of bonds or notes guaranteed by the Municipality, exceed 10 percent of the total assessed value of the property located within the Municipality plus the balance of the ad valorem taxes in the debt service fund, for bonds payable to be repaid with the proceeds of property taxes restricted for debt service.

In addition, before any new bonds or notes are issued, the revenues of the debt services fund should be sufficient to cover the projected debt service requirement. At June 30, 2011, the Municipality is in compliance with the debt limitation requirements.

Bonds Payable

The Municipality issues general and special (public improvements) obligations bonds and notes to provide for the acquisition, construction and improvements of major capital assets, as well as, to finance certain operations needs.

The laws and regulations of the Commonwealth provide that the Municipality's public debt will constitute a first claim on the available revenue of the Municipality. Public debt includes bonds and bond anticipation notes. The good faith, credit and taxing power of the Municipality are irrevocably pledged for the prompt payment of the principal and interest of bonds and bond anticipation notes.

COMMONWEALTH OF PUERTO RICO
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NOTES TO FINANCIAL STATEMENTS (continued)
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The Municipality levies an annual additional special tax of the assessed value of personal and real property. The proceeds of this additional special tax are deposited in a sinking fund established at GDB whereby sufficient funds are set aside to redeem the bonds payable of the Municipality in minimum annual or semiannual principal and interest payments. The collections of this special tax are recorded in the Municipality's debt service fund.

For financial reporting purposes, the outstanding balances of bonds represent the total principal to be repaid. Bonds payable is composed as follows at June 30, 2011:

	<u>Outstanding balance</u>
<u>General obligation and special bonds:</u>	
2010 serial bonds, original issue amount of \$23,395,000, due in annual principal installments ranging from \$565,000 to \$1,475,000; plus interest due in semiannually installments with variables rates through July 1, 2035	\$ 22,855,000
2009 serial bonds, original issue amount of \$21,165,000, due in annual principal installments ranging from \$715,000 to \$1,515,000; plus interest due in semiannual installments with variable through July 1, 2030	19,885,000
2009 serial bonds, original issue amount of \$38,940,000, due in annual principal installments ranging from \$1,140,000 to \$2,640,000; plus interest due in semiannual installments with variable rates through July 1, 2032	36,895,000
2008 serial bonds, original issue amount of \$6,370,000, due in annual principal installments ranging from \$360,000 to \$585,000; plus interest due in semiannual installments with variable through July 1, 2023	5,440,000
2008 serial bonds, original issue amount of \$3,650,000, due in annual principal installments ranging from \$95,000 to \$245,000; plus interest due in semiannual installments with variable rates through July 1, 2033	3,415,000
2008 serial bonds, original issue amount of \$35,610,000, due in annual principal installments ranging from \$1,125,000 to \$2,845,000; plus interest due in semiannual installments with variable rates through July 1, 2030	32,695,000

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NOTES TO FINANCIAL STATEMENTS (continued)
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	<u>Outstanding balance</u>
<u>General obligation and special bonds:</u>	
2007 serial bonds, original issue amount of \$800,000, due in annual principal installments ranging from \$120,000 to \$130,000; plus interest due in semiannual installments with variable rates through July 1, 2015	490,000
2007 serial bonds, original issue amount of \$32,355,000, due in annual principal installments ranging from \$1,745,000 to \$2,845,000; plus interest due in semiannual installments with interest rate at 5.00% through July 1, 2023	26,460,000
2007 serial bonds, original issue amount of \$1,450,000, due in annual principal installments ranging from \$90,000 to \$135,000; plus interest due in annually installments with interest rate at 5.125% through July 1, 2021	1,081,000
2006 serial bonds, original issue amount of \$2,830,000, due in annual principal installments ranging from \$80,000 to \$195,000; plus interest due in semiannual installments with interest rate at 5.00% through July 1, 2031	2,505,000
2006 serial bonds, original issue amount of \$27,475,000, due in annual principal installments ranging from \$1,425,000 to \$2,325,000; plus interest due in semiannual installments with interest rate at 5.00% through July 1, 2023	21,605,000
2006 serial bonds, original issue amount of \$866,390, due in annual principal installments ranging from \$135,200 to \$141,690; plus interest due in annually installments with interest rate at 4.125% through July 1, 2014	405,990
2005 serial bonds, original issue amount of \$12,470,000, due in annual principal installments ranging from \$530,000 to \$955,000; plus interest due in semiannual installments with interest rate at 5.00% through July 1, 2025	9,905,000
2005 serial bonds, original issue amount of \$12,470,000, due in annual principal installments ranging from \$530,000 to \$955,000; plus interest due in semiannual installments with interest rate at 5.00% through July 1, 2025	9,905,000

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NOTES TO FINANCIAL STATEMENTS (continued)
JUNE 30, 2011

	<u>Outstanding balance</u>
<u>General obligation and special bonds:</u>	
2005 serial bonds, original issue amount of \$12,460,000, due in annual principal installments ranging from \$530,000 to \$955,000; plus interest due in semiannual installments with interest rate at 5.00% through July 1, 2025	9,895,000
2004 serial bonds, original issue amount of \$15,550,000, due in annual principal installments ranging from \$730,000 to \$1,190,000; plus interest due in semiannual installments with interest rate at 5.00% through July 1, 2023	11,060,000
2008 serial bonds, original issue amount of \$23,500,000, due in annual principal installments ranging from \$750,000 to \$1,810,000; plus interest due in semiannual installments at 5.60% through January 1, 2027	18,890,000
2003 serial bonds, original issue amount of \$4,000,000, due in annual principal installments ranging from \$139,000 to \$259,000; plus interest due in annually installments with interest rate at 4.50% through July 1, 2027	3,030,000
2003 serial bonds, original issue amount of \$1,310,000, due in annual principal installments ranging from \$40,000 to \$105,000; plus interest due in semiannual installments with interest rate at 6.50% through July 1, 2027	1,055,000
2003 serial bonds, original issue amount of \$23,000,000, due in annual principal installments ranging from \$770,000 to \$1,625,000; plus interest due in semiannual installments with interest rate at 5.50% through July 1, 2027	17,940,000
2003 serial bonds, original issue amount of \$1,360,000, due in annual principal installments ranging from \$45,000 to \$88,000; plus interest due in semiannual installments with interest rate at 5.50% through July 1, 2027	1,073,000
2003 serial bonds, original issue amount of \$5,040,000, due in annual principal installments ranging from \$165,000 to \$365,000; plus interest due in semiannual installments with interest rate at 5.04% through July 1, 2027	3,955,000

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NOTES TO FINANCIAL STATEMENTS (continued)
JUNE 30, 2011

	<u>Outstanding balance</u>
<u>General obligation and special bonds:</u>	
2009 serial bonds, original issue amount of \$9,586,000, due in annual principal installments ranging from \$393,000 to \$631,000; plus interest due in semiannually installments with variables rates through July 1, 2028	8,551,000
2003 serial bonds, original issue amount of \$4,310,000, due in annual principal installments ranging from \$135,000 to \$330,000; plus interest due in annually installments with interest rate at 5.60% through July 1, 2027	3,445,000
2001 serial bonds, original issue amount of \$20,120,000, due in annual principal installments ranging from \$1,105,000 to \$1,805,000; plus interest due in semiannual installments with variable rates July 1, 2020	12,455,000
2000 serial bonds, original issue amount of \$30,285,000, due in annual principal installments ranging from \$2,070,000 to \$2,400,000; plus interest due in semiannual installments with variable rates through July 1, 2017	13,270,000
1998 serial bonds, original issue amount of \$13,165,000, due in annual principal installments ranging from \$685,000 to \$1,175,000; plus interest due in semiannual installments with variable rates through July 1, 2020	7,935,000
1998 serial bonds, original issue amount of \$23,890,000, due in annual principal installments ranging from \$915,000 to \$1,860,000; plus interest due in semiannual installments with variables rates through January 1, 2017	16,855,000
1997 serial bonds, original issue amount of \$2,370,000, due in annual principal installments ranging from \$105,000 to \$205,000; plus interest due in annually installments with variable rates through July 1, 2022	1,585,000
1996 serial bonds, original issue amount of \$10,475,000, due in annual principal installments ranging from \$865,000 to \$1,010,000; plus interest due in semiannual installments with variable rates July 1, 2015	3,610,000

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NOTES TO FINANCIAL STATEMENTS (continued)
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	<u>Outstanding balance</u>
<u>General obligation and special bonds:</u>	
1995 serial bonds, original issue amount of \$16,630,000, due in annual principal installments ranging from \$790,000 to \$1,465,000; plus interest due in semiannual installments with variable rates through July 1, 2019	<u>9,080,000</u>
Total general obligation and special bonds	<u>337,225,990</u>
<u>Federal notes payables:</u>	
2006 serial loan guarantee federal program, original issue amount of \$5,000,000, due in annual principal installments of \$250,000; plus interest due in semiannually installments with variable rates through August 1, 2026	4,000,000
2001 serial loan guarantte federal program, original issue amount of \$14,300,000, due in annual principal installments of \$715,000 to \$2,145,000; plus interest due in semiannual installments with variable rates through August 1, 2020	<u>7,150,000</u>
Total federal notes	<u>11,150,000</u>
Total municipal obligation bonds and notes payables	<u>348,375,990</u>
Less: current portion due in fiscal year ended June 30, 2012 (reported as bonds and interest notes payables in Statement of Net Assets)	<u>(19,071,100)</u>
Long-term portion (reported as bonds and notes payables in Statement Net Assets)	<u>\$329,304,890</u>

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NOTES TO FINANCIAL STATEMENTS (continued)
JUNE 30, 2011

Variable interest rates on serial bonds are reviewed periodically by GDB and are based on the fluctuation of GDB's weighted average rate for its commercial paper program. Under this program, GDB issues commercial paper: (1) in the taxable and tax-exempt markets of the United States of America, (2) in the Eurodollar market and (3) to corporations having tax exemptions under the Commonwealth's Industrial Incentives Acts and, which qualify for benefits provided by the former Section 936 of the U.S. Internal Revenue Code. The principal and interest maturities for the general obligation bonds of the Municipality of Carolina at June 30, 2011 are as follows:

General obligations and Special bonds			
Year Ending June 30	Principal	Interest	Total
2012	\$ 19,071,100	\$ 18,777,251	\$ 37,848,351
2013	20,007,200	18,126,158	38,133,358
2014	21,059,690	17,067,716	38,127,406
2015	22,036,000	15,941,709	37,977,709
2016-2020	112,413,000	61,765,103	174,178,103
2021-2025	92,580,000	32,605,413	125,185,413
2026-2030	48,354,000	12,649,368	61,003,368
2031-2035	12,855,000	2,430,621	15,285,621
Total	\$ 348,375,990	\$ 179,363,339	\$ 527,739,329

Notes payable to CRIM

At June 30, 2011, the liability to CRIM is composed as follow:

	Balance at June 30, 2010	Additions	Payments or Deductions	Balance at June 30, 2011	Due within one year	Long term portion
Interest due for accounts sold (Act. No. 146)	\$ 6,984,608	\$ -	\$ (317,482)	\$ 6,667,126	\$ 317,482	\$ 6,349,644
LIM S refinancing debt	1,060,957	-	(696,888)	364,069	364,069	-
Amount due to CRIM for excess of preproperty taxes advance received on prior years (Act. No. 42)	3,867,653	-	(86,132)	3,781,521	91544	3,689,977
Amount due to CRIM - 2008-09 (reported as due to other government agencies)	2,782,295	-	(2,782,295)	-	-	-
Amount due to CRIM - 2009-10 (reported as due to other government agencies)	4,326,140	-	-	4,326,140	4,326,140	-
Amount due to CRIM - 2010-11 (reported as due to other government agencies)	-	688,776	-	688,776	688,776	-
Total	\$ 19,021,653	\$ 688,776	\$ (3,882,797)	\$ 15,827,632	\$ 5,788,011	\$ 10,039,621

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NOTES TO FINANCIAL STATEMENTS (continued)
JUNE 30, 2011

Public Act No. 42 – The Commonwealth's Public Act No. 42 of January 26, 2000 was enacted to authorize CRIM to enter into a financing agreement of up to \$200 million, for a term not exceeding 30 years. The financing agreement authorized CRIM to finance a debt that the municipalities of Puerto Rico had with such entity, which arose from the difference between the yearly final settlements of property tax advances made by CRIM to the municipalities and the actual property tax collections received by CRIM from taxpayers through fiscal year 2000.

The amounts that the municipalities will collect from the additional property taxes resulting from the increases in the subsidy from the Commonwealth are assigned through Act No. 42 to repay such note. The increase in this subsidy was the result of Public Act No. 238 of August 15, 1999. The repayment agreement bears interest rate at 6.1875% (beginning in July 1, 2002). The outstanding principal of the note payable to CRIM amounted to \$3,781,521 at June 30, 2011. The principal and interest maturities are as follows:

Year Ending June 30	Principal	Interest	Total
2012	\$ 91,544	\$ 232,587	\$ 324,131
2013	97,296	226,835	324,131
2014	103,410	220,721	324,131
2015	109,907	214,224	324,131
2016-2020	662,213	958,440	1,620,653
2021-2025	898,093	722,562	1,620,655
2026-2030	1,217,992	402,660	1,620,652
2031-2035	601,066	47,196	648,262
Total	\$ 3,781,521	\$ 3,025,225	\$ 6,806,746

Public Act No. 146 – On September 24, 2002, CRIM, on behalf of the municipalities of Puerto Rico, entered into a financing agreement with GDB pursuant to the provisions of Public Act No. 146 of October 11, 2001, as amended (Act No. 146). The purpose of this financing agreement was to extinguish in advance certain bonds payable issued by Public Finance Corporation (PFC), a subsidiary of GDB, which were originally issued to pay certain property tax receivables owned by the municipalities of Puerto Rico through 1996, which were acquired by PFC with recourse.

Principal payments are made in March of each year and interest in March and September. Which last payment is due in March 2032. Interest payments on this financing agreement are accounted for in the general fund. On October, 2002, the Resolution Num. 20 Series 2002-03 was enacted which authorized the Municipality to obtain up to \$7,937,055, for a term not exceeding 25 years, for the repayment of bonds issued for the sale of delinquent accounts.

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NOTES TO FINANCIAL STATEMENTS (continued)
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The repayment agreement bears interest at variable rates (beginning in 6.22% at July 1, 2007). The outstanding balance of the interest due for accounts sold as of June 30, 2011 was \$6,667,126.

The principal and interest maturities are as follows:

Year Ending June 30	Principal	Interest	Total
2012	\$ 317,482	\$ 414,696	\$ 732,178
2013	317,482	394,948	712,430
2014	317,482	375,200	692,682
2015	317,482	355,452	672,934
2016-2020	1,587,411	1,481,054	3,068,465
2021-2025	1,587,411	987,370	2,574,781
2026-2030	1,587,411	493,684	2,081,095
2031-2035	634,965	59,242	694,207
Total	\$ 6,667,126	\$ 4,561,646	\$ 11,228,772

LIMS – On October 17, 1996, CRIM entered into a financing agreement for the acquisition of a geographic information system known as *Land Information Management System* (LIMS) for the benefit of all of the municipalities of Puerto Rico. The total cost of LIMS was also allocated to all of the municipalities of Puerto Rico by CRIM. On August 31, 2001, CRIM refinanced through GDB, the debt for a term not exceeding 10 years, at no interest. The repayment agreement bears interest at variable rates (beginning in 5.95% at November 28, 2001). This note is payable in monthly installments of \$62,483 (accounted for in the general fund) through December 1, 2011.

On November 28, 2001 the CRIM, financed the Real Property Digitalization System (LIMS) that must be used in the island. The total cost of this System was distributed among all Municipalities. The share of this cost assigned to the Municipality of Carolina amounted to \$5,590,483, financed for 10 years at a 5.95% interest rate, payable in semiannual installments. The outstanding balance of the LIMS refinancing debt as of June 30, 2011 was \$364,069. The principal and interest maturities are as follows:

Year Ending June 30	Principal	Interest	Total
2012	\$ 364,069	\$ 10,831	\$ 374,900

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NOTES TO FINANCIAL STATEMENTS (continued)
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Municipality solid waste landfill closure and post-closure care costs

The Municipality is required to place a final cover on the Municipality's solid waste landfill site when it stops accepting waste and to perform certain maintenance and monitoring functions at the site for 30 years after closure. The Municipality has performed a study of the activities that need to be implemented at the Municipality's solid waste landfill to guarantee the maximum yield of available space and to comply with applicable state and federal regulations.

Based on this study, the Municipality has recorded an estimated liability for landfill closure in 30.22 acres of \$2,568,700 in the accompanying GWFS, using current costs allocated, based on the actual landfill capacity used at June 30, 2011.

The portion of the estimated current costs to be incurred in future years is approximately \$170,000 annually, which has not been recorded yet in the accompanying GWFS. Actual costs may be different to the recorded estimated liability due to inflation, changes in technology, or changes in laws and regulations. At June 30, 2011, the Municipality's solid waste landfill is still operating and its remaining estimated useful life is approximately 10 years. Approximately 50% of the Municipality's total capacity has been used at June 30, 2011.

Compensated absences

At June 30, 2011, the liability for compensated absences is composed as follows:

	Due within one year	Due after one year	Total
Vacation leave	\$ 312,851	\$ 5,964,867	\$ 6,277,718
Sick leave	1,335,764	5,849,806	7,185,570
Total	<u>\$ 1,648,615</u>	<u>\$ 11,814,673</u>	<u>\$ 13,463,288</u>

Revolving line of credit

On December 24, 2008 the executive director of the *Corporación Carolina Beisbol Gigantes, Inc.*, signed a revolving loan agreement with a commercial bank amounting to \$250,000 with variable interest rate up to 6%. The outstanding balance of the recovery line of credit as of June 30, 2011 was \$250,000, which are recorded in the accompanying GWFS and GFFS.

Note 12 - Employees Retirement System

The Municipality's employees participate in the Employee's Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS), a cost-sharing multi-employer (as related to the Municipality's reporting entity) defined pension plan established by the Commonwealth. The ERS was created under Act No. 447 approved on May 15, 1951, as amended, and became effective on January 1, 1952. The ERS covers all regular employees of the Commonwealth and its instrumentalities, the Municipality and other municipalities of the Commonwealth.

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The ERS provides for retirement, death and disability benefits. Death and disability retirement benefits are available to members for occupational and non-occupational death and disabilities. Retirement benefits depend upon age at retirement and number of years of credited service.

Benefits vest after 10 years of plan participation. Retirement benefits are determined by the application of stipulated benefit to the member's average compensation. Average compensation is computed based on the highest 36 months of compensation recognized by ERS. The annuity, for which a plan member is eligible, is limited to a minimum of \$200 per month and a maximum of 75 percent of the average compensation. On September 24, 1999, Public Act No. 305, an amendment to Act. No. 447, was enacted to establish a defined contribution plan, known as System 2000, to cover employees joining ERS on or after January 1, 2000. Employees that participated in the original plan as of December 31, 1999, had the option to either stay in the defined benefit plan or transfer to System 2000. Employees that joined the Municipality on or after January 1, 2000, were only allowed to become members of System 2000.

System 2000 is a hybrid defined contribution plan, also known as cash balance plan. Under this new plan, there is a pool of pension assets, which is invested by the System, together with those of the cost-sharing multi-employer defined benefit plan. Neither the Commonwealth nor the Municipality guarantee benefits at retirement age. The annuity will be based on a formula which assumes that each year the employees' contribution (with a minimum of 8.275 % of the employees' salary up to a maximum of 10.00 percent) will be invested in an account which will either: (1) earns a fixed rate based on the two-year Constant Maturity U.S. Treasury Notes; (2) earns a rate equal to 75 percent of the return of the ERS' investment portfolio (net of management fees); or (3) earns a combination of both alternatives. Participants receive periodic account statements similar to those of defined contribution plans showing their accrued balances. Disability pensions are not being granted under System 2000. The employer's contributions (9.275 % of the employee's salary) will be used to fund the cost-sharing multi-employer defined benefit plan. System 2000 reduced the retirement age from 65 years to 60 for those employees who joined the current plan on or after January 1, 2000.

Contribution requirements to ERS are established by law and are not actuarially determined. These contributions are as follows:

Municipality and others employers	9.275% of gross salary
Employees:	
Hired on or before March 31, 1990	5.775% of gross salary up to \$6,600 per year, plus 8.275% of gross salary in excess of \$6,600
Hired on or after April 1, 1990	8.275% of gross salary

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On August 12, 2000, Act No. 174 was approved to allow certain participants of the ERS to be eligible for early retirement upon attaining at least age 55 with 25 years of service, provided they made their election on or before April 1, 2001. Those who elected early retirement under this law will receive monthly benefits of 75 percent (if 25 or more years of service and age 55, or 30 or more years or services and 50) or benefits of 65 percent (if 25 years of service by less than age 55) of their average compensation, which is computed based on the highest 36 months of compensation recognized by the ERS. In these cases, the employer (including the Municipality) is responsible for contributing to the System the amount needed to cover the benefit payments and employer contribution with respect to the participants covered until the participants reach the normal retirement age.

In June and July 2003, the Governor of the Commonwealth signed three Public Acts that provided the following certain benefits to retirees:

- (a) Increase in minimum monthly pension payments to \$300, effective January 1, 2004
- (b) Triennial 3 percent increase in all pensions, effective January 1, 2004.
- (c) Increase in widow and/or beneficiaries to 50 percent of the benefit received by the deceased pensioner, effective January 1, 2004.

All the benefits granted will be funded through budgetary assignments in the Municipality's general fund with respect to its retired employees. The required contribution(s) rate in accordance with the funding policy, in dollars or as a percentage of the current year covered payroll and any changes for or during the current year:

Employer Contribution:	9.275% of gross salary
Required contribution in dollars:	
ERS and System 2000	\$3,261,026
Actual contribution in dollars	\$3,261,026

Historically, the Commonwealth has reported ERS and System 2000 in its basic financial statements as pension trust funds. Accordingly, the Commonwealth will assume any actuarial deficiency that may exist or arise related to the Municipality's participating employees since the ERS does not allocate any actuarial deficiencies pertaining to municipal employees participating in the ERS. The Municipality is only required by law to make statutory contributions in the rates mentioned above. As a result, no net pension obligation nor net pension asset that may be allocable to the Municipality's participating employees, if any, has been recorded in the accompanying basic financial statements.

On July 6, 2011, Act No. 116 was approved to increase the Municipality's contribution to the ERS:

Contribution by the Municipality	10.275% of gross salary
	Increasing by 1% each July 1 from the year 2012 to 2015 and then,
	Increasing by 1.25% each July 1 from the year 2016 to 2020

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Under GASB Statement No. 50, Pension Disclosures, the note disclosures for pension plans of governmental entities have been expanded. However, the methods of measurement and recognition have not changed and remain defined by Statements No. 25 and No. 27.

The changes required on pension disclosures have the intention of align the reporting requirements for pension plans with the requirements for other post employment benefits (OPEB). As noted previously, the Municipality of Carolina does not offer its employees any other postemployment benefits plan, apart from the aforementioned Employee's Retirement System (ERS).

Note 13 - Fund Balances

As June 30, 2011, the fund balances is comprised of the following categories:

	General fund	Debt services fund	Capital project fund	Economic development fund	Workforce investment fund	Other governmental fund	Total governmental funds
Restricted for:							
General government	\$ 7,554,821	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 7,554,821
Public safety	2,909,704	-	-	-	-	-	2,909,704
Public works and transportation	1,568,489	-	27,743,716	-	-	1,401,072	30,713,277
Sanitation	3,240,128	-	1,086,393	-	-	-	4,326,521
Recreation and sports	751,528	-	998,229	-	-	-	1,749,757
Education and trainings	816,167	-	861,124	-	-	639,847	2,317,138
Housing and buildings	813,690	-	4,046,278	-	-	4,854,824	9,714,792
Economic development	-	-	-	9,762,750	-	3,002,269	12,765,019
Welfare	776,280	-	-	-	-	703,514	1,479,794
Employment opportunity	-	-	-	-	8,833	-	8,833
Debt payments	-	37,873,578	-	-	-	-	37,873,578
Committed:							
Encumbrances	15,930,522	-	3,1913,831	4,008,332	-	3,865,255	55,717,940
Unassigned	1,854,591	-	-	-	-	-	1,854,591
	<u>\$ 36,215,920</u>	<u>\$ 37,873,578</u>	<u>\$ 66,649,571</u>	<u>\$ 13,771,082</u>	<u>\$ 8,833</u>	<u>\$ 14,466,781</u>	<u>\$ 168,985,765</u>

Note 14 - Commitments and Contingencies

Commitments

The Municipality has several outstanding or planned non-cancelable construction projects amounting to \$35,922,163 at June 30, 2011. These projects are evidenced by contractual commitments and are generally accounted for in the capital project fund and economic development fund. The Municipality has reported, outstanding encumbrances amounting to \$15,930,522 in the general fund at June 30, 2011. The Municipality intends to honor these encumbrances, which will continue to be liquidated under the current fiscal year's budget during a lapse period that extends into the next fiscal year.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA

NOTES TO FINANCIAL STATEMENTS (continued)
JUNE 30, 2011

Contingencies

Legal claims - The Municipality is defendant in various legal proceedings pertaining to matters incidental to the performance of routine governmental operations. Under Act No. 104 of June 25, 1995 as amended, persons are authorized to sue the Municipality only for causes of actions set forth in said Act to a maximum amount of \$75,000 or \$150,000 if it involves actions for damages to more than one person or where a single injured party is entitled to several causes of action. Under certain circumstances, as provided in Act No. 9 of November 26, 1975, as amended, the Municipality may provide its officers and employees with legal representation, as well as assume the payment of any judgment that may be entered against them. However, there is no limitation on the payment of such judgment.

With respects to pending or threatened litigation, the Municipality has reported liabilities of \$2,691,976 or awarded and anticipated unfavorable judgments as of June 30, 2011. This amount was reported within claims and judgments liabilities in the government-wide statement of net assets. Management and legal counsel believes that the ultimate liability in excess of amounts provided, if any, would not be significant.

Federal grants - The Municipality receives financial assistance from the federal government in the form of grants and entitlements. Receipt of grants is generally conditioned upon compliance with terms and conditions of the grant agreements and applicable federal laws and regulations, including the expenditure of resources for eligible purposes. Accordingly, expenditures financed by these programs are subject to financial and compliance audits by the grantor agencies, which could result in request for reimbursement by the grantor agencies for expenditures, if disallowed under the terms of the grants. These amounts, if any, of expenditures, which may be disallowed by the granting agencies, cannot be determined at this time. The Municipality's administration believes that such disallowances, if any, will not have a material adverse effect on the financial position of the Municipality.

Note 15 - Leases

The Municipality has a several short-term operating lease agreements covering some of the Municipality's premises and equipment. All of the agreements are renewed annually. Total rental charges for the year ended June 30, 2011, was \$771,146.

Note 16 - Healthcare Costs

During the year ended June 30, 2000 the Governor of the Commonwealth imposed to the municipalities of Puerto Rico an annual contribution to subsidy the costs of the implementation and administration of the Healthcare Reform. Such contributions are required to be disbursed from general fund operating budget. Total contribution made by the Municipality amounted to \$7,885,802 for the fiscal year ended June 30, 2011.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA

NOTES TO FINANCIAL STATEMENTS (continued)
JUNE 30, 2011

Note 17 - Prior Period Adjustments

The beginning fund balance of total governmental funds at July 1, 2010 has been restated to correct an overstatement of account payable balances.

Note 18 - Subsequent events

On December 15, 2011, the Government Development Bank for Puerto Rico approved the issuance of a general obligation bond amounting to \$5,880,000. The proceeds of this bond will be used for construction and major capital improvements.

Note 19 - Recent Accounting Pronouncements

The GASB has issued the following accounting standards that have effective dates after June 30, 2011:

- GASB Statement No. 57, OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans. This statement is effective for periods beginning after June 30, 2012;
- GASB Statement No. 59, Financial Instruments Omnibus. This statement is effective for periods beginning after June 30, 2011;
- GASB Statement No. 60, Accounting and Financial Reporting for Service Concession Arrangements. The objective of this Statement is to improve financial reporting by addressing issues related to service concession arrangements, which are a type of public-private or public-public partnership. This statement is effective for periods beginning after December 31, 2012;
- GASB Statement No. 61, The Financial Reporting Entity; Omnibus-an amendment of GASB Statement No. 14 and No. 34. The objective of this Statement is to improve financial reporting for a governmental financial reporting entity. This statement is effective for periods beginning after June 30, 2013;
- GASB Statement No. 62, Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements. The objective of this Statement is to incorporate into GASB's authoritative literature certain accounting and financial reporting guidance that is included in FASB and AICPA pronouncements issued on or before November 30, 1989, which does not conflict with or contradict GASB pronouncements. This statement is effective for periods beginning after December 31, 2012;

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA

NOTES TO FINANCIAL STATEMENTS (continued)
JUNE 30, 2011

- GASB Statement No. 63, Financial Reporting and Deferred Outflows of Resources, Deferred Inflows of Resources and Net Position. This statement is effective for periods beginning after December 31, 2012;
- GASB Statement No. 64, Derivative Instruments: Application of Hedge Accounting Termination Provisions (an amendment of GASB Statement No. 53). This statement is effective for periods beginning after June 30, 2013;

The Authority's management has concluded that the future adoption of these GASB Statements will not have a significant impact on the Authority's basic financial statements.

COMMONWEALTH OF PUERTO RICO
MUNICIPALITY OF CAROLINA

Schedule of Revenues and Expenditures
Budget and Actual- General Fund
Non GAAP Budgetary Basis
For the Fiscal Year Ended June 30, 2011

	<u>Original Budget</u>	<u>Final Budget</u>	<u>Actual amounts in the budgetary basis</u>	<u>Variance Favorable (Unfavorable)</u>
Resources:				
Property taxes	\$ 51,235,440	\$ 51,184,923	\$ 50,436,721	\$ (748,202)
Volume of business taxes	29,959,400	30,798,224	31,557,080	758,856
Licenses and permits	3,550,000	4,176,599	4,214,063	37,464
Property rent	-	85,000	86,800	1,800
Miscellaneous	580,000	580,000	481,569	(98,431)
Intergovernmental services	460,074	460,074	533,874	73,800
Intergovernmental grant	10,063,274	12,212,112	12,212,112	-
Interest	2,000,000	2,000,000	1,478,330	(521,670)
Fines and penalties	900,000	900,000	849,751	(50,249)
Readjustments of prior years	-	1,055,038	1,055,038	-
Amount available for appropriation	<u>\$ 98,748,188</u>	<u>\$ 103,451,970</u>	<u>\$ 102,905,338</u>	<u>\$ (546,632)</u>
Expenditures charged to appropriations:				
General government	46,663,921	55,622,857	55,479,200	143,657
Public safety	19,403,725	17,924,926	17,866,755	58,171
Highways, streets and transportation	4,556,312	4,115,741	4,109,191	6,550
Sanitation	5,016,984	4,339,831	4,328,698	11,133
Health	5,870,254	5,165,227	5,141,257	23,970
Recreation and sports	5,180,988	4,705,012	4,701,370	3,642
Education and training	4,622,682	4,419,344	4,405,469	13,875
Housing	1,477,248	1,202,958	1,141,661	61,297
Debt Services:				
Principal	2,335,000	2,335,000	2,335,000	-
Interest	3,621,074	3,621,074	3,621,074	-
Total charges to appropriations	<u>92,792,114</u>	<u>97,495,896</u>	<u>103,129,675</u>	<u>322,295</u>
Excess of appropriations over resources	<u>\$ 5,956,074</u>	<u>\$ 5,956,074</u>	<u>\$ (224,337)</u>	<u>\$ (224,337)</u>

MUNICIPALITY OF CAROLINA (RQ014)
 CAROLINA, PUERTO RICO
 14.871 Housing Choice Voucher
 Balance Sheet Summary

Submission Type: Audited/A-133

Fiscal Year End: 6/30/11

Assets	Current Assets - Cash:	
111	Cash - Unrestricted	\$ 413,216
113	Cash - Other Restricted	302,343
100	Total Cash	715,559
	Receivables:	
122	Accounts Receivable - HUD Other Projects	210
124	Accounts Receivable - Other Government	25,595
128	Fraud Recovery	86,000
128.1	Allowance for Doubtful Accounts - Fraud Recovery	-
120	Total Receivable, Net of Allowance for Doubtful Accounts	111,805
150	Total Current Assets	827,364
	Fixed Assets:	
164	Furniture, Equipment & Machinery - Administration	102,441
166	Accumulated Depreciation	(65,442)
160	Total Capital Assets, Net of Accumulated Depreciation	36,999
190	Total Assets	\$ 864,363
Liabilities and Equity	Liabilities:	
	Current Liabilities:	
312	Accounts Payable <=90 days	\$ 20,443
342	Deferred Revenues	-
345	Other Current Liabilities	19,088
310	Total Current Liabilities	39,531
	Non-Current Liabilities:	
353	Non-Current Liabilities - Other	86,000
354	Accrued Compensated Absences - Non Current	78,118
350	Total Non-Current Liabilities	164,118
300	Total Liabilities	203,649
Equity	Equity	
509.2	Fund Balance Reserved	286,161
512.2	Unreserved, Undesignated Fund Balance	374,553
513	Total Equity / Net Assets	660,714
600	Total Liabilities and Equity / Net Assets	\$ 864,363

MUNICIPALITY OF CAROLINA (RQ014)
 CAROLINA, PUERTO RICO
 14.871 Housing Choice Voucher
 PROGRAM REVENUE AND EXPENSE SUMMARY

Submission Type: Audited/A-133

Fiscal Year End: 6/30/11

70600	HUD PHA Operating Grants	\$ 4,262,789
71100	Investment Income - Unrestricted	-
71400	Fraud Recovery	35,293
71500	Other Revenue	46,039
72000	Investment Income - Restricted	-
70000	Total Revenue	4,344,121
	Expenses:	
	Administrative:	
91100	Administrative Salaries	346,471
91400	Advertising and Marketing	2,993
91500	Employee Benefit Contributions - Administrative	66,814
91600	Office Expenses	27,724
91900	Other	300
91000	Total Operating - Administrative	444,302
96900	Total Operating Expenses	444,302
97000	Excess of Operating Revenue over Operating Expenses	3,899,819
97300	Housing Assistance Payments	3,748,080
97350	HAP Portability-In	42,120
97400	Depreciation Expense	11,880
97500	Fraud Losses	-
90000	Total Expenses	4,246,382
10010	Total Other Financing Sources (Uses)	-
10000	Excess (Deficiency) of Total Revenue Over (Under) Total Expenses	\$ 97,739
	Memo Account Information:	
11030	Beginning Equity	\$ 458,664
11040	Prior Period Adjustments, Equity Transfers and Corrections Errors	\$ 104,311
11170	Administrative Fee Equity	\$ 374,553
11180	Housing Assistance Payments Equity	\$ 286,161
11190	Units Months Available	8,892
11210	Number of Units Months Leased	7,487

MUNICIPALITY OF CAROLINA
 NOTES TO 4.871 HOUSING CHOICE VOUCHER
 FOR THE FISCAL YEAR ENDED JUNE 30, 2011

1. GENERAL

The accompanying financial data schedule presents the expenditures of Housing Choice Vouchers Section 8 federal award program, for the fiscal year ended June 30, 2011, of the Municipality of Carolina.

2. ACCOUNTING BASIS

The schedule was prepared on accrual basis of accounting except for fraud recoveries plans that are accounted using the Section 8 Housing Voucher following the statutory basis of accounting required by the US Department of Housing and Urban Development (HUD).

3. RELATIONSHIP TO THE BASIC FINANCIAL STATEMENTS (SECTION 8 HOUSING CHOICE VOUCHERS)

A reconciliation of the net income / net assets reported in the accompanying Statement of Activities of the Municipality's basic financial statements to the related amount in the schedule of expenditures of federal awards is as follows:

<u>Description</u>	<u>Net Income</u>	<u>Net Assets</u>
Total Section 8 net income / net assets per Accrual basis of accounting in accordance to the Statement of Activities of the Municipality's basic financial statements	\$183,739	\$746,714
Less: fraud recoveries receivables presented as revenues as per GAAP but deferred as per HUD regulatory accounting basis	<u>(86,000)</u>	<u>(86,000)</u>
Total Section 8 net income / net assets as per financial data Schedule as required by HUD	<u>\$97,739</u>	<u>\$660,714</u>

INDEPENDENT AUDITORS' 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

Hon. José C. Aponte Dalmau and
Members of the Municipal Legislature of the
Commonwealth of Puerto Rico
Municipality of Carolina
Carolina, Puerto Rico

We have audited the basic financial statements of the Municipality of Carolina (the Municipality) as of and for the year ended June 30, 2011 and have issued our report thereon dated March 3, 2011. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States of America.

Internal control over financial reporting

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

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 significant deficiency, or combination of deficiencies, in internal control such that there is a possibility that a material misstatement of the Municipality's financial statements will not be prevented, or detected and corrected on a timely basis.

Hon. José C. Aponte Dalmau and
Members of the Municipal Legislature of the
Commonwealth of Puerto Rico
Municipality of Carolina
Carolina, Puerto Rico
Page 2

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 did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Municipality's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and 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 no instances of noncompliance or other matters that are required to be reported under Government Auditing Standards.

This report is intended solely for the information of the Mayor, the Municipal Assembly, management, 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.

PKF, LUP

License No. 22
Expires on December 1, 2013



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

Hon. José C. Aponte Dalmau and
Members of the Municipal Legislature of the
Commonwealth of Puerto Rico
Municipality of Carolina
Carolina, Puerto Rico

Compliance

We have audited the compliance of the Municipality of Carolina (the Municipality) with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement that are applicable to each of its major federal programs for the year ended June 30, 2011. The Municipality's major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the Municipality's management. Our responsibility is to express an opinion on the Municipality's compliance based on our audit.

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

In our opinion, Municipality of Carolina complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the fiscal year ended June 30, 2011.

Hon. José C. Aponte Dalmau and
Members of the Municipal Legislature of the
Commonwealth of Puerto Rico
Municipality of Carolina
Carolina, Puerto Rico
Page 2

Internal control over compliance

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

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 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

Our consideration of internal control over compliance 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 compliance that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.



March 28, 2012

PKF, LLP

License No. 22
Expires on December 1, 2013

MUNICIPALITY OF CAROLINA
 SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
 FISCAL YEAR ENDED JUNE 30, 2011

<u>Federal Grantor</u>	<u>Program Title</u>	<u>Federal CFDA Number</u>	<u>Expenditures</u>
US Department of Agriculture	Child and Adult Care Food Program Pass-through the Puerto Rico Department of Education	10.558	\$902,854
	Nutrition Assistance for Puerto Rico	10.566	64,113
US Department of Justice	Edward Byrne Memorial Formula Grant Program Pass-through the Puerto Rico Department of Justice	16.579	47,315
	Juvenile Justice and Delinquency Prevent Act Pass-Through the office of the Commissioner of the Municipal Affairs	16.540	-
US Department of Health and Human Services	Head Start and Early Head Start Grants	93.600	5,869,379
	ARRA - Head Start and Early Head Start Grants	93.708	227,835
	Head Start Grant Pass-through the Puerto Rico Department of the Family	93.600	1,542,994
	ARRA - Head Start Grant Pass-through the Puerto Rico Department of the Family	93.708	60,859
	Child Care and Development Block Grant Pass-through the Puerto Rico Department of the Family	93.575	863,597
	ARRA - Child Care and Development Block Grant Pass-through the Puerto Rico Department of the Family	93.713	68,926
	Special Programs for Aging (Title III Part C), Nutrition Services	93.045	200,491
	Promoting Safe and Stable Families Pass-through the Puerto Rico Department of the Family	93.556	34,432
	Aging Home – Delivered Nutrition Services Grant Pass-through the Office of the Elderly Affairs	93.705	3,054
US Department of Homeland Security	Homeland Security Grant Program Pass-through the Public Security Governor's Office	97.067	241,675
US Department of Housing and Urban Development	Community Development Block Grants /Entitlement Grants	14.218	3,556,118
	ARRA - Community Development Block Grants /Entitlement Grants	14.253	687,755
	Emergency Shelter Grants Program	14.231	150,065
	Home Investment Partnership Program	14.239	418,622
	Section 8 Housing Choice Vouchers	14.871	4,262,789
	Community Development Block Grants /Section 108 Loan Guarantees (98 & 99)	14.248	2,556,027
	Public and Indian Housing Pass-Through the Puerto Rico Public Housing Administration	14.850	203,081
	Housing Opportunities for Persons with AIDS Program Pass-through Municipality of San Juan (HOPWA Program)	14.241	90,130
	Homelessness Prevention and Rapid Re-Housing program	14.257	861,870
	Supportive Housing Program/ Emergency Shelter Grant Program	14.235	295,170

MUNICIPALITY OF CAROLINA

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (continued)
FISCAL YEAR ENDED JUNE 30, 2011

<u>Federal Grantor</u>	<u>Program Title</u>	<u>Federal CFDA Number</u>	<u>Expenditures</u>
US Department of Transportation	Federal Transit – Formula Grants (Urbanized Area Formula Program	20.507	1,349,183
	ARRA - Federal Transit – Formula Grants (Urbanized Area Formula Program	20.507	755,593
US Department of Energy	Energy Efficiency and Conservation Block Grant	81.128	678,094
US Department of Labor	Workforce Investment Act- Adult Program Pass-through the Puerto Rico Department of Labor	17.258	1,063,960
	ARRA - Workforce Investment Act- Adult Program Pass- through the Puerto Rico Department of Labor	17.258	191,503
	Workforce Investment Act- Youth Activities Pass-through the Puerto Rico Department of Labor	17.259	1,288,905
	ARRA - Workforce Investment Act- Youth Activities Pass- through the Puerto Rico Department of Labor	17.259	38,119
	Workforce Investment Act- Dislocated Worker Pass- through the Puerto Rico Department of Labor	17.260	355,803
	ARRA - Workforce Investment Act- Dislocated Worker Pass-through the Puerto Rico Department of Labor	17.260	112,657
Total Expenditures			\$29,042,968

MUNICIPALITY OF CAROLINA
NOTES TO THE SCHEDULE OF
EXPENDITURES OF FEDERAL AWARDS
FISCAL YEAR ENDED JUNE 30, 2011

Note 1 - General

The accompanying schedule of expenditures of federal awards presents the expenditures, for the fiscal year ended June 30, 2011, of all the federal assisted programs of the Municipality of Carolina.

Note 2 - Accounting basis

The schedule was prepared following the modified accrual basis of accounting, which is further explained in note 1 of the basic financial statements of the Municipality of Carolina for the fiscal year ended June 30, 2011.

MUNICIPALITY OF CAROLINA
 SCHEDULE OF FINDINGS AND QUESTIONED COSTS
 FISCAL YEAR ENDED JUNE 30, 2011

Section 1 - Summary of Auditor's Results

Financial Statements:

Type of auditor's report issued: Unqualified

Internal control over financial reporting:

- | | |
|--|----|
| 1. Material weakness identified? | No |
| 2. Significant deficiency(ies) identified that are not considered to be material weakness? | No |
| 3. Noncompliance material to financial statements noted? | No |

Federal awards:

Internal control over major programs:

- | | |
|---|----|
| 1. Material weakness(es) identified? | No |
| 2. Significant deficiency(ies) that are not considered to be material weaknesses? | No |

Type of auditor's report issued on compliance for major program? Unqualified

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

Identification of major programs:

CFDA Number(s)

Name of Federal Program or Cluster

10.558	Child and Adult Care Food Program
14.871	Section 8 Housing Choice Voucher
14.248	Section 8 Loan Guarantees
14.257	Homelessness Prevention and Rapid Rehousing Program
93.575	Child Care and Development Block Grant/ Pass-through the PR Department of Family

CDBG Entitlement Cluster:

14.218	Community Development Block Grant/ Entitlement
14.253	ARRA - Community Development Block Grant/ Entitlement

Head Start Cluster:

93.600	Head Start
93.600	Head Start Program Pass-through the Puerto Rico Department of the Family

MUNICIPALITY OF CAROLINA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)
FISCAL YEAR ENDED JUNE 30, 2011**WIA Cluster:**

17.258	Workforce Investment Act Adult Program/ Pass-through the PR Department of Labor
17.258	ARRA - Workforce Investment Act Adult Program/ Pass-through the PR Department of Labor
17.259	Workforce Investment Act Youth Activities/ Pass-through the PR Department of Labor
17.259	ARRA - Workforce Investment Act Youth Activities/ Pass-through the PR Department of Labor
17.260	Workforce Investment Act Dislocated Workers/ Pass-through the PR Department of Labor
17.260	ARRA - Workforce Investment Act Dislocated Workers / Pass-through the PR Department of Labor

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

\$866,920

Auditee qualified as a low-risk auditee?

No

MUNICIPALITY OF CAROLINA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)
FISCAL YEAR ENDED JUNE 30, 2011

Section 2 - Financial Statement Findings

No audit findings came to our attentions that are required to be reported under Government Auditing Standards.

MUNICIPALITY OF CAROLINA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)
FISCAL YEAR ENDED JUNE 30, 2011

Section 3 - Federal Awards Findings

No audit findings came to our attentions that are required to be reported under OMB A-133.

MUNICIPALITY OF CAROLINA

REPORT ON THE STATUS OF UNCORRECTED MATERIAL FINDINGS AND
RECOMMENDATIONS FROM PRIOR AUDITS THAT AFFECT THE FINANCIAL STATEMENT
AUDITS AS REQUIRED BY GOVERNMENT AUDITING STANDARDS
YEAR ENDED JUNE 30, 2011

None

MUNICIPALITY OF CAROLINA
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
AS REQUIRED BY OMB CIRCULAR A-133

Finding 2010-1

Condition:

Workforce Investment Act Adult Program; Youth Activities and Dislocated Workers)

- a. We found that several disbursement vouchers were signed by the Accounting Supervisor and by the Executive Director on a dated after of the check date issued for payment. We requested 68 disbursement vouchers for examination, of these disbursement, 8 had this condition. We noted the client didn't comply with this internal controls requirement.
- b. We found that in several disbursement vouchers the pre-intervention stamp was signed and dated, after the payout date of the check. We requested 68 disbursement vouchers for examination, of these disbursement, 23 had this condition. We noted the client didn't comply with this internal controls requirement.

Audit Finding Status

Corrected

The Finance's Director of the WIA Local Area (AMOE) is required to sign and submit the disbursement vouchers before make a check for payment. These cases were isolated situations and were corrected during the program year 2011.

As a part of the Municipality fiscal regulations and procedures, the pre-intervention process is made before the issuance of a check for payment. However, to address the finding, the Municipality re-enforce its pre-intervention guidelines in order to assure that the situation as above does not occur again.

Finding 2010-2

Condition:

Workforce Investment Act Adult Program; Youth Activities and Dislocated Workers)

To determine compliance with the cash management agreement, we requested the petitions of funds for a sample of transactions for the major program. The sample consisted of 15 items. Five of this cases, were not disbursed in a reasonable time between the transfer of funds from the United States Treasury and the State's payout of funds. After performing the cash management test, we noted the client didn't comply with this requirement.

Audit Finding Status

Corrected

The Finance's Director obtained the cash flow report from MIP. The Report is sent to the CDORH with a Control Sheet as part of the Monthly Petitioned Funds Request. Later the Finance Director verifies the bank account to validate that the deposit was done. When the funds are deposited, the Municipality make the payments, in a period no longer than five (5) days, by check or electronic transfer.

Finding 2010-3

(Home Investment Partnership Program)

To determine compliance with the cash management agreement, we requested the petitions of funds for a sample of transactions for the major program. The sample consisted of 24 items. Three of this cases, were not disbursed in a reasonable time between the transfer of funds from the United States Treasury and the State's payout of funds. After performing the cash management test, we noted the client didn't comply with this requirement.

Audit Finding Status

Corrected

The Finance's Director implemented a periodic evaluation to the cash disbursement process in compliance with Federal Regulations (CFR 24).

MUNICIPALITY OF CAROLINA
CORRECTIVE ACTION PLAN
FISCAL YEAR ENDED JUNE 30, 2011

None