

**OFICINA DEL COMISIONADO DE ASUNTOS MUNICIPALES  
ÁREA DE ASESORAMIENTO, REGLAMENTACIÓN E INTERVENCIÓN FISCAL  
ÁREA DE ARCHIVO DIGITAL**

**MUNICIPIO DE CAROLINA  
AUDITORÍA 2011-2012  
30 DE JUNIO DE 2012**

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAROLINA**

**FINANCIAL STATEMENTS AND  
REPORTS REQUIRED UNDER  
CIRCULAR A-133**

**FISCAL YEAR ENDED JUNE 30, 2012**



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**COMMONWEALTH OF PUERTO RICO  
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Management's Discussion and Analysis  
For the Fiscal Year Ended June 30, 2012

**a) Government-Wide Financial Statements (Continuation)**

**2. Statement of Activities**

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).

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.

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*b) Governmental Fund Financial Statements (Continuation)*

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.

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.

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*c) Notes to Financial Statements*

The NFS 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.

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**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,**

	<b>2012</b>	<b>2011</b>
<b>Assets:</b>		
Current assets	\$ 217,971,806	\$ 251,132,583
Noncurrent assets:		
Capital assets, net	1,934,986,460	1,905,972,136
Other noncurrent assets	1,530,622	1,528,582
Total assets	2,154,488,888	2,158,633,301
 <b>Liabilities:</b>		
Current liabilities	59,327,253	52,837,901
Long-term liabilities due within one year	35,888,200	32,325,038
Noncurrent liabilities:		
Long-term liabilities due after one year	341,061,787	356,255,409
Total liabilities	436,277,240	441,418,348
 <b>Net assets:</b>		
Invested in capital assets, net of related debt	1,585,306,570	1,557,596,146
Restricted	108,008,963	132,761,012
Unrestricted	24,896,115	26,857,795
Total net assets	\$ 1,718,211,648	\$ 1,717,214,953

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 \$1,718,211,648 at June 30, 2012.

The Municipality's current assets amounting to \$217,971,806 are mainly composed of restricted cash (\$123,890,814), unrestricted cash and certificates of deposits (\$53,756,172), federal grants receivables (\$22,336,737), property taxes receivable (\$4,320,673) and municipal license taxes receivable (\$4,019,225).

**COMMONWEALTH OF PUERTO RICO  
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**Financial Analysis of Government-Wide Financial Statements (Continuation)**

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 \$1,936,517,082 at June 30, 2012, are substantially composed of capital assets, with a cost basis of \$2,060,177,068 which are reported net of accumulated depreciation, and amortization of \$125,190,608.

At June 30, 2012, the Municipality's current liabilities amounting to \$95,215,453 are mainly composed of unearned revenues (\$28,570,944), the portions due within one year of bonds and notes payable (\$35,888,200), accounts payables and accrued liabilities (\$14,598,054) and due to other government agencies (\$3,333,739). 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 \$122,756,353 for a current ratio (current assets to current liabilities) of 2.0 to 2.5.

The Municipality's noncurrent liabilities, amounting to \$341,061,787 at June 30, 2012, are mainly composed of portions due after one year of bonds and notes payable (\$313,791,690), compensated absences (\$12,158,927), interest due for account sold (\$6,032,162), governmental agencies payables (\$3,592,681), estimated liability for the municipal solid waste landfill closure and post closure care costs (\$2,568,700) and accrued legal claims (\$2,917,627).

The largest portions of the Municipality's net assets are invested in capital assets net of their related debt which amount to \$1,585,306,570. The Municipality's net assets are also composed of net assets amounting to \$108,008,963 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 \$24,896,115.

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.

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.

**COMMONWEALTH OF PUERTO RICO  
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**Comparative Condensed Statement of Activities  
Governmental Activities  
Fiscal Years Ended June 30,**

	<b>2012</b>	<b>2011</b>
<b>Program Revenues:</b>		
Operating grants and contributions	\$ 21,574,492	\$ 26,988,629
Capital grants and contributions	1,336,671	1,430,279
Charges for services	5,654,501	1,901,950
<b>Total program revenues</b>	<b>28,565,664</b>	<b>30,320,858</b>
<b>General Revenues:</b>		
Property taxes	86,286,602	81,060,593
Municipal license taxes	34,501,425	31,767,564
Sales taxes	21,312,513	20,486,968
Construction excise and permits	5,893,060	6,475,308
Intergovernmental grants	15,363,451	15,452,369
Other general revenues	4,409,520	3,982,779
<b>Total revenues</b>	<b>167,766,571</b>	<b>159,225,581</b>
	<b>196,332,235</b>	<b>189,546,439</b>
<b>Program expenses:</b>		
General government	51,424,967	42,846,416
Public safety	15,860,147	16,302,905
Public works, streets and transportation	42,576,332	42,321,809
Sanitation	17,045,990	19,371,724
Health	7,885,802	7,885,802
Recreation and sports	7,586,476	6,439,321
Education and training	13,200,819	13,946,864
Housing and buildings	17,978,991	14,301,279
Economic development	6,954,074	4,369,065
Welfare	5,548,801	5,569,777
Employment opportunities	1,781,628	2,728,131
Interest on long-term obligations	11,360,881	11,794,887
<b>Total expenses</b>	<b>199,204,908</b>	<b>187,877,980</b>
<b>Net increase (decrease) in assets</b>	<b>(2,872,673)</b>	<b>1,668,459</b>
Net assets, at beginning of fiscal year	1,717,214,953	1,713,423,851
Prior period adjustment	3,869,368	2,122,643
Net assets, at beginning of fiscal year (restated)	1,721,084,321	1,715,546,494
<b>Net assets, at end of fiscal year</b>	<b>\$ 1,718,211,648</b>	<b>\$ 1,717,214,953</b>

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The total revenues of the Municipality increase from \$189,546,439 for the fiscal year ended June 30, 2011 to \$196,332,235 for the fiscal year ended June 30, 2012, for an increase of \$6,785,796. Of this amount, \$147,933,600 (75%) came from property taxes, municipal license, sales taxes and construction excise and permits, while \$22,911,163 came from capital and operating grants and contributions (12%) and \$5,654,501 (3%) 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:

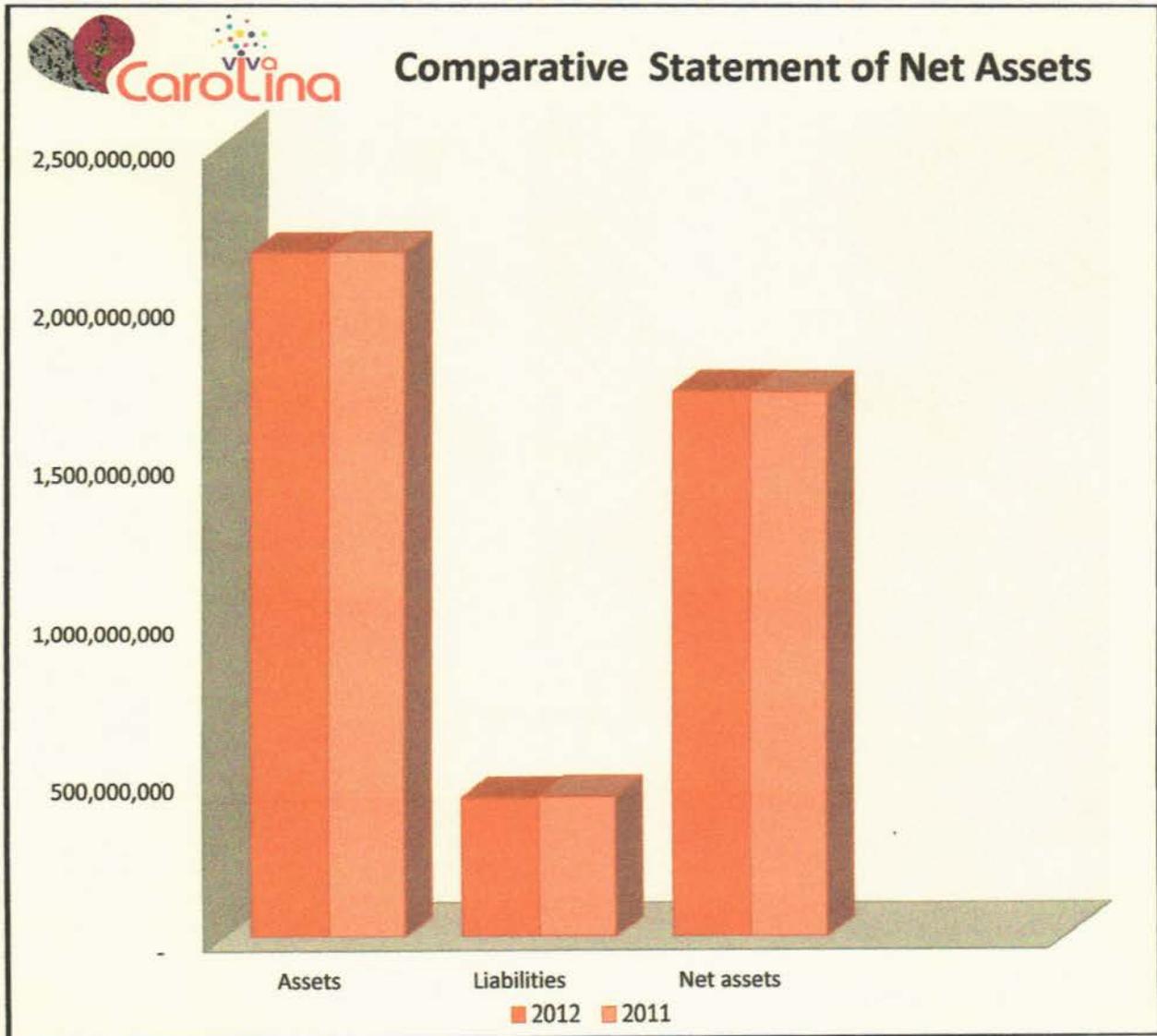
- Total program revenues (Operating grants and contributions, capital grants and charge for service) decrease by \$1,755,194 during the fiscal year. Operating grants and contributions decreased by \$5,414,137 as compared with last fiscal year.
- Property taxes increase by \$5,226,009 during the fiscal year.
- Municipal license and sales taxes increased by \$2,733,861 and \$825,545, respectively, as compared with last fiscal year.
- The Municipality's expenses cover a wide range of services. During fiscal year 2011-12, the Municipality's total expenses increased from \$187,877,980 for the fiscal year ended June 30, 2011 to \$199,204,908 for the fiscal year ended June 30, 2012, for an increase of \$11,326,928.
- The largest expenses were related to capital improvements to streets, public works and transportation (\$42,576,332) and general administrating and operating costs (\$51,424,967), which were classified as "general government".
- Sanitation expenses decreased by \$2,325,734, while public housing and economic development, increased by \$3,677,712 and \$2,585,009, respectively as compared with last fiscal year.

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**Management's Discussion and Analysis  
For the Fiscal Year Ended June 30, 2012**

The following table presents the comparative statements of net assets for the fiscal years ended June 30, 2012 and 2011:

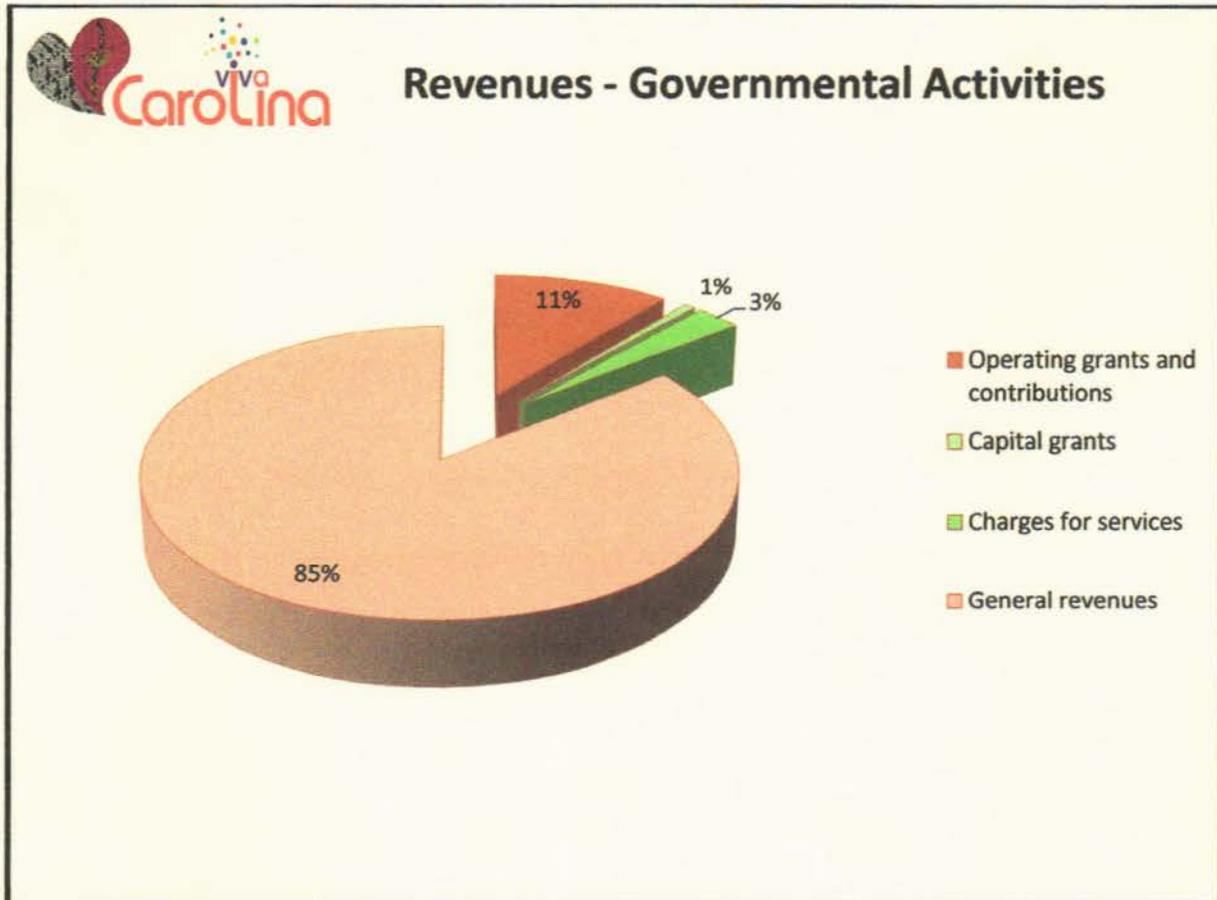


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**COMMONWEALTH OF PUERTO RICO  
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Management's Discussion and Analysis  
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The following table presents the composition of revenues for the fiscal years ended June 30, 2012:

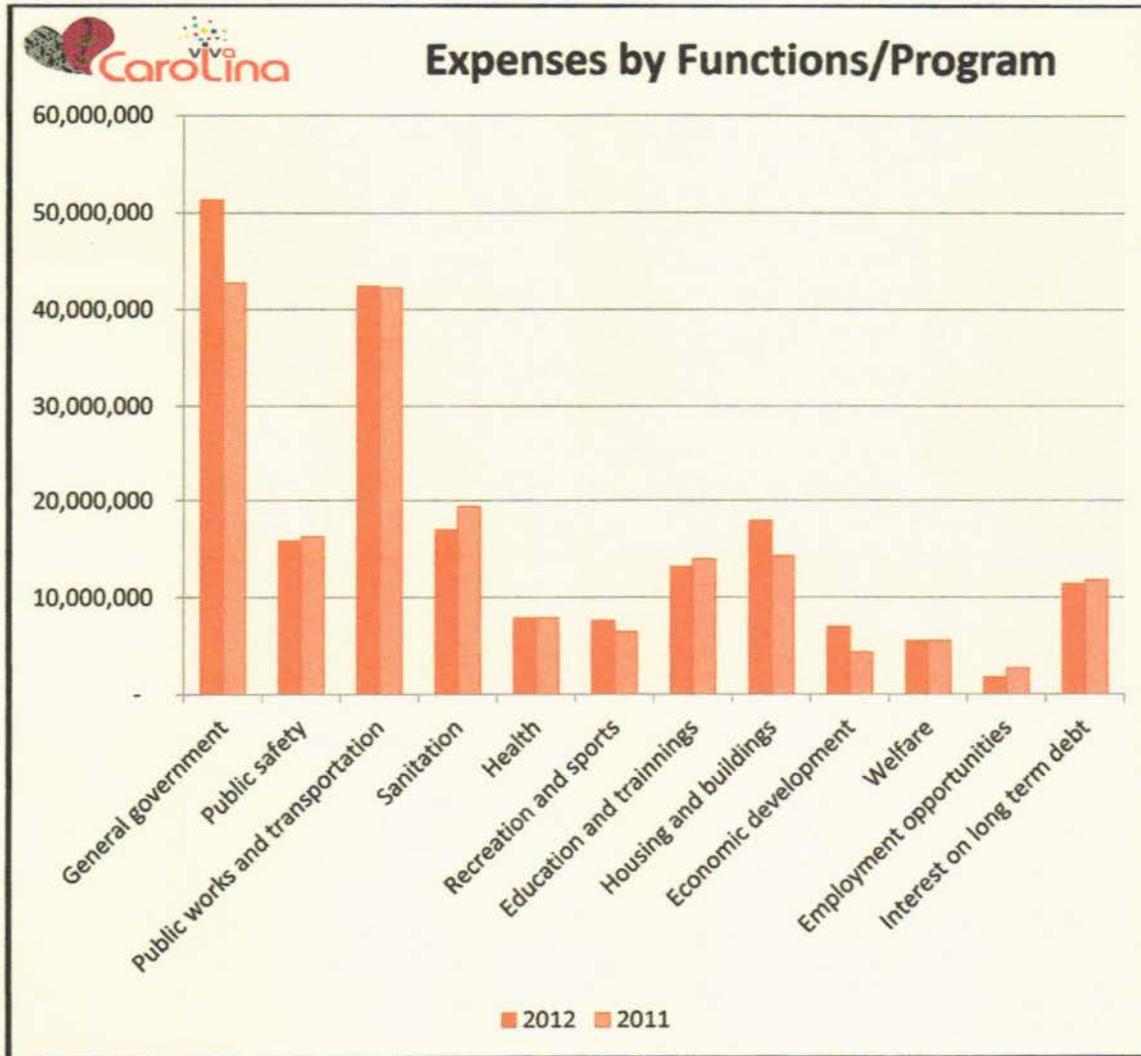


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The following table presents the composition of expenses for the fiscal years ended June 30, 2012 and 2011:



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**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 \$140,766,213, a decrease of \$28,219,552 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 Statement of Net Assets  
Governmental Activities  
Fiscal Years Ended June 30,**

	2012	2011
<b>Assets:</b>		
Total assets - major governmental funds	\$ 205,514,324	\$ 231,468,813
Total assets - other governmental funds	24,099,887	27,384,399
Total assets	229,614,211	258,853,212
<b>Liabilities:</b>		
Total liabilities - major governmental funds	78,929,646	76,949,829
Total liabilities - other governmental funds	9,918,352	12,917,618
Total liabilities	88,847,998	89,867,447
<b>Fund balances:</b>		
Restricted	85,918,288	92,458,878
Committed	40,676,809	55,717,940
Assigned	11,616,096	18,954,356
Unrestricted	2,555,020	1,854,591
Total net assets	\$ 140,766,213	\$ 168,985,765
Total liabilities and net assets	229,614,211	258,853,212

At June 30, 2012, the total assets of governmental funds decreased by \$29,239,001 in comparison with the prior fiscal year principally for: (1) a decrease in cash and certificates of deposits of \$32,535,873, (2) a decrease in federal grant receivable (\$5,279,303), (3) a net increase in due from other funds (\$3,786,472), and (4) an undisbursed loan proceed (\$5,995,000).

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**Financial Analysis of Governmental Funds Financial Statements (Continuation)**

At June 30, 2012, the total liabilities of governmental funds decreased by \$1,019,449 in comparison with the prior fiscal year principally for: (1) a decrease of \$1,776,110 in accounts payable, and (2) an increase of \$1,176,000 in matured bonds and interest payables.

At the end of the current fiscal year, total unassigned fund balances of the governmental funds amounted to \$2,555,020, while total fund balance reached \$140,766,213. 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 (\$58,551,772), due from other funds (\$8,366,697), municipal license taxes receivables (\$4,019,225) and sales taxes receivables (\$2,247,431). GF's liabilities are mainly composed of deferred municipal license taxes (\$28,570,944), due to government's agencies (\$3,236,273), accounts payable and accrued liabilities (\$6,417,349), and due to other funds (\$1,450,748).

Debt Service Fund (DSF) - The DSF's assets consist mainly of restricted cash with fiscal agent (\$67,320,481) and restricted property tax receivable (\$4,320,673). DSF's liabilities are mainly composed of matured bonds and notes principal payable (\$15,491,000), matured interest due and payable (\$4,080,975) and deferred revenues (\$3,869,368).

Capital Project Fund (CPF) - The CPF's assets are mainly composed of unrestricted and restricted cash (\$41,928,658), undisbursed loan proceed (\$5,995,000), due from contractors (\$450,280), and due from other funds (\$809,428). CPF's liabilities are mainly composed of accounts payable (\$6,532,322) and due to other funds (\$5,354,743).

Economic Development Fund (EDF) - The EDF's assets are mainly composed of restricted cash (\$5,037,519) and federal grants receivables (\$4,148,959). EDF's liabilities are mainly composed of accounts payables (\$632,849) and short-term loans to other funds (\$1,511,880).

Workforce Investment Act Fund (WIAF) - The WIAF's assets consist mainly of restricted cash (\$135,675) and federal grants receivable (\$369,759). WIAF's liabilities are mainly composed of accounts payables and accrued liabilities (\$545,566).

Other Governmental Fund (OGF) - The OGF's total assets are mainly composed of restricted cash (\$4,672,881), federal grants receivable (\$17,818,019) and due from other funds (\$1,330,124). The OGF's liabilities are principal composed of due to other funds (\$3,038,671), deferred federal revenues (\$5,619,000) and accounts payables and accrued liabilities (\$469,968).

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

	<b>2012</b>	<b>2011</b>
<b>Revenues:</b>		
Total revenues - major governmental funds	\$ 172,847,438	\$ 167,702,077
Total revenues - other governmental funds	18,185,938	21,282,569
Total revenues	191,033,376	188,984,646
<b>Expenditures</b>		
Total expenditures - major governmental funds	219,922,340	214,638,784
Total expenditures - other governmental funds	21,321,328	21,727,794
Total expenditures	241,243,668	236,366,578
Excess of revenues over (expenditures)	(50,210,292)	(47,381,932)
<b>Other financing sources (uses), net:</b>		
Proceeds from debt issuance - major funds	20,685,000	23,395,000
Proceeds from sale of land lots - major funds	1,226,920	-
Transfer from other funds - major funds	25,581,451	19,354,886
Transfer from other funds - other funds	3,048,820	1,513,196
Transfer to other funds - major funds	(28,532,748)	(20,153,683)
Transfer to other funds - other funds	(97,523)	(714,399)
Total other financing sources (uses), net	21,911,920	23,395,000
<b>Net changes in fund balance</b>	(28,298,372)	(23,986,932)
Fund balance, at beginning of fiscal year	168,985,765	190,208,578
Prior period adjustments	78,820	2,764,119
Fund balance, at beginning of fiscal year (restated)	169,064,585	192,972,697
Fund balance, at ending of fiscal year	\$ 140,766,213	\$ 168,985,765

The Municipality's total revenues increase from \$188,984,646 for the fiscal year ended June 30, 2011 to \$191,033,376 for the fiscal year ended June 30, 2012, for an increase of \$2,048,730. Of this amount, \$143,921,661(75%) came from property taxes, municipal license taxes, sales taxes and construction excise and permits, while \$38,274,614 (20%) 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:

- Property taxes increased by \$1,842,845

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**Financial Analysis of Governmental Funds Financial Statements (Continuation)**

- Municipal licenses taxes and sales increased by \$2,733,861, and \$825,545, respectively.
- Federal grants, construction excise and interest income decreased by \$4,976,014, \$582,248 and \$1,031,633, 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 (\$49.1 million) and general administrating and operating costs (\$54.3 million), which were classified as "general government".
- During fiscal year 2011-12, the Municipality's total expenditures increased from \$236,366,578 for the fiscal year ended June 30, 2011 to \$241,243,668 for the fiscal year ended June 30, 2012, for an increase of \$4,877,090.

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 \$131,721,885 are mainly composed of property taxes (\$52,087,709), municipal license taxes (\$34,501,425), sales taxes (\$18,271,056), construction excise and permits (\$5,893,060), intergovernmental grants and contributions (\$15,338,891), charge for services (\$2,060,474) and interest income (\$1,169,481).

The GF's expenditures amounting to \$130,145,477 are mainly composed of general administrative and operational costs (\$53,078,202), public safety operations (\$18,300,454), solid waste disposal, landfill operations and sanitation services (\$18,354,817), public works, transportation and improvements to streets (\$10,497,676) 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 sanitation and public safety operations, for a decreased of \$3,095,042 and \$961,972, respectively. Otherwise, general and administrative costs reflect an increase of \$3,064,800 as compared with prior fiscal year.

Debt Service Fund (DSF) – The DSF's revenues consist mainly of restricted property taxes (\$30,126,954), restricted sales taxes (\$3,041,457) and operating transfer in for debt payment (\$7,607,850). The DSF's expenditures consist mainly of matured principal payments (\$19,381,100) and matured interest payments on loans (\$11,360,881).

Capital Project Fund (CPF) – The CPF's revenues are mainly composed of proceeds from debt issuance (\$20,685,000) and intergovernmental grants and contributions (\$1,336,671). The CPF's expenditures increased from \$46,604,209 for the fiscal year ended June 30, 2011 to \$48,955,069 for the fiscal year ended June 30, 2012. Those expenditures were related to capital outlays which capitalized on government wide financial statements.

Economic Development Fund (EDF) – The EDF's revenues and expenditures are mainly composed of federal grants (\$3,502,391) and economic development projects (\$8,024,056).

Workforce Investment Act Fund (WIAF) – The WIAF's revenues and expenditures consist mainly of federal grants (\$2,017,345) and direct benefits of employment opportunities to citizens (\$2,055,757).

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**Financial Analysis of Governmental Funds Financial Statements (Continuation)**

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 \$2,060,177,068, of which \$591,227,196 represents buildings, infrastructure and improvements and \$95,287,161 relates to construction and infrastructure in progress at June 30, 2012. The accumulated depreciation of capital assets amounted to \$125,190,608, of which \$103,947,612 is related to buildings, infrastructure and improvements at June 30, 2012. 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 \$44,129,365 for the year ended June 30, 2012. Depreciation and amortization charges for the year ended totaled \$14,480,263. 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 it are entirely for such purpose and cannot be used for any other purposes. Major capital assets additions during fiscal year include:

- ❖ Capital improvements on roads and construction of buildings and other municipalities facilities
- ❖ Improvements to recreational facilities and Acquisition of land for developments projects

Major additions to construction and infrastructure in progress (disbursements of more than \$750,000) as of June 30, 2012 are as follows:

<u>Project</u>	<u>Amount</u>
Museo y Parque del Niño	\$ 5,889,268
Mejoras ave. Isla Verde	3,342,720
Construcción sistema pluvial Villamar	2,518,196
Museo de Arte e Historia de Carolina	2,199,391
Bloque 73, Desarrollo uso Mixto	2,118,400
Bloque 74, Desarrollo uso Mixto	1,390,966
Bloque 47, Bolsillo de Estacionamiento	1,214,800
Facilidades Recreativas Parque Buenavista	980,670
Facilidades Recreativas 4ta Ext. Country Club	919,243
Bloque 68, Bolsillo de Estacionamiento	846,150
Parque Aquasol Barrazas	<u>786,919</u>
 Total major capital additions for the fiscal year ended June 30, 2012	 \$ <u>22,206,723</u>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAROLINA**

Management's Discussion and Analysis  
For the Fiscal Year Ended June 30, 2012

**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.

**Budgetary Highlights**

The original budget of the general fund (operating fund) for the fiscal year ended June 30, 2012 amounted to \$102,405,660. Over the course of the fiscal year, the Municipality revised the general fund budget in order to include increase 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 \$85,000 in total budgeted revenues, to reach the total revised budget amount of \$102,490,660. Increases in budgeted expenditures were also made since the laws and regulations of the Commonwealth mandate a balanced budget. At June 30, 2012, the Municipality's total revised budget for all governmental funds was \$302 million.

The total actual revenue (budgetary basis) of the general fund for the fiscal year ended June 30, 2012 was \$104,500,123, which is \$2,009,463 (2%) more than the budgeted revenues. The favorable variance was primarily attributed to an increase in municipal license taxes of \$2,480,322.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAROLINA**

Management's Discussion and Analysis  
For the Fiscal Year Ended June 30, 2012

**Budgetary Highlights (Continuation)**

The total actual expenditures (budgetary basis) of the general fund for the fiscal year ended June 30, 2012 were \$102,377,710, which is \$113,350 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 approximately of 12%, which is lower than the state average of 16% as of June 30, 2012.

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 2012-2013 fiscal year. There were no significant changes between the budgets for fiscal year 2010-2011 and the budgets for fiscal year 2011-2012.

**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, 2012

Assets

Current assets:	
Cash and cash equivalents	\$ 71,395,416
Cash with fiscal agent	106,251,570
Undisbursed loan proceeds	5,995,000
Accounts receivable:	
Municipal license taxes, net	4,019,225
Sales taxes, net	2,247,431
Intergovernmental	577,956
Federal grants	22,336,737
Property taxes, net	4,320,673
Other accounts	<u>827,798</u>
 Total current assets	 <u>217,971,806</u>
 Noncurrent assets:	
Capital assets, net	1,934,986,460
Deferred debt issue costs	<u>1,530,622</u>
 Total noncurrent assets	 <u>1,936,517,082</u>
 Total assets	 <u><u>2,154,488,888</u></u>

Liabilities

Current liabilities:	
Bonds and notes payable	35,888,200
Accounts payable and accrued liabilities	14,598,054
Accrued legal claims	52,317
Accrued compensated absences	1,703,709
Accrued interest payable	4,080,975
Due to other governments	3,333,739
Interest due for accounts sold	317,482
Due to federal agency	716,686
Municipal licenses tax deferred revenue	28,570,944
Deferred federal grant revenue	<u>5,953,347</u>
 Total current liabilities	 \$ <u>95,215,453</u>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAROLINA**

Liabilities

Non current liabilities, net of currents portions:	
Bonds and notes payable	313,791,690
Accrued legal claims	2,917,627
Accrued compensated absences	12,158,927
Due to other governments	3,592,681
Interest due for accounts sold	6,032,162
Landfill obligations	<u>2,568,700</u>
 Total non current liabilities	 <u>341,061,787</u>
 Total liabilities	 <u>436,277,240</u>

Net Assets

Invested in capital assets, net of related debt	1,585,306,570
Restricted for:	
Economic development projects	8,110,237
Capital projects	37,803,743
Debt service	47,913,448
Other special purposes	14,181,535
Unrestricted	<u>24,896,115</u>
 Total net assets	 <u>1,718,211,648</u>
 Total liabilities and net assets	 \$ <u><u>2,154,488,888</u></u>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAROLINA**

Statement of Activities  
For the Fiscal Year Ended June 30, 2012

Functions Programs	Expenses	Revenues			Net (expense) revenue and change in net assets
		Charge for Service	Operating grants and Contributions	Capital grants and Contributions	
<b>Governmental activities:</b>					
General government	\$ 51,424,967	1,730,757	-	-	(49,694,210)
Public safety	15,860,147	241,711	-	-	(15,618,436)
Public works, streets and transportation	42,576,332	-	500,104	1,336,671	(40,739,557)
Sanitation	17,045,990	959,586	-	-	(16,086,404)
Health	7,885,802	-	-	-	(7,885,802)
Recreation and sports	7,586,476	2,060,470	-	-	(5,526,006)
Education and training	13,200,819	-	8,734,287	-	(4,466,532)
Housing	17,978,991	188,277	6,325,647	-	(11,465,067)
Economic development	6,954,074	473,700	3,502,391	-	(2,977,983)
Welfare	5,548,801	-	494,718	-	(5,054,083)
Employment opportunities	1,781,628	-	2,017,345	-	235,717
Interest	11,360,881	-	-	-	(11,360,881)
<b>Total governmental activities</b>	<b>\$ 199,204,908</b>	<b>5,654,501</b>	<b>21,574,492</b>	<b>1,336,671</b>	<b>(170,639,244)</b>
<b>General revenue:</b>					
Property taxes				\$ 86,286,602	
Municipal license taxes				34,501,425	
Sales taxes				21,312,513	
Intergovernmental				15,363,451	
Construction excise and permits				5,893,060	
Interest income				1,320,336	
Other				3,089,184	
<b>Total general revenues</b>				<b>167,766,571</b>	
Changes in net assets				(2,872,673)	
Net assets - beginning (as previously reported)				1,717,214,953	
Prior period adjustments				3,869,368	
Net assets - beginning (as restated)				1,721,084,321	
Net assets - ending				<b>\$ 1,718,211,648</b>	

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAROLINA**

Governmental Fund Financial Statements  
Balance Sheet  
Year Ended June 30, 2012

Major governmental funds

	General fund	Debt service fund	Capital projects fund	Economic development fund	Workforce investment fund	Other governmental fund	Total governmental funds
<b>Assets</b>							
Cash and certificate of deposit	\$ 58,551,580	-	2,997,761	5,037,519	135,675	4,672,881	\$ 71,395,416
Cash with fiscal agent	192	67,320,481	38,930,897	-	-	-	106,251,570
Municipal license taxes receivable	4,019,225	-	-	-	-	-	4,019,225
Sales taxes receivable	2,247,431	-	-	-	-	-	2,247,431
Due from other government	-	-	507,442	36,495	-	34,019	577,956
Federal grant receivable	-	-	-	4,148,959	369,759	17,818,019	22,336,737
Due from other funds	8,366,697	-	809,428	1,136,156	-	1,330,124	11,642,405
Property taxes receivable	-	4,320,673	-	-	-	-	4,320,673
Undistributed loan proceeds	-	-	5,995,000	-	-	-	5,995,000
Other receivables	91,778	-	450,280	594	40,302	244,844	827,798
<b>Total assets</b>	<b>73,276,903</b>	<b>71,641,154</b>	<b>49,690,808</b>	<b>10,359,723</b>	<b>545,736</b>	<b>24,099,887</b>	<b>229,614,211</b>
<b>Liabilities</b>							
Accounts payable and accrued liabilities	6,417,349	-	6,532,322	632,849	545,566	469,968	14,598,054
Matured bonds due and payable	-	15,491,000	-	-	-	-	15,491,000
Matured interest due and payable	-	4,080,975	-	-	-	-	4,080,975
Due to other governments	3,236,273	-	-	-	170	-	3,236,443
Due to other funds	1,450,748	286,363	5,354,743	1,511,880	-	3,038,671	11,642,405
Due to federal agency	-	-	-	-	-	716,686	716,686
Deferred volume of business taxes	28,570,944	-	-	-	-	-	28,570,944
Deferred federal revenue	-	-	-	-	-	5,619,000	5,619,000
Other deferred revenues	844,339	3,869,368	-	104,757	-	74,027	4,892,491
<b>Total liabilities</b>	<b>40,519,653</b>	<b>23,727,706</b>	<b>11,887,065</b>	<b>2,249,486</b>	<b>545,736</b>	<b>9,918,352</b>	<b>88,847,998</b>
<b>Fund balances</b>							
Restricted	1,519,106	47,913,448	20,982,164	6,132,958	-	9,370,612	85,918,288
Committed	17,067,028	-	16,821,579	1,977,279	-	4,810,923	40,676,809
Assigned	11,616,096	-	-	-	-	-	11,616,096
Unassigned	2,555,020	-	-	-	-	-	2,555,020
<b>Total fund balances</b>	<b>32,757,250</b>	<b>47,913,448</b>	<b>37,803,743</b>	<b>8,110,237</b>	<b>-</b>	<b>14,181,535</b>	<b>140,766,213</b>
<b>Total liabilities and fund balances</b>	<b>\$ 73,276,903</b>	<b>71,641,154</b>	<b>49,690,808</b>	<b>10,359,723</b>	<b>545,736</b>	<b>24,099,887</b>	<b>\$ 229,614,211</b>

**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, 2012

Total fund balance of governmental fund	\$ 140,766,213
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	1,934,986,460
Bond issue costs of governmental activities are not financial resources and not reported as assets in the funds	1,530,622
Other economic resources used in governmental activities are not financial resources and not reported as revenue in the funds	688,776
Other long-term liabilities, such as accrued compensated absences, litigations, interest of accounts sold, current year and other contingencies are not available to pay for expenditures and therefore not reported in the funds	( 25,571,533)
General obligations, special and federal loans are not due and payable in the current period and therefore not reported in the funds	<u>(334,188,890)</u>
Total net assets of governmental activities	<u>\$ 1,718,211,648</u>

# COMMONWEALTH OF PUERTO RICO MUNICIPALITY OF CAROLINA

Governmental Fund Financial Statement  
Statement of Revenues, Expenditures and Changes in Fund Balances - Governmental Funds  
Fiscal Year Ended June 30, 2012

Major governmental funds:

	General fund	Debt service fund	Capital projects fund	Economic development fund	Workforce investment fund	Other governmental fund	Total governmental funds
<b>Revenues:</b>							
Property taxes	\$ 52,087,709	30,128,954	-	-	-	-	\$ 82,216,663
Municipal license tax	34,501,425	-	-	-	-	-	34,501,425
Sales taxes	18,271,076	3,041,457	-	-	-	-	21,312,533
Construction excise and permits	5,893,060	-	-	-	-	-	5,893,060
Fees and forfeitures	237,305	-	-	-	-	4,606	241,911
Federal grants	-	-	444,911	3,502,391	2,017,345	15,609,845	21,574,492
Interest income	1,169,481	5,590	61,797	62,619	-	20,849	1,320,336
Intergovernmental grants	15,338,891	-	1,338,671	-	-	24,560	16,702,122
Charges for services	2,060,474	-	-	-	-	1,489,751	3,550,225
Landfill	595,547	-	-	-	-	-	595,547
Rent	657,641	-	-	473,700	-	188,277	1,280,618
Other	942,696	-	-	14,280	37,828	808,050	1,802,854
<b>Total Revenues</b>	<b>151,721,885</b>	<b>33,174,001</b>	<b>1,843,379</b>	<b>4,052,990</b>	<b>2,055,183</b>	<b>18,185,959</b>	<b>191,033,376</b>
<b>Expenditures:</b>							
General Government	53,078,202	-	1,227,770	-	-	-	54,305,972
Public safety	18,300,454	-	-	-	-	-	18,300,454
Public works, streets and transportation	10,497,476	-	38,507,730	-	-	121,895	49,127,101
Sanitation	18,314,817	-	1,313,938	-	-	-	19,628,755
Health	7,885,902	-	-	-	-	-	7,885,902
Recreation and sports	5,120,842	-	71,000	-	-	3,581,921	8,703,763
Education and training	9,029,812	-	83,844	-	-	9,118,495	17,231,951
Housing and buildings	5,933,517	-	7,733,902	-	-	7,077,894	20,745,313
Economic development	-	-	-	8,024,056	-	-	8,024,056
Welfare	4,944,355	-	17,085	-	-	1,441,123	6,402,563
Employment opportunity	-	-	-	-	2,055,757	-	2,055,757
Debt service payments	-	-	-	-	-	-	-
Principal	-	19,381,100	-	-	-	-	19,381,100
Interest	-	11,360,881	-	-	-	-	11,360,881
<b>Total expenditures</b>	<b>130,145,477</b>	<b>30,741,981</b>	<b>48,951,069</b>	<b>8,024,056</b>	<b>2,055,757</b>	<b>21,321,328</b>	<b>241,343,668</b>
<b>Excess (deficiency) of revenues over (under) expenditures</b>	<b>1,576,408</b>	<b>2,432,020</b>	<b>(47,111,690)</b>	<b>(3,971,066)</b>	<b>(574)</b>	<b>(9,135,369)</b>	<b>(50,710,282)</b>
<b>Other financial sources (uses):</b>							
Proceeds from debt issuance	-	-	20,685,000	-	-	-	20,685,000
Proceeds from sale of land lot	1,071,673	-	155,247	-	-	-	1,226,920
Transfer-in from other funds	2,044,684	7,607,870	2,684,155	1,244,752	-	3,048,820	26,630,271
Transfer-out to other funds	(14,131,445)	-	(11,493,676)	(2,887,627)	-	(97,523)	(28,609,271)
<b>Total other financing sources (uses), net</b>	<b>(7,025,088)</b>	<b>7,607,870</b>	<b>18,868,726</b>	<b>(1,642,875)</b>	<b>-</b>	<b>2,951,297</b>	<b>21,911,920</b>
<b>Net changes in fund balance</b>	<b>(5,448,680)</b>	<b>10,039,870</b>	<b>(29,080,964)</b>	<b>(5,613,941)</b>	<b>(574)</b>	<b>(184,093)</b>	<b>(28,298,372)</b>
<b>Fund Balances at beginning of fiscal year (as previously reported):</b>							
Fund Balances at beginning of fiscal year (as corrected)	36,215,920	37,873,578	66,648,571	13,771,082	8,833	14,466,781	169,085,765
Post period adjustment	-	-	235,126	(46,904)	(8,750)	(101,152)	78,820
<b>Fund Balances at beginning of fiscal year (as corrected)</b>	<b>36,215,920</b>	<b>37,873,578</b>	<b>66,884,697</b>	<b>13,724,178</b>	<b>574</b>	<b>14,365,629</b>	<b>169,064,585</b>
<b>Fund Balances end of fiscal year</b>	<b>\$ 30,767,240</b>	<b>\$ 47,913,448</b>	<b>\$ 37,803,733</b>	<b>\$ 8,110,237</b>	<b>\$ -</b>	<b>\$ 14,181,536</b>	<b>\$ 148,766,213</b>

See notes to financial statements.

\$32,757,250<sup>20</sup> plus -  
Owe

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAROLINA**

Reconciliation of the Statements of Revenues, Expenditures and Changes in Fund Balances of  
Governmental Funds to the Statement of Activities  
For the Fiscal Year Ended June 30, 2012

(Deficiency) of revenues and other financing sources over  
Expenditures and other financing uses – total governmental funds \$ (28,298,372)

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 29,649,102

Revenues in the statement of activities that do not provide current financial resources are not reported as revenues in the funds 4,071,939

Repayment from debt issuance are other financing sources in the governmental funds but such proceeds increase long term liabilities in the statement of net assets 19,381,100

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 (20,685,000)

Some expenses reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditure in the governmental Funds ( 6,991,442)

Changes in net assets of governmental activities \$ ( 2,872,673)

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF CAROLINA**  
Notes to Financial Statements  
For the Year Ended June 30, 2012

**1. GOVERNMENTAL ENTITY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**A. 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.

**B. 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, 2012, 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  
For the Year Ended June 30, 2012

**B. Financial Reporting Model (Cont.)**

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.
- **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.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAROLINA**

Notes to Financial Statements  
For the Year Ended June 30, 2012

**B. Financial Reporting Model (Cont.)**

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 meet 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.

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, 2012, 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.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAROLINA**

Notes to Financial Statements  
For the Year Ended June 30, 2012

**B. Financial Reporting Model (Cont.)**

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.

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.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF CAROLINA**

Notes to Financial Statements  
For the Year Ended June 30, 2012

**B. Financial Reporting Model (Cont.)**

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.

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.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF CAROLINA**

Notes to Financial Statements  
For the Year Ended June 30, 2012

**B. Financial Reporting Model (Cont.)**

- ***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.

- ***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.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAROLINA**

Notes to Financial Statements  
For the Year Ended June 30, 2012

**B. Financial Reporting Model (Cont.)**

**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.

**C. 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.

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, 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:

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAROLINA**

Notes to Financial Statements  
For the Year Ended June 30, 2012

**C. Financial Reporting Entity (Cont.)**

- 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, 2012.

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.

**D. 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.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF CAROLINA**

Notes to Financial Statements  
For the Year Ended June 30, 2012

**D. Measurement Focus and Basis of Accounting (Cont.)**

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).

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.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF CAROLINA**  
Notes to Financial Statements  
For the Year Ended June 30, 2012

**D. Measurement Focus and Basis of Accounting (Cont.)**

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.

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.

**Governmental Fund Financial Statements (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, 2012, 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, 2012.

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.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF CAROLINA**  
Notes to Financial Statements  
For the Year Ended June 30, 2012

**D. Measurement Focus and Basis of Accounting (Cont.)**

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 (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.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAROLINA**

Notes to Financial Statements  
For the Year Ended June 30, 2012

**D. Measurement Focus and Basis of Accounting (Cont.)**

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.

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.

**E. Major and Nonmajor 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, 2012, and accordingly, have been reported as major funds in the accompanying GFFS. All other governmental funds of the Municipality are considered Nonmajor for financial reporting purposes.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF CAROLINA**  
Notes to Financial Statements  
For the Year Ended June 30, 2012

**F. 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 preliminarily 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.

**G. 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.

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.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF CAROLINA**  
Notes to Financial Statements  
For the Year Ended June 30, 2012

**G. Statutory (Budgetary) Accounting (Cont.)**

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, 2012.

**H. 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 \$177,646,986 at June 30, 2012. 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 \$123,890,814 at June 30, 2012 (see note 3).

Cash and cash equivalents recorded in general fund, amounting to \$6,529,462, consist of restricted cash to finance specific commitments and activities. Cash held with fiscal agent recorded in the debt service funds, amounting to \$67,320,481, 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 \$40,555,765, 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.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF CAROLINA**  
Notes to Financial Statements  
For the Year Ended June 30, 2012

**H. Unrestricted and Restricted Deposits (Cont.)**

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.

**I. 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, 2012, 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.

**J. 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.

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**K. 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 \$137,875 at June 30, 2012 involve legal and accounting fees incurred in the new debt issuance of \$14,690,000 in the fiscal year 2011-12. 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 \$1,530,622 by current and prior debt issuances.

**L. 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.

**M. 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).

**N. Capital Assets**

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

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**N. Capital Assets (Cont.)**

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.

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

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**N. Capital Assets (Cont.)**

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 follows the provision of GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries – an amendment of GASB Statement No. 34*. This statement establishes guidance for accounting and reporting for the impairment of capital assets and for insurance recoveries. The Municipality has made such capital assets evaluation and has determined that there is no impairment of capital assets as of June 30, 2012 to be recorded in accordance with GASB Statement No. 42.

**O. 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.

**P. 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, 2012, 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.

**COMMONWEALTH OF PUERTO RICO**  
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For the Year Ended June 30, 2012

**P. Compensated Absences (Cont.)**

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, 2012, the Municipality has recorded a liability for compensated absences amounting to \$13,862,636 in the accompanying government-wide statement of net assets.

**Q. 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, 2012, post employment benefits paid amounted to \$1,086,335. 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.

**R. 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 general fund. The government wide financial statements include an amount estimated as contingent liability or liabilities with a fixed or expected due date, which will require future available financial resources for its payments.

**S. 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.

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**S. Long-Term Debt (Cont.)**

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.

**T. 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.

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**T. Fund Balances (Cont.)**

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.

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 Municipal Legislature is the highest level of decision-making authority within the Municipality to commit any amount within the fund balance for a specific purpose. Such commitment requires the issuance of either an ordinance or resolution. Those commitments amounts cannot used for any other purpose unless the Municipality removes or changes the specified use by taking the same type of action it employed to previously commit those amount. If a modification or cancellation needs to be made to any amount previously committed, an explanatory memorandum needs to be prepared accompanying the amended ordinance or resolution. There are instance in which public hearings might also need to be performed.

Amounts that are constrained by the Municipality's intent to be used for specific purposes, but are neither restricted nor committed, are reported as assigned fund balance. The intended use of such funds is expressed by the Municipality's management through their departmental budgets which are submitted to the Municipality's Budget Office. The nature of the actions necessary to remove or modify an assignment only requires the approval of the Director of each department.

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**T. Fund Balances (Cont.)**

The Municipality has the policy to consider that committed amounts would be reduced first, followed by assigned amounts, and then unassigned amounts as well as restricted amounts would be reduced first followed by unrestricted amounts, when expenditures are incurred for purposes for which amounts in any of those unrestricted fund balance classifications could be used. At June 30, 2012, the accompanying GFFS reported fund balances as restricted, committed, assigned and unassigned (see note 13).

**U. 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.

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, 2012. 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.

**V. 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.

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Notes to Financial Statements  
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**W. Current Adoption of New Accounting Pronouncements**

The following new accounting standard was adopted by the Municipality effective July 1, 2011:

- GASB Statement No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*. This Statement address issues related to the use of the alternative measurement method and the frequency and timing of measurements by employers that participate in agent multiple-employer other postemployment benefit (OPEB) plans. The provisions of this Statement related to the use and reporting of the alternative measurement method are effective immediately. The provisions related to the frequency and timing of measurement are effective for actuarial valuations first used to report funded status information in OPEB plan financial statements.

**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.

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 it's entirely 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.

**COMMONWEALTH OF PUERTO RICO**  
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Notes to Financial Statements  
For the Year Ended June 30, 2012

**2. STEWARDSHIP, COMPLIANCE, AND ACCOUNTABILITY (Cont.)**

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 1<sup>st</sup>. 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.
- 3) Prior to July 1<sup>st</sup>, 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.

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.

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For the Year Ended June 30, 2012

**2. STEWARDSHIP, COMPLIANCE, AND ACCOUNTABILITY (Cont.)**

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, 2012 was presented for the general fund as part of the accompanying budgetary comparison schedule.

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, 2012 are as follows:

Results of operations as per statement of revenues, expenditures and changes in fund balances	\$ (8,069,758)
Adjustments:	
Less:	
Non-budgeted revenues recorded	(36,338,130)
Current year encumbrances recognizes as expenditures for budgetary basis	(4,171,919)
Add:	
Non-budgeted expenditures recorded	48,250,357
Prior year encumbrances recorded as current year expenditures for GAAP purposes	<u>2,452,263</u>
Excess of revenues over expenditures - budgetary basis	\$ <u>2,122,813</u>

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.

**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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**3. DEPOSITS AND INVESTMENTS (Cont.)**

**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, 2012.

**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, 2012, (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, 2012, 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, 2012.

**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, 2012.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAROLINA**

Notes to Financial Statements  
For the Year Ended June 30, 2012

**3. DEPOSITS AND INVESTMENTS (Cont.)**

At June 30, 2012, the total deposits are as follows:

	Major governmental funds						Total governmental funds
	General Fund	Debt service Fund	Capital project Fund	Economic development fund	Workforce investment fund	Other governmental funds	
Unrestricted cash and cash equivalents in commercial banks	\$ 52,022,310	-	1,372,893	360,969	-	-	\$ 53,756,172
Total unrestricted cash	<u>52,022,310</u>	<u>-</u>	<u>1,372,893</u>	<u>360,969</u>	<u>-</u>	<u>-</u>	<u>53,756,172</u>
Restricted cash:							
Cash and cash equivalent in commercial banks	6,529,270	903,130	1,624,868	4,676,550	135,675	4,672,881	18,542,374
Cash with fiscal agent, GDB	192	66,417,351	38,930,897	-	-	-	105,348,440
Total restricted cash	<u>6,529,462</u>	<u>67,320,481</u>	<u>40,555,765</u>	<u>4,676,550</u>	<u>135,675</u>	<u>4,672,881</u>	<u>123,890,814</u>
Total deposits and investments	\$ <u>58,551,772</u>	<u>67,320,481</u>	<u>41,928,658</u>	<u>5,037,519</u>	<u>135,675</u>	<u>4,672,881</u>	\$ <u>177,646,986</u>

**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.

**COMMONWEALTH OF PUERTO RICO**  
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 For the Year Ended June 30, 2012

**4. PROPERTY TAXES (Cont.)**

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 \$1,900,054 during the fiscal year ended June 30, 2012.

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, 2012, the property tax collections not exceeded the advances remitted by CRIM by \$202,551, 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, 2012:

Amortization through collections of property taxes by the CRIM	\$50,310,409
Advance received from CRIM	<u>50,512,960</u>
Due to CRIM	<u>\$ ( 202,551 )</u>

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

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.

**COMMONWEALTH OF PUERTO RICO**  
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Notes to Financial Statements  
For the Year Ended June 30, 2012

**4. PROPERTY TAXES (Cont.)**

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.

**5. MUNICIPAL LICENSE TAXES AND SALES AND USE TAXES**

**A. Municipal License Tax**

The Municipality is authorized by Act No. 81 to impose 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 from 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 filing date is ten days after the State Income Tax is filed (usually the 15<sup>th</sup> day of April of each year).

Entities with sales volume of \$1 million or more must include rates established by the Municipality. At June 30, 2012, 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.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF CAROLINA**

Notes to Financial Statements  
For the Year Ended June 30, 2012

**5. MUNICIPAL LICENSE TAXES AND SALES AND USE TAXES (Cont.)**

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 2012, the total municipal volume of business tax collected was \$24,616,059 and the receivable balance (net of the allowance for estimated uncollectible amounts) was \$4,019,225.

**B. 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 10<sup>th</sup> 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 2011-12 amounted to \$18,109,474. 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 \$3,041,457 as of June 30, 2012. 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, 2012 was \$161,582.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAROLINA**

Notes to Financial Statements  
For the Year Ended June 30, 2012

**5. MUNICIPAL LICENSE TAXES AND SALES AND USE TAXES (Cont.)**

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 2011-12.

**6. INTERFUNDS TRANSACTIONS**

Interfund transactions at June 30, 2012 consisted of the following:

**A. Operating Transfer**

Transfer to:	Transfer from:					
	Major funds					
	General fund	Debt service fund	Capital project fund	Economic development fund	Other governmental funds	Total governmental funds
Major funds:						
General fund	\$ -	-	8,043,971	-	723	\$ 8,044,694
Debt service fund	5,964,976	-	-	1,642,875	-	7,607,851
Capital project fund	7,190,656	-	1,446,699	-	46,800	8,684,155
Economic development fund	-	-	-	1,244,752	-	1,244,752
Other funds	995,813	-	2,003,006	-	50,000	3,048,819
<b>Total</b>	<b>\$ 14,151,445</b>	<b>-</b>	<b>11,493,676</b>	<b>2,887,627</b>	<b>97,523</b>	<b>\$ 28,630,271</b>

**B. Due from / to**

Due to:	Due from:					
	Major funds					
	General fund	Debt service fund	Capital project fund	Economic development fund	Other governmental funds	Total governmental funds
Major funds:						
General fund	\$ -	286,363	634,579	506,978	2,327,688	3,755,608
Debt service fund	-	-	-	-	-	-
Capital project fund	5,336,043	-	16,866	-	46,800	5,399,709
Economic development fund	-	-	-	1,004,902	88,009	1,092,911
Other funds	725,793	-	92,210	-	576,174	1,394,177
<b>Total</b>	<b>6,061,836</b>	<b>286,363</b>	<b>743,655</b>	<b>1,511,880</b>	<b>3,038,671</b>	<b>11,642,405</b>

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, 2012. 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.

**COMMONWEALTH OF PUERTO RICO**  
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Notes to Financial Statements  
For the Year Ended June 30, 2012

**7. DEFERRED REVENUES**

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

**a. General Fund** – the deferred revenue of \$24,616,059 in the general fund is related to municipal license taxes collected in fiscal year 2011-12 that will be earned in fiscal year 2012-13. Otherwise, the balances of \$4,799,224 in the general fund and \$3,869,368 in the debt service fund represent receivables from municipal license taxes, sales taxes and property taxes of prior years, not collected as of June 30, 2012.

**b. Other Governmental Funds** – the deferred revenues recorded in the other governmental funds of \$5,619,000 represent the portion of federal grant for which qualifying expenditures have not been incurred.

**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
Puerto Rico Electric Power Authority	\$ 141,377	-	\$ 141,377
Municipal Revenue Collection Center (CRIM)	891,327	-	891,327
Employees Retirement System of the Government of Puerto Rico	1,984,213	-	1,984,213
Aqueduct and Sewer Authority (AAA)	219,356	-	219,356
Human Resource Development Occupational Council	-	170	170
<b>Total</b>	<b>\$ 3,236,273</b>	<b>170</b>	<b>\$ 3,236,443</b>

**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 (PREPA) amounting to \$1,682,407 and \$13,656,484, respectively. These intergovernmental revenues are accounted for in the general fund.

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**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAROLINA**

Notes to Financial Statements  
For the Year Ended June 30, 2012

**10. CAPITAL ASSETS**

Capital assets activity for the year ended June 30, 2012, was as follows:

	<u>Balance at June 30, 2011</u>	<u>Additions</u>	<u>Retirements, disposition and reclassifications</u>	<u>Balance at June 30, 2012</u>
Governmental activities				
Cost basis of capital assets, not being depreciated/amortized:				
Land	\$ 1,314,443,616	8,599,140	(355,000)	\$ 1,322,687,756
Construction in progress	101,365,342	14,159,383	(43,768,654)	71,756,071
Infrastructure in progress	22,940,797	9,097,264	(8,506,971)	23,531,090
Total capital assets, not being depreciated/amortized	<u>1,438,749,755</u>	<u>31,855,787</u>	<u>(52,630,625)</u>	<u>1,417,974,917</u>
Cost basis of capital assets, being depreciated/amortized:				
Buildings, infrastructure and improvements	531,476,436	7,554,674	52,196,086	591,227,196
Licensed vehicles, machinery, equipment furniture and fixtures	46,456,290	4,718,904	(200,239)	50,974,955
Total capital assets, being depreciated / amortized	<u>577,932,726</u>	<u>12,273,578</u>	<u>51,995,847</u>	<u>642,202,151</u>
Total cost basis of capital assets	<u>2,016,682,481</u>	<u>44,129,365</u>	<u>(634,778)</u>	<u>2,060,177,068</u>
Less: accumulated depreciation and amortization:				
Buildings, infrastructure and improvements	(93,841,286)	(10,106,326)	-	(103,947,612)
Licensed vehicles, machinery, equipment furniture and fixtures	(16,869,059)	(4,373,937)	-	(21,242,996)
Total accumulated depreciation and amortization	<u>(110,710,345)</u>	<u>(14,480,263)</u>	<u>-</u>	<u>(125,190,608)</u>
Total capital assets, net	<u>\$ 1,905,972,136</u>	<u>29,649,102</u>	<u>(634,778)</u>	<u>\$ 1,934,986,460</u>

Depreciation and amortization expense for the fiscal year ended June 30, 2012 was charged to functions in the accompanying government wide statement of activities as follows:

General government	\$ 3,881,062
Public safety	1,307,871
Public works, streets and transportation	3,510,960
Sanitation	1,405,659
Recreations and sports	625,601
Education and training	1,088,575
Housing and buildings	1,482,596
Economic Development	573,452
Welfare	457,569
Employment opportunity	146,918
Total depreciation and amortization expense	<u>\$ 14,480,263</u>

The Municipality's policy is to transfer construction in progress properly concluded to other classification of capital assets if such capital project is being used. When capital assets that are to be used in governmental activities are purchased or constructed, the resources expended for those assets are reported as expenditures in the governmental funds within the capital outlays and included as additions in the roll-forward activity of the capital assets in the government-wide financial statement.

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**10. CAPITAL ASSETS (Cont.)**

However, in the statement of activities, the cost of those assets is allocated over the estimated useful lives and reported as a depreciation expense. As a result, fund balance decreased by the capital outlays balance—the amount of financial resources expended, whereas net assets decreases by the amount of depreciation expense charged for the year.

**11. LONG TERM DEBT**

The general long-term debt activity for the year ended June 30, 2012 was as follows:

	Balance at June 30, 2011	Borrowings or Additions	Payments or Deductions	Balance at June 30, 2012	Due within one year	Long term portion
Bonds and notes payables	\$ 337,225,990	20,685,000	(18,416,100)	\$ 339,494,890	20,397,200	319,097,690
Federal notes payables	11,150,000	-	(965,000)	10,185,000	965,000	9,220,000
Notes payable to CRIM	15,827,632	202,551	(5,099,235)	10,930,948	1,103,554	9,827,394
Compensated absences	13,463,288	2,268,338	(1,868,990)	13,862,636	1,703,709	12,158,927
Estimated liability for municipal solid waste landfill closure and postclosure care costs	2,568,700	-	-	2,568,700	-	2,568,700
Claims and judgments	2,691,976	-	(84,614)	2,607,362	52,317	2,555,045
<b>Total</b>	<b>\$ 382,927,586</b>	<b>23,155,889</b>	<b>(26,433,939)</b>	<b>\$ 379,649,536</b>	<b>24,221,780</b>	<b>355,427,756</b>

**a. 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, 2012, the Municipality is in compliance with the debt limitation requirements.

**b. 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.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAROLINA**

Notes to Financial Statements  
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**11. LONG TERM DEBT (Cont.)**

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. 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, 2012:

	<b><u>Outstanding balance</u></b>
<b><u>General obligation and special bonds:</u></b>	
2011 serial bonds, original issue amount of \$5,995,000, due in annual principal installments ranging from \$245,000 to \$510,000; plus interest due in semiannual installments with variable rates through July 1, 2032	\$ 5,995,000
2011 serial bonds, original issue amount of \$8,810,000, due in annual principal installments ranging from \$245,000 to \$510,000; plus interest due in semiannual installments with interest rate at 7.50 % through July 1, 2036	8,580,000
2011 serial bonds, original issue amount of \$5,880,000 due in annual principal installments ranging from \$160,000 to \$350,000; plus interest due in semiannual installments with interest rate at 7.50 % through July 1, 2030	5,730,000
2010 serial bonds, original issue amount of \$23,395,000, due in annual principal installments ranging from \$615,000 to \$1,475,000; plus interest due in semiannually installments with variables rates through July 1, 2035	22,290,000
2009 serial bonds, original issue amount of \$21,165,000, due in annual principal installments ranging from \$745,000 to \$1,515,000; plus interest due in semiannual installments with variable through July 1, 2030	19,200,000
2009 serial bonds, original issue amount of \$38,940,000, due in annual principal installments ranging from \$1,195,000 to \$2,640,000; plus interest due in semiannual installments with variable rates through July 1, 2032	35,805,000
2009 serial bonds, original issue amount of \$9,586,000, due in annual principal installments ranging from \$411,000 to \$631,000; plus interest due in semiannually installments with variables rates through July 1, 2028	8,175,000

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<u>General obligation and special bonds:</u>	<u>Outstanding balance</u>
2008 serial bonds, original issue amount of \$6,370,000, due in annual principal installments ranging from \$375,000 to \$585,000; plus interest due in annually installments with variable rate through July 1, 2023	5,095,000
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 annually installments with variable rate through July 1, 2033	3,325,000
2008 serial bonds, original issue amount of \$35,610,000, due in annual principal installments ranging from \$1,180,000 to \$2,845,000; plus interest due in annually installments with variable rate through July 1, 2030	31,625,000
2007 serial bonds, original issue amount of \$800,000, due in annual principal installments ranging from \$125,000 to \$130,000; plus interest due in annually installments with variable rates through July 1, 2015	375,000
2007 serial bonds, original issue amount of \$32,355,000, due in annual principal installments ranging from \$1,835,000 to \$2,845,000; plus interest due in annually installments with interest rate at 5.00% through July 1, 2023	24,800,000
2007 serial bonds, original issue amount of \$1,450,000, due in annual principal installments ranging from \$94,000 to \$135,000; plus interest due in annually installments with interest rate at 5.125% through July 1, 2021	996,000
2006 serial bonds, original issue amount of \$2,830,000, due in annual principal installments ranging from \$85,000 to \$195,000; plus interest due in semiannual installments with interest rate at 5.00% through July 1, 2031	2,430,000
2006 serial bonds, original issue amount of \$27,475,000, due in annual principal installments ranging from \$1,495,000 to \$2,325,000; plus interest due in semiannual installments with interest rate at 5.00% through July 1, 2023	20,250,000
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	276,890
2005 serial bonds, original issue amount of \$12,470,000, due in annual principal installments ranging from \$560,000 to \$955,000; plus interest due in semiannual installments with interest rate at 5.00% through July 1, 2025	9,400,000

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF CAROLINA**  
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For the Year Ended June 30, 2012

**11. LONG TERM DEBT (Cont.)**

<u>General obligation and special bonds:</u>	<u>Outstanding balance</u>
2005 serial bonds, original issue amount of \$12,470,000, due in annual principal installments ranging from \$560,000 to \$955,000; plus interest due in semiannual installments with interest rate at 5.00% through July 1, 2025	9,400,000
2005 serial bonds, original issue amount of \$12,460,000, due in annual principal installments ranging from \$550,000 to \$955,000; plus interest due in semiannual installments with interest rate at 5.00% through July 1, 2025	9,390,000
2004 serial bonds, original issue amount of \$15,550,000, due in annual principal installments ranging from \$765,000 to \$1,190,000; plus interest due in semiannual installments with interest rate at 5.00% through July 1, 2023	10,365,000
2008 serial bonds, original issue amount of \$23,500,000, due in annual principal installments ranging from \$800,000 to \$1,810,000; plus interest due in semiannual installments at 5.60% through January 1, 2027	18,185,000
2003 serial bonds, original issue amount of \$4,000,000, due in annual principal installments ranging from \$146,000 to \$259,000; plus interest due in annually installments with interest rate at 4.50% through July 1, 2027	2,897,000
2003 serial bonds, original issue amount of \$1,310,000, due in annual principal installments ranging from \$45,000 to \$105,000; plus interest due in semiannual installments with interest rate at 6.50% through July 1, 2027	1,015,000
2003 serial bonds, original issue amount of \$23,000,000, due in annual principal installments ranging from \$810,000 to \$1,625,000; plus interest due in semiannual installments with interest rate at 5.50% through July 1, 2027	17,210,000
2003 serial bonds, original issue amount of \$1,360,000, due in annual principal installments ranging from \$47,000 to \$88,000; plus interest due in semiannual installments with interest rate at 5.50% through July 1, 2027	1,030,000
2003 serial bonds, original issue amount of \$5,040,000, due in annual principal installments ranging from \$175,000 to \$365,000; plus interest due in semiannual installments with interest rate at 5.04% through July 1, 2027	3,800,000

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**11. LONG TERM DEBT (Cont.)**

<u>General obligation and special bonds:</u>	<u>Outstanding balance</u>
2003 serial bonds, original issue amount of \$4,310,000, due in annual principal installments ranging from \$145,000 to \$330,000; plus interest due in annually installments with interest rate at 5.60% through July 1, 2027	3,315,000
2001 serial bonds, original issue amount of \$20,120,000, due in annual principal installments ranging from \$1,185,000 to \$1,805,000; plus interest due in semiannual installments with variable rates July 1, 2020	11,425,000
2000 serial bonds, original issue amount of \$30,285,000, due in annual principal installments ranging from \$2,165,000 to \$2,400,000; plus interest due in semiannual installments with variable rates through July 1, 2017	11,295,000
1998 serial bonds, original issue amount of \$13,165,000, due in annual principal installments ranging from \$740,000 to \$1,175,000; plus interest due in semiannual installments with variable rates through July 1, 2020	7,300,000
1998 serial bonds, original issue amount of \$23,890,000, due in annual principal installments ranging from \$970,000 to \$1,860,000; plus interest due in semiannual installments with variables rates through January 1, 2017	15,995,000
1997 serial bonds, original issue amount of \$2,370,000, due in annual principal installments ranging from \$110,000 to \$205,000; plus interest due in annually installments with variable rates through July 1, 2022	1,490,000
1996 serial bonds, original issue amount of \$10,475,000, due in annual principal installments ranging from \$935,000 to \$1,010,000; plus interest due in semiannual installments with variable rates July 1, 2015	2,810,000
1995 serial bonds, original issue amount of \$16,630,000, due in annual principal installments ranging from \$995,000 to \$1,465,000; plus interest due in semiannual installments with variable rates through July 1, 2019	<u>8,225,000</u>
<b>Total general obligation and special bonds</b>	<b><u>\$339,494,890</u></b>
<b><u>Federal notes payables:</u></b>	
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	3,750,000

**COMMONWEALTH OF PUERTO RICO**  
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Notes to Financial Statements  
For the Year Ended June 30, 2012

**11. LONG TERM DEBT (Cont.)**

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>6,435,000</u>
<b>Total federal notes</b>	<u>10,185,000</u>
Total municipal obligation bonds and notes payable (reported as bonds And interest notes payable in SNA.	<u>349,679,890</u>
Less: current portion due in fiscal year ended June 30, 2013 (reported as bonds and interest notes payables in SNA)	<u>(20,397,200)</u>
Long-term portion (reported as bonds and notes payables in SNA)	<u>\$ 329,282,690</u>

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, 2012 are as follows:

<u>Year Ending</u> <u>June 30</u>	<u>General obligations and Special bonds</u>		
	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2013	\$ 20,696,950	19,613,659	\$ 40,310,609
2014	21,764,440	18,114,754	39,879,194
2015	22,755,750	16,759,594	39,515,344
2016	38,889,750	15,362,084	54,251,834
2017-2021	110,238,750	57,507,357	167,746,107
2022-2026	82,453,750	29,657,735	112,111,485
2027-2031	39,905,750	12,024,520	51,930,270
2032-2036	12,974,750	2,783,516	15,758,266
<b>Total</b>	<b>\$ <u>349,679,890</u></b>	<b><u>171,823,219</u></b>	<b>\$ <u>521,503,109</u></b>

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**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF CAROLINA**  
Notes to Financial Statements  
For the Year Ended June 30, 2012

**c. Notes payable to CRIM**

At June 30, 2012, the liability to CRIM is composed as follow:

	Balance June 30, 2011	Additions	Payments or Deductions	Balance June 30, 2012	Due within one year	Long term portion
Interest due for accounts sold (Act No. 146)	\$ 6,667,126	-	(317,482)	\$ 6,349,644	317,482	6,032,162
LIMS refinancing debt	364,069	-	(364,069)	-	-	-
Amount due to CRIM for excess of property taxes advances received on prior years (Act No. 42)	3,781,521	-	(91,544)	3,689,977	97,296	3,592,681
Amount due to CRIM - 2009-10 (reported as due to other government agencies)	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	-
Amount due to CRIM - 2011-12 (reported as due to other government agencies)	-	202,551	-	202,551	-	202,551
<b>Total</b>	<b>\$ 15,827,632</b>	<b>202,551</b>	<b>(5,099,235)</b>	<b>\$ 10,930,948</b>	<b>1,103,554</b>	<b>9,827,394</b>

**Public Act No. 42** – The Commonwealth’s Pubic 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 \$3,689,977 at June 30, 2012. The principal and interest maturities are as follows:

Year Ending June 30	Principal	Interest	Total
2013	\$ 97,296	226,835	\$ 324,131
2014	103,410	220,721	324,131
2015	109,907	214,224	324,131
2016	116,812	207,319	324,131
2017-2021	703,822	916,833	1,620,655
2022-2026	954,522	666,133	1,620,655
2027-2032	1,604,208	340,578	1,944,786
<b>Total</b>	<b>\$ 3,689,977</b>	<b>2,792,643</b>	<b>\$ 6,482,620</b>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAROLINA**

Notes to Financial Statements  
For the Year Ended June 30, 2012

**11. LONG TERM DEBT (Cont.)**

**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. 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, 2012 was \$6,349,644.

The principal and interest maturities are as follows:

Year Ending June 30	Principal	Interest	Total
2013	\$ 317,482	394,948	\$ 712,430
2014	317,482	375,200	692,682
2015	317,482	355,452	672,934
2016	317,482	335,706	653,188
2017-2021	1,587,411	1,382,316	2,969,727
2022-2026	1,587,411	888,634	2,476,045
2027-2032	1,904,894	414,694	2,319,588
Total	\$ 6,349,644	4,146,950	\$ 10,496,594

**d. 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, 2012. 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, 2012, the Municipality's solid waste landfill is still operating and its remaining estimated useful life is approximately 12 years. Approximately 50% of the Municipality's total capacity has been used at June 30, 2012.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF CAROLINA**  
Notes to Financial Statements  
For the Year Ended June 30, 2012

**11. LONG TERM DEBT (Cont.)**

**e. Compensated absences**

At June 30, 2012, the liability for compensated absences is composed as follows:

	<u>Due within</u>	<u>Due after</u>		<u>Total</u>
	<u>one year</u>	<u>one year</u>		
Vacation leave	\$ 315,855	6,251,190	\$	6,567,045
Sick leave	1,387,854	5,907,737		7,295,591
Total	<u>\$ 1,703,709</u>	<u>12,158,927</u>	<u>\$</u>	<u>13,862,636</u>

**f. Revolving line of credit**

On December 24, 2008 the executive director of the *Corporación Carolina Beisbol Gigantes, Inc.*, signed a unsecured revolving loan agreement with a commercial bank amounting to \$250,000 with variable interest rate up to 6%. The loan agreement is for one year term and renewable for another one year term. The outstanding balance of the recovery line of credit as of June 30, 2012 was \$245,000.

**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.

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.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF CAROLINA**  
Notes to Financial Statements  
For the Year Ended June 30, 2012

**12. EMPLOYEES RETIREMENT SYSTEM (Cont.)**

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.

For the year ended June 30, 2012, total covered payroll was approximately \$33.9 million. Covered payrolls refer to all compensation paid by the Municipality to employees covered by the System on which contributions to the pension are based.

The amount of the annuity shall be one and one-half percent of the average compensation multiplied by the number of year of creditable service up to twenty years, plus two percent of the average compensation multiplied by the number of years of creditable service in excess of twenty years. For those employee covered after March 31, 1990, the annuity shall be one and one-half percent of the average compensation multiplied by the number of year of creditable service, in no case shall the annuity be less than \$2,400.

**Funding Policy**

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

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 of 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.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF CAROLINA**

Notes to Financial Statements  
For the Year Ended June 30, 2012

**12. EMPLOYEES RETIREMENT SYSTEM (Cont.)**

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, and; (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	\$3,143,093
Actual contribution in dollars	\$3,143,093

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, was issued the Act No. 116, an amendment to Act No. 447 of May 15, 1951. This act brought the following amendments to the employer contribution requirements effective July 1, 2011:

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

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).

Questions concerning any of the information provided in this disclosure or request for additional information should be addressed to the Commonwealth of Puerto Rico Government Employees and Judiciary Retirement Systems Administration, 437 Ponce de León Avenue, Hato Rey, Puerto Rico, 00918.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF CAROLINA**  
Notes to Financial Statements  
For the Year Ended June 30, 2012

**13. FUND BALANCES**

As June 30, 2012, the fund balances is comprised of the following categories:

	General Fund	Debt service fund	Capital project fund	Economic development fund	Other governmental fund	Total governmental funds
<i>Restricted for:</i>						
General government	\$ 774,640	-	19,418	-	-	\$ 794,058
Public safety	-	-	-	-	-	-
Public works and transportation	-	-	12,941,310	-	84,177	13,025,487
Sanitation	744,467	-	-	-	-	744,467
Recreation and sports	-	-	55,127	-	1,541,269	1,596,396
Education and trainings	-	-	114,463	-	3,129,549	3,244,012
Housing and buildings	-	-	7,854,853	-	3,523,156	11,378,009
Economic development	-	-	-	6,132,958	-	6,132,958
Welfare	-	-	-	-	1,092,461	1,092,461
Debt payments	-	47,913,448	-	-	-	47,913,448
<i>Committed:</i>						
Encumbrances	17,067,028	-	16,818,572	1,977,279	4,810,923	40,673,802
<i>Assigned</i>						
General government	3,024,749	-	-	-	-	3,024,749
Public safety	1,042,882	-	-	-	-	1,042,882
Public works and transportation	5,209,314	-	-	-	-	5,209,314
Sanitation	1,045,980	-	-	-	-	1,045,980
Recreation and sports	291,820	-	-	-	-	291,820
Education and trainings	343,619	-	-	-	-	343,619
Housing and buildings	338,131	-	-	-	-	338,131
Welfare	281,763	-	-	-	-	281,763
Employment opportunity	37,838	-	-	-	-	37,838
<i>Unassigned</i>	2,555,020	-	-	-	-	2,555,020
<b>Total</b>	<b>\$ 32,757,250</b>	<b>47,913,448</b>	<b>37,803,743</b>	<b>8,110,237</b>	<b>14,181,535</b>	<b>\$ 140,766,213</b>

**14. COMMITMENTS AND CONTINGENCIES**

**a. Commitments**

The Municipality has several outstanding or planned non-cancelable construction projects amounting to \$40,673,802 at June 30, 2012. 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 \$17,067,028 in the general fund at June 30, 2012. 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**  
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Notes to Financial Statements  
For the Year Ended June 30, 2012

**14. COMMITMENTS AND CONTINGENCIES (Cont.)**

**b. 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 \$2,969,944 or awarded and anticipated unfavorable judgments as of June 30, 2012. 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.

**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, 2012, was \$818,391.

**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, 2012.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF CAROLINA**  
Notes to Financial Statements  
For the Year Ended June 30, 2012

**17. RESTATEMENTS**

The Municipality has restated the beginning fund balances of fund financial statements at July 1, 2012 to correct inter-fund accounts and accounts payable to be in conformity with their respective subsidiaries. Since these transactions receive the same accounting treatment in fund financial statements in a government-wide, the effect is the same in both financial statements.

The following tables summarize the effects of the situations mention above per column of the financial statement:

<u>Fund description:</u>	<u>Amount</u>
Capital project fund	235,136
Economic development fund	(46,904)
Workforce investment fund	(8,259)
Other governmental fund	<u>(101,153)</u>
	<u>\$ 78,820</u>
<u>Other corrections having effect in Government-Wide Only</u>	
Property taxes revenues not previously recorded	<u>\$ 3,689,368</u>

**18. SUBSEQUENT EVENTS**

In preparing these financial statements, the Municipality has evaluated events and transactions for potential recognition or disclosure through December 31, 2012. Based on such analysis management decided to disclose the following:

- On July 10, 2012, the Municipality entered into a Loan Agreement (the Agreement) with the Governmental Development Bank (GDB) for the acquisition of equipment and improvements of various municipal works. The Agreement provides for borrowing in the amount of \$860,000, including finance charges, through July 1, 2019 (the Maturity Date) and shall be known as 2012 Municipal General Obligation Bonds. The Bonds will be issued as registered notes without coupons in determination of 5,000 and with increments of \$1,000 above that sum with maturities of July 1 of each year through 2019. Borrowings will bear interest at an annual rate which will not exceed the maximum interest rated authorized by law. Due interests shall be paid semi-annual in January 1 and July 1 each year. The Municipality's good faith, credit and its power to impose contributions will be compromised for the repayment of this liability and will begin on January 1, 2013. The Municipality will also pay legal, accounting, and other fees and expenses in accordance with the Loan Agreement.
  
- On July 10, 2012, the Municipality entered into a Loan Agreement (the Agreement) with the Governmental Development Bank (GDB) for the acquisitions of property and capital improvements. The Agreement provides for borrowing in the amount of \$830,000, including finance charges, through July 1, 2038 (the Maturity Date) and shall be known as 2012 Municipal General Obligation Bonds. The Bonds will be issued as registered notes without coupons in determination of 5,000 and with increments of \$1,000 above that sum with maturities of July 1 of each year through 2038.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF CAROLINA**  
Notes to Financial Statements  
For the Year Ended June 30, 2012

**18. SUBSEQUENT EVENTS (Cont.)**

- Borrowings will bear interest at an annual rate which will not exceed the maximum interest rated authorized by law. Due interests shall be paid semi-annual in January 1 and July 1 each year. The Municipality's good faith, credit and its power to impose contributions will be compromised for the repayment of this liability and will begin on January 1, 2013. The Municipality will also pay legal, accounting, and other fees and expenses in accordance with the Loan Agreement.
  
- On December 20, 2012, the Municipality entered into a Credit Agreement (the Agreement) with a local commercial bank for the purpose of: (i) authorizing its promissory note in anticipation of revenue bonds, in the aggregate principal amount of \$40,385,000 (the "Note"), which Note will be dated as of the December 20, 2012 will evidence the loan advances made by the local commercial bank to the Municipality under a non-revolving line of credit in an aggregate principal amount not to exceed \$40,385,000, the proceeds of which the Municipality will use for the construction, development and equipping of a 109-bed hospital to be known as the San Fernando Hospital in the Jesús T. Piñero building located in a parcel of land in the Municipality of Carolina, Puerto Rico; (ii) authorizing its Municipal Revenue Bonds of 2016 (the "Bonds"), which Bonds shall be dated the Bond issuance date and shall be in the aggregate principal amount not to exceed \$40,385,000, to provide permanent financing for the project by converting the outstanding principal amount of the Note into the Bonds on the issuance date; and (iii) securing the payment of the Note and the Bonds by pledging, among other collateral, all the revenues generated by the Municipality from the project.

The Agreement provides for borrowing in the amount of \$40,385,000, including finance charges, through July 1, 2040 (the Maturity Date) for a Revenue Bond. The Bonds will be issued as registered bonds without coupons in denominations of 5,000 and with increments of \$5,000 above that sum with maturities from July 1, 2016 through July 1, 2040. Bonds will bear interest at an annual rate of 5.95%. Due interests shall be paid semi-annual in January 1 and July 1 each year. The Municipality's good faith, credit and its power to impose contributions will not be compromised for the repayment of this liability and will begin on July 1, 2016. The Municipality will also pay legal, accounting, and other fees and expenses in accordance with the Loan Agreement.

**19. FUTURE ADOPTION OF ACCOUNTING PRONOUNCEMENTS**

The GASB has issued the following accounting standards that have effective dates after June 30, 2012:

- 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.

**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF CAROLINA**

Notes to Financial Statements  
For the Year Ended June 30, 2012

**19. FUTURE ADOPTION OF ACCOUNTING PRONOUNCEMENTS (Cont.)**

- The requirements of Statement No. 14, *The Financial Reporting Entity*, and the related financial reporting requirements of Statement No. 34, *Basic Financial Statements – and Management’s Discussion and Analysis-for State and Local Governments*, were amended to better meet user needs and to address reporting entity issues that have arisen since the issuance of those Standards. This Statement modifies certain requirements for inclusion of component units in the financial reporting entity. For organizations that previously were required to be included as component units by meeting the fiscal dependency criteria, a financial benefit or burden relationship also would need to be present between the primary government and that organization for it to be included in the reporting entity as a component unit.

Further, for organizations that do not meet financial accountability criteria for inclusion as component units but that, nevertheless, should be included because the primary government’s management determines that it would be misleading to exclude them, this Statement clarifies the manner in which that determination should be made and the types of relationship that generally should be considered in making the determination.

This Statement also amends the criteria for reporting component units as if they were part of the primary government (that is, blending) in certain circumstances. For component units that currently are blended based on the “substantively the same governing body” criteria, it additionally requires that (1) the primary government and the component unit have a financial benefit or burden relationship or (2) management (below the level of the elected officials) of the primary government have operational responsibility for the activities of the component unit. New criteria also are added to require blending of component unit whose total debt outstanding is expected to be repaid entirely or almost entirely resources of the primary government.

The blending provisions are amended to clarify that funds of a blended component unit have the same financial guidance requirements as a fund of the primary government. Lastly, additional reporting guidance is provided for blending a component unit if the primary government is a business-type activity that uses a single column presentation for financial reporting.

This Statement also clarifies the reporting of equity interest in legally separate organizations. It requires a primary government to report its equity interest in a component unit as an asset. The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2012.

- 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:
  1. Financial Accounting Standards Board (FASB) Statements and Interpretations.
  2. Accounting Principles Board Opinions
  3. Accounting Research Bulletins of the American Institute of Certified Public Accountants’ (AICPA) Committee an Accounting Procedure.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAROLINA**

Notes to Financial Statements  
For the Year Ended June 30, 2012

**19. FUTURE ADOPTION OF ACCOUNTING PRONOUNCEMENTS (Cont.)**

This Statement also supersedes Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, thereby eliminating the election provided for enterprise funds and business-type activities to apply post-November 30, 1989 FASB Statements and Interpretations that do not conflict with or contradict GASB pronouncements. However, those entities can continue to apply, as other accounting literature, post-November 30, 1989 FASB pronouncements that do not conflict with or contradict GASB pronouncements, including this Statement.

The requirements of this Statement are effective for financial statements for periods beginning after December 15, 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 15, 2013;

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

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**COMMONWEALTH OF PUERTO RICO**  
**MUNICIPALITY OF CAROLINA**  
Statement of Revenues and Expenditures  
Budget and Actual – General Fund  
Fiscal Year Ended June 30, 2012

	<u>Budgeted amounts</u>		<u>Actual amounts budgetary basis</u>	Variance
	<u>Original</u>	<u>Final</u>		favorable (unfavorable)
<b>Revenues:</b>				
Property taxes	\$ 50,512,960	\$ 50,512,960	\$ 50,310,410	\$ (202,550)
Municipal license tax	30,657,416	30,657,416	33,137,738	2,480,322
Construction excise and permits	3,600,000	3,600,000	5,036,407	1,436,407
Property rent	-	85,000	87,200	2,200
Miscellaneous	572,000	572,000	464,412	(107,588)
Charges for services	506,800	506,800	562,700	55,900
Intergovernmental grants	13,656,484	13,656,484	13,656,484	-
Interest income	2,000,000	2,000,000	1,053,766	(946,234)
Fines and forfeitures	<u>900,000</u>	<u>900,000</u>	<u>191,006</u>	<u>(708,994)</u>
Total revenues	<u>102,405,660</u>	<u>102,490,660</u>	<u>104,500,123</u>	<u>2,009,463</u>
<b>Expenditures:</b>				
General government	52,280,427	56,821,614	56,727,582	94,032
Public safety	19,324,150	17,209,275	17,207,524	1,751
Public works, streets & transportation	4,416,697	3,983,065	3,981,282	1,783
Sanitation	4,915,752	4,307,578	4,307,111	467
Welfare	5,617,715	5,005,898	5,001,756	4,142
Recreation & sports	5,085,835	4,759,081	4,751,611	7,470
Education & training	3,392,789	3,250,242	3,247,234	3,008
Housing & building	1,407,319	1,188,931	1,188,234	697
Debt service:				
Principal	2,535,000	2,535,000	2,535,000	-
Interest	<u>3,429,976</u>	<u>3,429,976</u>	<u>3,429,976</u>	<u>-</u>
Total expenditures	<u>102,405,660</u>	<u>102,490,660</u>	<u>102,377,310</u>	<u>113,350</u>
Excess of revenues (expenditures) over expenditures (revenues)			<u>\$ 2,122,813</u>	<u>\$ 2,122,813</u>

**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 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 year ended June 30, 2012, which collectively comprise the Municipality's basic financial statements and have issued our report thereon dated January 9, 2013. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

Management of the Municipality is responsible for establishing and maintaining effective 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 opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Municipality's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Municipality's internal control over financial reporting.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

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 previously.

**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 (CONTINUED)**

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 for the information and use of management, others within the organization 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.

San Juan, Puerto Rico  
January 9, 2013

*González Torres, CPA, PSC*  
GONZÁLEZ TORRES, Co., CPA, PSC  
License 96  
Expires December 1, 2014

The stamp number 2646866  
was affixed to the original report.



**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

We have audited Commonwealth of Puerto Rico, Municipality of Carolina's compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of the Municipality's major federal programs for the year ended June 30, 2012. The Municipality's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the Municipality's management. Our responsibility is to express an opinion on the Municipality's compliance based on our audit.

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

In our opinion, the Municipality complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2012. However, the results of our auditing procedures did not disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133.

Internal Control Over Compliance

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

**REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAMS AND ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133 (CONTINUED)**

expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of 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 and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

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.

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

This report is intended for the information and use of management, others within the organization 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.

San Juan, Puerto Rico  
January 9, 2013

*González Torres* CPA, PSC  
GONZÁLEZ TORRES & CO., CPA, PSC  
License 96  
Expires December 1, 2014

The stamp number 2646867  
was affixed to the original report.



**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAROLINA**

Schedule of Expenditures of Federal Awards  
Fiscal Year Ended June 30, 2012

Federal Grantor	Program Title	Federal CFDA	
		Number	Expenditures
US Department of Agriculture	Child and Adult Care Food Program Pass-through the Puerto Rico Department of Education Nutrition Assistance for Puerto Rico Program Pass-through the Puerto Rico Office of Elderly Affairs	10.558	\$ 902,684
	Edward Byrne Memorial Formula Grant Program Pass-through the Puerto Rico Department of Justice	10.566	49,570
US Department of Justice	Head Start and Early Head Start Grants	16.579	58,173
US Department of Health and Human Services	Head Start Grants Pass-through the Puerto Rico Department of Family	93.600	5,629,679
	Child Care and Development Block Grant Pass-through the Puerto Rico Department of Family	93.600	1,389,243
	Special Programs for Aging (Title III Part C) Grant Pass-through the Puerto Rico Office of Elderly Affairs	93.575	817,493
	Aging Congregate Nutrition Services Grant Pass-through the Puerto Rico Department of Family	93.045	278,493
	Homeland Security Grant Program Pass-through the Public Security Governor's Office	9..556	34,417
	Community Development Block Grants/Entitlement Grants	97.067	648,252
	Community Development Block Grant - ARRA Entitlement Grants	14.218	7,100,517
US Department of Housing and Urban Development	Emergency Shelter Grants Program	14.253	121,938
	Homelessness Prevention and Rapid Re-Housing Program	14.231	202,120
	Supportive Housing Program	14.257	391,616
	Home Investment Partnership Program	14.235	341,767
	Section 8 Housing Choice Vouchers	14.239	1,115,766
	Community Development Block Grants / Section 108 loan guarantees	14.871	4,175,596
	Public and Indian Housing Pass-through the Puerto Rico Public Housing administration	14.2448	2,010,796
	Housing Opportunities for Persons with Aids Program Pass-through the Municipality of San Juan	14.850	433,229
	Federal Transit - Formula Grants (Urbanized Area Formula Program)	14.241	86,878
	Energy Efficiency and Conservation Block Grant	20.507	73,884
US Department of Energy	Workforce Investment Act Adult Program Pass-through the Department of Labor	81.128	390,678
US Department of Labor	Workforce Investment Act Youth Activities Pass-through the Department of Labor	17.258	849,606
	Workforce Investment Act Dislocated Worker Pass-through the Department of Labor	17.259	929,534
		17.260	276,617
<b>Total Expenditures</b>			<b>\$ 28,308,546</b>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAROLINA**

Notes to the Schedule of Expenditures of Federal Awards  
Fiscal Year Ended June 30, 2012

**Note 1 – General**

The accompanying schedule of expenditures of Federal Awards presents the expenditures of the fiscal year ended June 30, 2012, 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, 2012

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAROLINA**

Schedule of Findings and Questioned Costs  
Fiscal Year Ended June 30, 2012

**Section I. Summary of Auditors' Results:**

**Part I Financial Statements**

1. Type of audit report:  

<input checked="" type="checkbox"/> Unqualified opinion	<input type="checkbox"/> Qualified opinion
<input type="checkbox"/> Adverse opinion	<input type="checkbox"/> Disclaimer of opinion
  
2. Reportable conditions reported  

<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> No
------------------------------	--
  
3. Reportable condition reported as a major weakness and/or significant deficiency:  

<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> No
------------------------------	--
  
4. Material noncompliance disclosed:  

<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> No
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**Part II Federal Awards**

1. Type of report: on compliance for major programs:  

<input checked="" type="checkbox"/> Unqualified opinion	<input type="checkbox"/> Qualified opinion
<input type="checkbox"/> Adverse opinion	<input type="checkbox"/> Disclaimer of opinion
  
2. Reportable condition reported as a major weakness and/or significant deficiency:  

<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> No
------------------------------	--
  
3. Material noncompliance disclosed:  

<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> No
------------------------------	--
  
4. Audit findings required to be reported under Section 510 (a) of Circular A-133:  

<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> No
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**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAROLINA**

Schedule of Findings and Questioned Costs (Continued)  
Fiscal Year Ended June 30, 2012

**Section I. Summary of Auditors' Results (continued):**

**Part II Federal Awards (continued):**

5. Major Programs:

<u>CFDA Number (s)</u>	<u>Federal Program Grantor / Program Name</u>
10.558	US Department of Agriculture: Child and Adult Care Food Program Pass-through the Puerto Rico Department of Education
93.600	US Department of Health and Human Services: Head Start and Early Head Start Grants
93.600	US Department of Health and Human Services: Head Start Grants Pass-through the Puerto Rico Department of Family
93.575	US Department of Health and Human Services: Child Care and Development Block Grant Pass-through the Puerto Rico Department of Family
14.218	US Department of Housing and Urban Development: Community Development Block Grants/Entitlement Grants
14.239	US Department of Housing and Urban Development: Home Investment Partnership Program
14.871	US Department of Housing and Urban Development: Section 8 Housing Choice Vouchers
14.2448	US Department of Housing and Urban Development: Community Development Block Grants / Section 108 loan guarantees
17.258	US Department of Labor: Workforce Investment Act Adult Program Pass-through the Department of Labor
17.259	US Department of Labor: Workforce Investment Act Youth Activities Pass-through the Department of Labor
17.260	US Department of Labor: Workforce Investment Act Dislocated Worker Pass-through the Department of Labor
6.	Dollar threshold used to distinguish Type A and Type B programs: <span style="float: right;"><u>\$300,000</u></span>
7.	Low-risk auditee <input type="checkbox"/> Yes <span style="margin-left: 200px;"><input checked="" type="checkbox"/> No</span>
8.	Waive risk criteria under 520 (i) of Circular A -133 <input type="checkbox"/> Yes <span style="margin-left: 200px;"><input checked="" type="checkbox"/> No</span>

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAROLINA**

Schedule of Findings and Questioned Costs (Continued)  
Fiscal Year Ended June 30, 2012

**Section II. Financial Statements Findings**

None.

**Section III. Federal Awards Findings and Questioned Costs**

None.

**COMMONWEALTH OF PUERTO RICO  
MUNICIPALITY OF CAROLINA**

**Summary Schedule of Prior Year Findings and Questioned Costs  
June 30, 2012**

None