

OFFICE FOR THE IMPROVEMENTS OF PUBLIC SCHOOLS
(A Component Unit of the Commonwealth of Puerto Rico's Department of Education)

FINANCIAL STATEMENTS

AND

OMB CIRCULAR A-133 REPORT

YEAR ENDED JUNE 30, 2011

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INDEPENDENT AUDITORS' REPORT

Honorable Jesús Rivera
Office for the Improvements of
Public Schools (OMEP)
San Juan, Puerto Rico

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregated remaining fund information of the Office for the Improvements of Public Schools (OMEP, by its Spanish acronym) (a component unit of the Commonwealth of Puerto Rico's Department of Education), an agency of the Commonwealth of Puerto Rico (the Agency), as of and for the year ended June 30, 2011, which collectively comprised OMEP's basic financial statements, as listed in the table of contents. These financial statements are the responsibility of OMEP's management. Our responsibility is to express opinions on these financial statements based on our audit.

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

We did not observe the taking of the physical inventories at June 30, 2011 (stated at \$1,374,328), since this date was prior to the time we were engaged as auditors for OMEP. We were unable to satisfy ourselves about inventory quantities by means of other auditing procedures.

OMEP has not maintained adequate property accounting records for the year ended June 30, 2011, and we were unable to apply procedures to determine whether the opening balances in the financial statements as of July 1, 2010, were fairly presented in conformity with accounting principles generally accepted in the United States of America.

In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had the accounting records been adequate to satisfy ourselves about inventories and capital assets, the financial statements referred to above present fairly, in all material respects, the financial position of the governmental activities, each major fund, and the aggregated remaining fund information of OMEP as of June 30, 2011, and the results of its operations for the year then ended in conformity with accounting principles generally accepted in the United States of America.

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

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 4 through 8 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the OMEP's financial statements as a whole. The combining and individual nonmajor fund financial statements are presented for purposes of additional analysis and are not a required part of the financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is also not a required part of the financial statements. The combining and individual nonmajor fund financial statements and the schedule of expenditures of federal awards are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion the information is fairly stated in all material respects in relation to the financial statements as a whole.

Stamp No.
has been affixed to the
original report

OFFICE FOR THE IMPROVEMENTS OF PUBLIC SCHOOLS
(A Component Unit of the Commonwealth of Puerto Rico's Department of Education)
MANAGEMENT'S DISCUSSION AND ANALYSIS
FISCAL YEAR ENDED JUNE 30, 2011

As management of the Office for the Improvements of Public Schools (OMEP), we offer readers of the financial statements this narrative overview and analysis of OMEP's financial performance during the fiscal year ended June 30, 2011. Please read in conjunction with the OMEP financial statements.

FINANCIAL HIGHLIGHTS

- Total assets as of June 30, 2011 amounted to \$73,124,654.
- The investment in capital assets as of June 30, 2011 amounted to \$220,705 (net of accumulated depreciation).
- The net deficit of OMEP amounted to \$32,454,786 at the close of fiscal year 2011.

USING THIS ANNUAL FINANCIAL REPORT

This annual report is required supplementary information to the basic financial statements and is intended to serve as an introduction to the basic financial statements. The basic financial statements are comprised of three components: government-wide financial statements, fund financial statements and notes to the financial statements.

REPORTING THE OFFICE AS A WHOLE

Government-Wide Financial Statements

These statements include all assets and liabilities using the accrual basis of accounting, which is similar to the accounting used by most private-sector companies. All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

These two statements report the Office's net assets and changes in them. You can think of the Office's net assets (the difference between assets and liabilities) as one way to measure the Office's financial health, or financial position. Over time, increases or decreases in the Office's net assets are one indicator of whether its financial health is improving or deteriorating.

The Statement of Net Assets and the Statement of Activities are commonly divided into two kinds of activities:

- Governmental activities
- Business-type activities

OMEP reports all its activities as governmental activities.

OFFICE FOR THE IMPROVEMENTS OF PUBLIC SCHOOLS
(A Component Unit of the Commonwealth of Puerto Rico's Department of Education)
MANAGEMENT'S DISCUSSION AND ANALYSIS - CONTINUED
FISCAL YEAR ENDED JUNE 30, 2011

Fund Financial Statements

OMEF operates under five major funds: the General Fund, QZAB Debt Funds, Debt Service Funds, Special Revenue Funds and the Capital Projects Funds.

- Most of OMEF's basic services are reported in governmental funds, which focus on how money flows into and out of those funds and the balances left at year-end that are available for spending. These funds are reported using the modified accrual basis of accounting, which measures cash and other financial assets that can readily be converted to cash. The governmental fund statements provide detailed short-term view of the OMEF's general government operations and the basic services it provides. Governmental fund information helps you determine whether there are more or fewer financial resources that can be spent in the near future to finance OMEF's activities. We describe the relationship (or differences) between governmental activities (reported in the Statements of Net Assets and the Statement of Activities) and governmental funds in the reconciliation at the bottom of the fund financial statements.
- *Governmental Funds* - The following are the governmental fund types presented in the financial statements as of and for the year ended June 30, 2011.
 - ❖ **General Fund** – Accounts for and reports the financial resources, which relate to the general operations of the Office. These operations consist of the general administration and other activities.
 - ❖ **Special Revenue Fund** – Accounts for and reports the proceeds of specific revenue sources that are restricted or committed for specified purposes such as federal grants and legislative resolutions.
 - ❖ **Capital Projects Funds** - Accounts for and reports financial resources to be used for capital outlays.
 - ❖ **Debt Service Fund** - Accounts for and reports the accumulation of financial resources to be used in payment of general long-term debt principal and interest.
 - ❖ **Other Funds** - Accounts for and reports other financial resources not included in the General Fund or the Special Revenue Fund.

OFFICE FOR THE IMPROVEMENTS OF PUBLIC SCHOOLS
(A Component Unit of the Commonwealth of Puerto Rico's Department of Education)
MANAGEMENT'S DISCUSSION AND ANALYSIS - CONTINUED
FISCAL YEAR ENDED JUNE 30, 2011

Notes to the Financial Statements

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

Required Supplementary Information

This Management's Discussion and Analysis and the Combining Financial Statements represent financial information required to be presented by accounting principles generally accepted in the United States of America. Such information provides users of this report with additional data that supplements the statement and notes.

FINANCIAL ANALYSIS AS A WHOLE

OMEP has presented its financial statements under the requirements of GASB Statement No. 34. This reporting model changes significantly both the recording and the presentation of financial data. A condensed Statement of Net Assets is presented below:

Condensed Statement of Net Assets
June 30, 2011

| | <u>2011</u> | <u>2010</u> | <u>Change</u> | <u>%</u> |
|---|------------------------|-------------------|------------------------|----------|
| Assets | | | | |
| Cash and other assets | \$ 72,903,949 | \$102,116,232 | \$ (29,212,283) | -29% |
| Capital assets, net of accumulated depreciation | <u>220,705</u> | <u>407,859</u> | <u>(187,154)</u> | -46% |
| Total assets | 73,124,654 | 102,524,091 | (29,399,437) | -29% |
| Liabilities | | | | |
| Accounts payables and other liabilities | 13,520,449 | 13,557,367 | (36,918) | 0% |
| Long term liabilities | <u>92,058,991</u> | <u>88,625,000</u> | <u>3,433,991</u> | 4% |
| Total liabilities | 105,579,440 | 102,182,367 | 3,397,073 | 4% |
| Net asset (deficit) | | | | |
| Invested in capital assets | 220,705 | 407,859 | (187,154) | -46% |
| Restricted | (49,137,901) | (23,898,386) | (25,239,515) | 106% |
| Unrestricted | <u>16,462,410</u> | <u>23,832,251</u> | <u>(7,369,841)</u> | -31% |
| Total net asset (deficit) | <u>\$ (32,454,786)</u> | <u>\$ 341,724</u> | <u>\$ (32,796,510)</u> | -9597% |

OFFICE FOR THE IMPROVEMENTS OF PUBLIC SCHOOLS
(A Component Unit of the Commonwealth of Puerto Rico's Department of Education)
MANAGEMENT'S DISCUSSION AND ANALYSIS - CONTINUED
FISCAL YEAR ENDED JUNE 30, 2011

FINANCIAL ANALYSIS AS A WHOLE - CONTINUED

Unrestricted net assets can be used to finance day-to-day operations without constraints established by debt covenants, enabling legislation or other legal requirements.

Statement of Net Assets Comparison

| | <u>2011</u> | <u>2010</u> | <u>Change</u> |
|-------------------|--------------------------|--------------------|------------------------|
| Total Assets | \$ 73,124,654 / | \$ 102,524,091 | \$ (29,399,437) |
| Total Liabilities | <u>105,579,440 /</u> | <u>102,182,367</u> | <u>3,397,073</u> |
| Net Assets | <u>\$ (32,454,786) /</u> | <u>\$ 341,724</u> | <u>\$ (32,796,510)</u> |

Statement of Activities Comparison

| | <u>2011</u> | <u>2010</u> | <u>Change</u> |
|----------------------|--------------------------|---------------------|------------------------|
| Revenues | \$ 36,266,420 / | \$ 84,090,595 | \$ (47,824,175) |
| Expenditures | <u>69,062,930 /</u> | <u>84,711,072</u> | <u>(15,648,142)</u> |
| Change in Net Assets | <u>\$ (32,796,510) /</u> | <u>\$ (620,477)</u> | <u>\$ (32,176,033)</u> |

Governmental Funds

The OMEP uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. The focus of the OMEP's governmental funds is to provide information on near term inflows, outflows and balances of resources available for spending. In particular, unreserved fund balance may serve as a useful measure of OMEP's net resources available at the end of a fiscal year.

OFFICE FOR THE IMPROVEMENTS OF PUBLIC SCHOOLS
(A Component Unit of the Commonwealth of Puerto Rico's Department of Education)
MANAGEMENT'S DISCUSSION AND ANALYSIS - CONTINUED
FISCAL YEAR ENDED JUNE 30, 2011

CAPITAL ASSETS

The balances of depreciable capital assets are presented below:

Capital assets, net of accumulated depreciation

| | <u>Balance</u> <u>June 30, 2011</u> | <u>Balance</u> <u>June 30, 2010</u> | <u>Change</u> | <u>%</u> |
|--------------------|--|--|---------------------|----------|
| Equipment | \$ 3,511 | \$ 118,267 | \$ (114,756) | -97% |
| Motor vehicles | <u>217,194</u> | <u>289,592</u> | <u>(72,398)</u> | -25% |
| Net capital assets | <u>\$ 220,705</u> | <u>\$ 407,859</u> | <u>\$ (187,154)</u> | |

CONTACTING THE OMEP'S FINANCIAL MANAGEMENT

The financial report is designed to provide our citizen, taxpayers, and creditors with a general overview of OMEP's finances and to demonstrate OMEP's accountability for the money it receives. If you have questions about this report or need additional information, contact OMEP's Finance Department at (787) 281-7575.

OFFICE FOR THE IMPROVEMENTS OF PUBLIC SCHOOLS
(A Component Unit of the Commonwealth of Puerto Rico's Department of Education)
STATEMENT OF NET ASSETS
JUNE 30, 2011

| | <u>Governmental Activities</u> |
|--|------------------------------------|
| ASSETS | |
| Cash | \$ 32,366,388 |
| Cash with fiscal agent | 28,620,805 |
| Receivables | 155 |
| Inventories | 1,374,328 |
| Deferred charges, net of amortization | 10,542,272 |
| Capital assets, net of accumulated depreciation | <u>220,705</u> |
| Total assets | <u>73,124,653</u> |
| LIABILITIES | |
| Accounts payable | 6,441,347 |
| Current pension benefits payable | 441,044 |
| Accrued interest payable | 4,671,277 |
| Unamortized premium | 1,966,781 |
| Non Current Liabilities: | |
| Non current pension benefits payable | 3,433,990 |
| Non current liabilities | <u>88,625,000</u> |
| Total liabilities | <u>105,579,439</u> |
| NET ASSETS (DEFICIT) | |
| Invested in capital assets | 220,705 |
| Restricted for: | |
| Maintenance, construction and improvement of schools | 30,911,608 |
| Unrestricted | 16,462,410 |
| Unassigned | <u>(80,049,509)</u> |
| Total net assets (deficit) | <u>\$ (32,454,786)</u> |

See notes to financial statements.

OFFICE FOR IMPROVEMENTS OF PUBLIC SCHOOLS
(A Component Unit of the Commonwealth of Puerto Rico's Department of Education)
STATEMENT OF ACTIVITIES
YEAR ENDED JUNE 30, 2011

| <u>Functions/Programs</u> | <u>Expenses</u> | <u>Revenues</u> | | <u>Net (expenses) revenues</u> |
|--|------------------------|---------------------------------|--|------------------------------------|
| | | <u>Charges for services</u> | <u>Grants and similar programs</u> | |
| Governmental activities: | | | | |
| Administrative support | \$ 57,701,795 | \$ 32,201,782 | \$ 1,671,460 | \$ (23,828,553) |
| Construction and maintenance of schools | 6,265,197 | 1,958,927 ✓ | - | (4,306,270) |
| Interest on long term debt | <u>5,095,938</u> ✓ | - | - | (5,095,938) |
| Total expenditures | <u>\$ 69,062,930</u> ✓ | <u>\$ 34,160,709</u> ✓ | <u>\$ 1,671,460</u> ✓ | \$ (33,230,761) |
| General revenues | | | | |
| Interest income | | | | 283,833 ✓ |
| Other income | | | | <u>150,418</u> ✓ |
| Total | | | | <u>434,251</u> |
| Change in net assets | | | | (32,796,510) ✓ |
| Net assets at beginning of year | | | | <u>341,724</u> |
| Net assets (deficit) at end of year | | | | <u>\$ (32,454,786)</u> ✓ |

See notes to financial statements.

OFFICE FOR THE IMPROVEMENTS OF PUBLIC SCHOOLS
(A Component Unit of the Commonwealth of Puerto Rico's Department of Education)
BALANCE SHEET
GOVERNMENTAL FUNDS
JUNE 30, 2011

| | <u>General Fund</u> | <u>QZAB Debt Fund</u> | <u>Debt Service Fund</u> | <u>Extraordinary Improvements</u> |
|---|-------------------------|---------------------------|------------------------------|---------------------------------------|
| ASSETS | | | | |
| Cash | \$ 19,899,947 | \$ - | \$ - | \$ 3,177,238 |
| Cash with fiscal agent | - | 28,620,805 | - | - |
| Receivable | 155 | - | - | - |
| Inventories | <u>1,374,328</u> | <u>-</u> | <u>-</u> | <u>-</u> |
| TOTAL ASSETS | <u>\$ 21,274,430</u> | <u>\$ 28,620,805</u> | <u>\$ -</u> | <u>\$ 3,177,238</u> |
| LIABILITIES | | | | |
| Accounts payable | \$ 5,227,434 | \$ 473,210 | \$ - | \$ 389,228 |
| Pension benefits payable | <u>441,044</u> | <u>-</u> | <u>-</u> | <u>-</u> |
| TOTAL LIABILITIES | <u>5,668,478</u> | <u>473,210</u> | <u>-</u> | <u>389,228</u> |
| FUND BALANCES | | | | |
| Nonspendable: | | | | |
| Inventories | 1,374,328 | - | - | - |
| Restricted for: | | | | |
| QZAB Debt Fund | - | 28,147,595 | - | - |
| Special Revenue Fund | - | - | - | - |
| Capital Project | - | - | - | 2,788,010 |
| Committed to: | | | | |
| Special Revenue Fund | - | - | - | - |
| Assigned to: | | | | |
| General Fund | 14,231,624 | - | - | - |
| Capital Project | <u>-</u> | <u>-</u> | <u>-</u> | <u>-</u> |
| | <u>15,605,952</u> | <u>28,147,595</u> | <u>-</u> | <u>2,788,010</u> |
| TOTAL LIABILITIES AND FUND BALANCE | <u>\$ 21,274,430</u> | <u>\$ 28,620,805</u> | <u>\$ -</u> | <u>\$ 3,177,238</u> |

See notes to financial statements.

| <u>ARRA Special Revenue</u> | <u>Other Governmental Funds</u> | <u>Total Governmental Funds</u> |
|---------------------------------|-------------------------------------|-------------------------------------|
| \$ - | \$ 9,289,204 | \$ 32,366,389 |
| - | - | 28,620,805 |
| - | - | 155 |
| - | - | <u>1,374,328</u> |
| <u>\$ -</u> | <u>\$ 9,289,204</u> | <u>\$ 62,361,677</u> |
| \$ 45,337 | \$ 306,138 | \$ 6,441,347 |
| - | - | 441,044 |
| <u>45,337</u> | <u>306,138</u> | <u>6,882,391</u> |
| - | - | 1,374,328 |
| - | - | 28,147,595 |
| (45,337) | - | (45,337) |
| - | - | 2,788,010 |
| - | 1,439,522 | 1,439,522 |
| - | - | 14,231,624 |
| - | 7,543,544 | 7,543,544 |
| <u>(45,337)</u> | <u>8,983,066</u> | <u>55,479,286</u> |
| <u>\$ -</u> | <u>\$ 9,289,204</u> | <u>\$ 62,361,677</u> |

OFFICE FOR THE IMPROVEMENTS OF PUBLIC SCHOOLS
(A Component Unit of the Commonwealth of Puerto Rico's Department of Education)
RECONCILIATION OF THE BALANCE SHEET OF GOVERNMENTAL FUNDS TO
THE STATEMENT OF NET ASSETS
JUNE 30, 2011

| | |
|--|--------------------------|
| Total fund balance - governmental funds | \$ 55,479,286 / |
| Amounts reported for governmental activities in the statement of net assets are different because: | |
| Capital assets are not financial resources and, therefore, are not reported in the funds, net of accumulated depreciation | 220,705 / |
| Deferred charges, net of accumulated amortization, are not available for current year expenditures and, therefore, are deferred in the funds | 10,542,273 / |
| Noncurrent Pension benefits payable | (3,433,991) / |
| General bond obligations that are not due and payable in the current period and are not reported in the funds | (88,625,000) / |
| Less: unamortized premium | (1,966,782) / |
| Less: accrued interest payable | <u>(4,671,277) /</u> |
| Net assets of governmental activities | <u>\$ (32,454,786) /</u> |

OFFICE FOR THE IMPROVEMENTS OF PUBLIC SCHOOLS

(A Component Unit of the Commonwealth of Puerto Rico's Department of Education)

STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES

GOVERNMENTAL FUNDS

YEAR ENDED JUNE 30, 2011

| | <u>General Fund</u> | <u>QZAB Debt Fund</u> | <u>Debt Service Fund</u> | <u>Extraordinary Improvements</u> |
|--|------------------------|------------------------|--------------------------|-----------------------------------|
| Revenues | | | | |
| Appropriations | \$ - | \$ - | \$ - | \$ - |
| Interest | 22,124 ✓ | 247,688 ✓ | | 6,366 ✓ |
| Appropriations from Department of Education and other income | <u>32,201,782 ✓</u> | <u>-</u> | <u>-</u> | <u>-</u> |
| Total revenues | <u>32,223,906 ✓</u> | <u>247,688 ✓</u> | <u>-</u> | <u>6,366 ✓</u> |
| Expenditures | | | | |
| Current | | | | |
| Payroll and related costs | 10,002,936 ✓ | - | - | - |
| Utilities and payments for public services | 311,302 ✓ | 51,305 ✓ | - | 39,549 ✓ |
| Purchased services | 33,637,799 ✓ | - | - | 538,082 ✓ |
| Transportation expenses | 1,057,605 ✓ | - | - | - |
| Professional services | 1,124,567 ✓ | 5,935 ✓ | - | - |
| Purchase of equipment | 106,534 ✓ | - | - | - |
| Materials and supplies | 1,188,225 ✓ | - | - | 69,980 ✓ |
| Advertising | 772 ✓ | - | - | - |
| Maintenance, construction and improvement of public schools | - | 2,854,334 ✓ | - | 5,198,725 ✓ |
| Debt Service | | | | |
| Interest | - | - | 5,095,938 ✓ | - |
| Total expenditures | <u>47,429,740 ✓</u> | <u>2,911,574 ✓</u> | <u>5,095,938 ✓</u> | <u>5,846,336 ✓</u> |
| Excess (deficit) of revenues over expenditures | <u>(15,205,834)</u> | <u>(2,663,886) ✓</u> | <u>(5,095,938)</u> | <u>(5,839,970)</u> |
| Other financing sources (uses): | | | | |
| Transfer in | - | - | - | 12,101 ✓ |
| Transfer out | <u>(4,500) ✓</u> | <u>-</u> | <u>-</u> | <u>(22,942) ✓</u> |
| | <u>(4,500) ✓</u> | <u>-</u> | <u>-</u> | <u>(10,841) ✓</u> |
| Net change in fund balances | <u>(15,210,334) ✓</u> | <u>(2,663,886) ✓</u> | <u>(5,095,938)</u> | <u>(5,850,811) ✓</u> |
| Fund balances beginning | <u>30,816,286 ✓</u> | <u>30,811,481 ✓</u> | <u>5,095,938</u> | <u>8,638,821 ✓</u> |
| Fund balances ending | <u>\$ 15,605,952 ✓</u> | <u>\$ 28,147,595 ✓</u> | <u>\$ -</u> | <u>\$ 2,788,010 ✓</u> |

See notes to financial statements.

| ARRA Special Revenue | Other Governmental Funds | Total Governmental Funds |
|----------------------|--------------------------|--------------------------|
| \$ - | \$ 1,958,927 | \$ 1,958,927 |
| - | 7,655 | 283,833 |
| <u>1,671,460</u> | <u>189,967</u> | <u>34,063,209</u> |
| <u>1,671,460</u> | <u>2,156,549</u> | <u>36,305,969</u> |
| - | 25,774 | 10,028,710 |
| - | - | 402,156 |
| - | 470 | 34,176,351 |
| - | - | 1,057,605 |
| - | 452,595 | 1,583,097 |
| - | - | 106,534 |
| - | - | 1,258,205 |
| - | 2,884 | 3,656 |
| - | 22 | 22 |
| 1,289,554 | 2,121,308 | 11,463,921 |
| - | - | 5,095,938 |
| <u>1,289,554</u> | <u>2,603,053</u> | <u>65,176,195</u> |
| <u>381,906</u> | <u>(446,504)</u> | <u>(28,870,226)</u> |
| - | 27,442 | 39,543 |
| - | (12,101) | (39,543) |
| - | 15,341 | - |
| 381,906 | (431,163) | (28,870,226) |
| <u>(427,243)</u> | <u>9,414,229</u> | <u>84,349,512</u> |
| <u>\$ (45,337)</u> | <u>\$ 8,983,066</u> | <u>\$ 55,479,286</u> |

OFFICE FOR THE IMPROVEMENTS OF PUBLIC SCHOOLS
(A Component Unit of the Commonwealth of Puerto Rico's Department of Education)
RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES AND
CHANGES IN FUND BALANCES OF GOVERNMENTAL FUNDS TO THE
STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2011

Net change in fund balances - total governmental funds \$ (28,870,226)

Amounts reported for governmental activities 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 and reported as depreciation expense.

Current year depreciation (187,154)

Governmental funds report the current amount of enactment of Law 70, Voluntary Termination Benefits. However, the financial impact resulting of benefits to participants was the recognition of a pension benefits liability in the statement of net assets. (3,433,991)

Governmental funds report the effect of issuance costs, premiums, discounts, and similar items when debt is first issued, whereas these amounts are deferred and amortized in the statement of activities. This amount is the net effect of these differences in the treatment of long term debt and related items. (305,139)

Change in net assets of governmental activities \$ (32,796,510)

OFFICE FOR THE IMPROVEMENTS OF PUBLIC SCHOOLS
(A Component Unit of the Commonwealth of Puerto Rico's Department of Education)
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2011

NOTE 1 - REPORTING ENTITY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization and nature of activities

The Office for the Improvements of Public Schools (OMEP) is a blended component unit of the Commonwealth of Puerto Rico's Department of Education, created by means of the Joint Resolution No. 3 of August 28, 1990 for the purpose of setting in function an accelerated program for the repair and the betterment of the schools structures and for the purchase of books, furniture, materials, and didactic equipment necessary for the process of teaching.

On January 26, 1995, by means of the Administrative Bulletin No. 0E-1195-11, the direction and administration of OMEP were transferred to the Department of Education, and the Secretary of Education (Secretary) was appointed as the Executive Director.

On April 30, 1996, the Secretary converted the regional offices of the School Buildings Maintenance Unit of the Department in regional offices of OMEP, transferring, the personnel, the materials, the equipment and the supplies that it had at that moment, to the regional offices.

At June 30, 2011 the services offered by OMEP were conducted from a central office and seven regional offices as follows: San Juan, Caguas, Bayamón, Arecibo, Ponce, Mayaguez, and Humacao.

The operations of OMEP are administered by a General Manager appointed by the Executive Director. The regional offices are administered by a regional Director appointed by the General Manager.

Basic financial statements

The financial statements of OMEP have been prepared in accordance with accounting principles generally accepted in the United States of America as applied to governmental units. The Governmental Accounting Standards Board (GASB) is the standard-setting body for governmental accounting and financial reporting. The GASB periodically updates its existing Governmental Accounting and Financial Reporting Standards, which, along with subsequent GASB pronouncements (Statements and Interpretations), constitutes U.S Generally Accepted Accounting Principles (GAAP) for governmental units.

OFFICE FOR THE IMPROVEMENTS OF PUBLIC SCHOOLS
(A Component Unit of the Commonwealth of Puerto Rico's Department of Education)
NOTES TO FINANCIAL STATEMENTS - CONTINUED
JUNE 30, 2011

NOTE 1 - REPORTING ENTITY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

The basic financial statements include both government-wide and fund financial statements. Both levels of statements categorize primary activities as governmental type, which are primarily supported by taxes and intergovernmental revenues.

Basis of Accounting and Measurement Focus

Basis of accounting refers to the point at which revenues and expenditures are recognized and reported.

The fund financial statements are presented on the modified accrual basis of accounting. Accordingly, revenues are recorded when they are measurable and available to finance current expenditures of the fund, during the current period or after but in time to pay for current year-end liabilities. Expenditures are recorded normally in the accrual basis as they are measurable when they are incurred, affected by the measurement focus applied.

Government-wide financial statements are presented on the accrual basis of accounting. Accordingly, revenues are recognized in the period they are earned while expenditures are recognized when incurred. The elements in the accrual basis of accounting are: (1) deferral of expenditures and the subsequent amortization of deferral costs, (2) the deferral of revenues until they are earned, (3) capitalization of certain expenditures, and (4) accrual of revenues that have been earned and expenses that have been incurred.

The measurement focus is concerned with the inflow and outflow of resources that affect the entity. The flow of economic resources is applied on an accrual basis and the flow of total financial resources and the flow of current financial resources are used in the modified accrual basis.

Federal financing assistance received from the federal government is recorded following the applicable legal and contractual requirements. Essentially, revenues are recognized based upon the expenditures recorded. This occurs when expenditures are incurred for the specific purpose of the project. Revenues are revocable only for failure to comply with prescribed compliance requirements.

OFFICE FOR THE IMPROVEMENTS OF PUBLIC SCHOOLS
(A Component Unit of the Commonwealth of Puerto Rico's Department of Education)
NOTES TO FINANCIAL STATEMENTS - CONTINUED
JUNE 30, 2011

NOTE 1 - REPORTING ENTITY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

Management Discussion and Analysis

This consists of a narrative introduction and analytical overview of the OMEP's financial activities. This analysis is similar to the analysis that the private sector provides in their annual reports.

Basis of Presentation - Fund Accounting

The financial report of OMEP consists of a Management Discussion and Analysis (MD&A), basic financial statements, notes to the financial statements and required supplementary information other than the MD&A. Following is a summary presentation of each, including the measurement focus and basis of accounting.

The accounts of OMEP are organized on the basis of funds, each of which is considered a separate accounting entity. The operations of each fund are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, reserves, fund equity, revenues, and expenditures. Funds are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions, or limitations. Governmental funds include the general, special revenue, and other funds. Account groups are established to maintain accountability over capital assets or long-term general obligations.

Government-wide financial statements

The government-wide financial statements include a Statement of Net Assets and a Statement of Activities and Changes in Net Assets. These statements are presented on an "economic resources" measurement focus and the accrual basis of accounting. All transactions and events that affect the total economic resources (net assets) during the period are reported. Fiduciary activities, if any, whose resources are not available to finance government programs, are excluded from the government-wide statements. The effect of Inter-fund activities is eliminated.

The Statement of Net Assets incorporates all capital (long lived) assets and receivables as well as long term liabilities and obligations. The Statement of Activities reports revenues and expenses in a format that focus on the net cost of each function of OMEP. Both the gross and net cost of the function which is otherwise being supported by the general government revenues is compared to the revenues generated directly by the function. This Statement reduces gross expenses, including depreciation, by related program revenues, operating and capital grants, and contributions. Program revenues must be directly associated with the function.

OFFICE FOR THE IMPROVEMENTS OF PUBLIC SCHOOLS
(A Component Unit of the Commonwealth of Puerto Rico's Department of Education)
NOTES TO FINANCIAL STATEMENTS - CONTINUED
JUNE 30, 2011

NOTE 1 - REPORTING ENTITY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

Government-wide financial statements - continued

The types of transactions included as program revenues are charges for services, fees, licenses and permits; operating grants which include operating-specific and discretionary (either operating or capital) grants; and capital grants which are capital-specific grants. Internally dedicated resources are reported as general revenues rather than as program revenues. Revenues on both operating and capital grants are recognized when all eligibility requirements (which include time requirements) imposed by the provider have been met.

For certain expenditure-driven grants revenue is recognized after allowable expenditures are incurred. As a policy, indirect expenses in the Statement of Activities are not allocated. OMEP first uses restricted assets for expenses incurred for which both restricted and unrestricted assets are available.

Governmental fund financial statements

The Governmental Fund Financial Statements include a Balance Sheet and a Statement of Revenues, Expenditures and Changes in Fund Balances with one column for the general fund, one column for each major fund and one column combining all non-major governmental funds. Major funds are determined based on a minimum criterion, which is a percentage of the assets, liabilities, revenues or expenditures (for Commonwealth Legislature Resolutions Fund and Debt Service Fund) or based on Management official's criteria. OMEP reports the following major governmental funds:

- General Fund - Accounts for and reports all financial resources except those required in another fund.
- Special Revenue Fund - Accounts for and reports the proceeds of specific revenue's sources that are legally restricted expenditure for specific purpose such as federal grants and legislative resolutions.
- Debt Service Fund - Accounts for and reports the accumulation of resources for, and the payment of general long-term debt, principal and interest.
- Other Fund - Accounts for and reports other financial resources not included in the General Fund or the Special Revenue Fund.

OFFICE FOR THE IMPROVEMENTS OF PUBLIC SCHOOLS
(A Component Unit of the Commonwealth of Puerto Rico's Department of Education)
NOTES TO FINANCIAL STATEMENTS - CONTINUED
JUNE 30, 2011

NOTE 1 - REPORTING ENTITY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

Assets, liabilities and net assets

Cash and cash equivalents

Cash is comprised of cash on hand and demand deposits held in the Government Development Bank of Puerto Rico and in commercial banks. OMEP maintains separate cash accounts for each federal award programs.

Inventories

Inventories in the Governmental Fund Financial Statements have been recorded using the consumption method and are stated at the lower of cost (first-in, first out method) or market. Inventories consist primarily of supplies held for consumption for the repairs of the school plants.

OMEP uses the purchase method of accounting where purchases of inventories are recognized as expenditures when the goods are received and the transaction is vouched. Generally accepted accounting principles allows the purchase method to account for inventories but concludes that when the inventory amount is significant, the amount must be reported in the government's fund balance sheets.

An estimated value for inventories is reported as both, an asset and a fund balance reserve in the General Fund.

Capital Assets

Capital assets are defined by OMEP as assets with an initial, individual cost of more than \$500 and an estimated useful life of more than one year. Purchased or constructed capital assets are reported at cost or estimated historical cost. Maintenance and repairs that do not extend the life of the asset are charged to expense.

OFFICE FOR THE IMPROVEMENTS OF PUBLIC SCHOOLS
(A Component Unit of the Commonwealth of Puerto Rico's Department of Education)
NOTES TO FINANCIAL STATEMENTS - CONTINUED
JUNE 30, 2011

NOTE 1 - REPORTING ENTITY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

Depreciation

Depreciation expense is not reported in governmental funds. All reported capital assets are depreciated using straight line method over the following estimated lives as follows:

| <u>Assets</u> | <u>Years</u> |
|----------------|--------------|
| Equipment | 5 |
| Motor Vehicles | 5-10 |

Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Risk Management

The Secretary of the Bureau of Income Tax is the agent with the responsibility of obtaining and payment of insurance for the Department of Education that includes OMEP for loss or damage to property and general liability.

Compensated absences

OMEP employees accrue thirty days of regular vacation and eighteen days of sick leave per year up to a maximum of sixty and ninety days, respectively. The payroll and payroll expenses are the responsibility of the Department of Education of Puerto Rico. Therefore, OMEP does not accrue for compensated absences.

Budgetary accounting

OMEP prepares an internal annual budget for administrative purposes. The budget is not integrated with the accounting system; therefore the financial statements are not presented in comparison budget to actual.

OFFICE FOR THE IMPROVEMENTS OF PUBLIC SCHOOLS
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NOTES TO FINANCIAL STATEMENTS - CONTINUED
JUNE 30, 2011

NOTE 2 - FUND BALANCE REPORTING

Substantially all the restricted fund balances as of June 30, 2011 are related to special revenue activity, federal awards and proceeds from QZAB issuance. Such restricted balances may only be utilized in accordance with the purposes established by the federal laws and regulations, and are in contrast to unassigned funds over which the governing board retained full control to use in achieving of its purposes.

OMEPE maintains an encumbrance system for all disbursements made during the course of its operations, except for payroll and related expenses. As part of the encumbrances made during the year, OMEPE encumbered for Extraordinary Improvements and Other Governmental Funds, \$1,672,881 and \$1,439,522, respectively.

OMEPE maintains separate cash accounts for each federal awards program. This cash is restricted to be used only for federal awards purposes. Also, OMEPE maintains separate cash accounts for other non-federal programs.

NOTE 3 - DEPOSITS

OMEPE maintains its cash in bank deposit accounts at high credit qualified financial institutions.

OMEPE follows the provisions of GASB Statement No. 40 (GASB No. 40), *Deposit and Investment Risk Disclosure, an Amendment to GASB Statement No. 3*. Accordingly, the following is essential information about credit risk, interest rate risk, custodial credit risk, and foreign exchange exposure of deposits and investments of OMEPE at June 30, 2011:

- A. *Credit risk* – This is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. At June 30, 2011, OMEPE has cash and cash with fiscal agents in a commercial bank, which are insured by the Federal Deposit Insurance Corporation (FDIC) up to a maximum of \$250,000. No investments in debt or equity securities were made during the fiscal year ended June 30, 2011. Therefore, OMEPE's management has concluded that the credit risk related to any possible loss related to defaults by commercial and government banks on the OMEPE's deposits is considered low at June 30, 2011.

OFFICE FOR THE IMPROVEMENTS OF PUBLIC SCHOOLS
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NOTES TO FINANCIAL STATEMENTS - CONTINUED
JUNE 30, 2011

NOTE 3 – DEPOSITS - CONTINUED

- B. Interest rate risk* – This is the risk that changes in interest rates of debt investments will adversely affect the fair value of an investment. OMEP manages its exposure to declines in fair values by: (1) not including debt or equity investments in its investments portfolio at June 30, 2011, (2) limiting the weighted average maturity of its investments in certificates of deposit to periods of three months or less and (3) keeping most of its banks deposits and certificates of deposit in interest bearing accounts generating interest at prevailing market rates. At June 30, 2011, the interest rate risk associated with the OMEP's cash and cash with fiscal agents are considered low since they have no investment portfolio.
- C. Custodial credit risk* – In the case of deposits, this is the risk that in the event of a bank failure, OMEP's deposits may not be recovered. At June 30, 2011, OMEP has balances deposited in commercial banks amounting to \$28.6 million which are insured by the Federal Deposit Insurance Corporation (FDIC) up to a maximum of \$250,000. At June 30, 2011, all OMEP's bank balance at the Government Development Bank of Puerto Rico (GDB), aggregating approximately \$32,366,000, was exposed to custodial credit risk since such deposits maintained at the bank are uninsured. However, no losses related to defaults by GDB on deposit transactions have been incurred by OMEP through June 30, 2011. It is management's policy to only maintain deposits in banks affiliated to FDIC to minimize the custodial credit risk, except for GDB. Therefore, OMEP's management has concluded that at June 30, 2011, the custodial credit risk associated with the OMEP's cash and cash with fiscal agents is considered low.
- D. Foreign exchange risk* – This is the risk that changes in exchange rates will adversely affect the value of an investment or a deposit. OMEP is prevented from investing in foreign securities or any other types of investments for which foreign exchange risk exposure may be significant. Accordingly, management has concluded that the foreign exchange risk related to the OMEP's deposits is considered low at June 30, 2011.

OFFICE FOR THE IMPROVEMENTS OF PUBLIC SCHOOLS
(A Component Unit of the Commonwealth of Puerto Rico's Department of Education)
NOTES TO FINANCIAL STATEMENTS - CONTINUED
JUNE 30, 2011

NOTE 4 - CAPITAL ASSETS

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

| Description | Balance at June 30, 2010 | Additions | Retirements | Balance at June 30, 2011 |
|----------------------------------|-----------------------------|--------------|-------------|-----------------------------|
| Capital assets being depreciated | | | | |
| Equipment | \$ 1,590,600 | \$ - | \$ - | \$ 1,590,600 |
| Motor vehicles | 2,066,925 | - | - | 2,066,925 |
| Total capital assets | 3,657,525 | - | - | 3,657,525 |
| Less accumulated depreciation | | | | |
| Equipment | (1,472,333) | (114,756) | - | (1,587,089) |
| Motor vehicles | (1,777,333) | (72,398) | - | (1,849,731) |
| Total accumulated depreciation | (3,249,666) | (187,154) | - | (3,436,820) |
| Net capital assets | \$ 407,859 | \$ (187,154) | \$ - | \$ 220,705 |

NOTE 5 - COMMITMENTS AND CONTINGENCIES

OMEF participates in federally assisted grant programs. These programs are subject to program compliance audits by the grantors or their representatives. Accordingly, the amount of expenditures which may be disallowed by the granting agencies, if any, will be established at some future date. However, OMEF's Management expects such amounts, if any, to be immaterial.

OMEF is a defendant in various pending lawsuits. They are primarily related to worker/employer and contracts disputes. The estimated maximum amount of these cases will not exceed the amount of approximately \$240,000. However, it is reasonably possible that a liability could result in the near term. Since the resulting liability, if any, is considered immaterial, no amount has been accrued in these financial statements.

OMEF's main office is located on a leased facility under an operating lease agreement. Total expenditures for the year ended June 30, 2011 amounted to approximately \$139,000.

OFFICE FOR THE IMPROVEMENTS OF PUBLIC SCHOOLS
(A Component Unit of the Commonwealth of Puerto Rico's Department of Education)
NOTES TO FINANCIAL STATEMENTS - CONTINUED
JUNE 30, 2011

NOTE 5 - COMMITMENTS AND CONTINGENCIES- CONTINUED

OMEP leases its office under a cancelable operating lease. The agreement provides for a minimum monthly lease payment of \$10,950. The lease contains a renewal options. In case of continuance of the lease without an amendment of the agreement, following is a schedule of future minimum lease payments required under the lease and a five year increment thereafter:

| | |
|------------|---------------------|
| 2012 | \$ 131,400 |
| 2013 | 131,400 |
| 2014 | 131,400 |
| 2015 | 131,400 |
| 2016 | 131,400 |
| Thereafter | <u>657,000</u> |
| | <u>\$ 1,314,000</u> |

NOTE 6 - GENERAL OBLIGATION BONDS

The following is a summary activity of OMEP's general obligation bonds for the year ended June 30, 2011:

| <u>Bonds</u> | <u>Balance at June 30, 2010</u> | <u>Increase</u> | <u>Decrease</u> | <u>Balance at June 30, 2011</u> |
|-----------------|-------------------------------------|-----------------|-----------------|-------------------------------------|
| Refunding bonds | <u>\$ 88,625,000</u> | <u>\$ -</u> | <u>\$ -</u> | <u>\$ 88,625,000</u> |

OFFICE FOR THE IMPROVEMENTS OF PUBLIC SCHOOLS
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NOTES TO FINANCIAL STATEMENTS - CONTINUED
JUNE 30, 2011

NOTE 6 - GENERAL OBLIGATION BONDS-CONTINUED

The remaining general obligation bonds of \$88,625,000, which were issued during the year ended June 30, 2005 to refinance bonds maturing in 2004, bear interest at rates ranging from 4.10% to 5.75% and mature in August 2030. The annual requirements to amortize all bonds outstanding as of June 30, 2011, including principal and interest payments will be from Legislative appropriations. The following are the related principal and interest requirements:

Series A Refunding Bonds

| Year Ending June 30, | Principal | Interest |
|--|----------------------|----------------------|
| 2012 | - | 5,262,109 |
| 2013 | 6,100,000 | 3,651,173 |
| 2014 | - | 3,532,070 |
| 2015 | - | 3,532,070 |
| 2016 | - | 3,532,070 |
| 2017-2021 | 8,535,000 | 17,121,866 |
| 2022-2026 | <u>73,990,000</u> | <u>12,729,303</u> |
| | 88,625,000 | <u>\$ 49,360,661</u> |
| Plus unamortized premium | 1,966,782 | |
| Less deferred charges net of amortization | <u>(10,542,273)</u> | |
| | <u>\$ 80,049,509</u> | |

NOTE 7 - VOLUNTARY TERMINATION BENEFITS

On July 2, 2010, the Commonwealth enacted Act No. 70 to establish a program that provides benefits for early retirement or economic incentives for voluntary employment termination to eligible employees, as defined, including employees of the Office for the Improvements of Public Schools. Act No. 70 established that early retirement benefits will be provided to eligible employees that have completed between 15 to 29 years of credited service in the Retirement System and will consist of biweekly benefits ranging from 37.5% to 50 % of each employee's salary, as defined. In this early retirement benefit program, the Office for the Improvements of Public Schools will make the employer contributions to the Retirement System and pay the corresponding pension until the employee complies with the requirements of age and 30 years of

OFFICE FOR THE IMPROVEMENTS OF PUBLIC SCHOOLS
(A Component Unit of the Commonwealth of Puerto Rico's Department of Education)
NOTES TO FINANCIAL STATEMENTS - CONTINUED
JUNE 30, 2011

NOTE 7 - VOLUNTARY TERMINATION BENEFITS-CONTINUED

credited service in the Retirement System. Economic incentives are available to eligible employees who have less than 15 years of credited service in the Retirement System or who have at least 30 years of credited service in the Retirement System and the age for retirement or who have the age for retirement. Economic incentives will consist of a lump-sum payment ranging from one-month to six-month salary based on employment years. Additionally, eligible employees that choose to participate in the early retirement benefit program or that choose the economic incentive and have less than 15 years of credited service in the Retirement System are eligible to receive health plan coverage for up to 12 months in a health plan selected by management of the Office for the Improvements of Public Schools.

The Voluntary Termination Benefits are the responsibility of the Department of Education of Puerto Rico. The financial impact resulting for the benefits granted to participants of the Office for the Improvements of Public Schools on this program was the recognition of a liability of \$3,875,000 in the statement of net assets as of June 30, 2011 and a charge of \$4,062,000 in the statement of activities for the year ended June 30, 2011. At June 30, 2011, unpaid long-term benefits granted on this program were discounted at 2.72%.

NOTE 8 - SUBSEQUENT EVENT

In December 2011, the non current liability amounted to \$88,625,000 related to a general obligation bonds was fully paid by the issuance of bonds of The Puerto Rico Sales Tax Financing Corporation, better known by its Spanish acronym COFINA.

REQUIRED SUPPLEMENTARY INFORMATION

OFFICE FOR THE IMPROVEMENTS OF PUBLIC SCHOOLS
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COMBINING BALANCE SHEET
YEAR ENDED JUNE 30, 2011

| | Various Special Revenue Funds | School Renovation Fund | \$29 M Project Fund | \$7 M Project Fund |
|-------------------------------------|--|---------------------------------------|------------------------------------|-----------------------------------|
| ASSETS | | | | |
| Cash | <u>\$ 1,625,955</u> ✓ | <u>\$ 1,288,440</u> ✓ | <u>\$ 10,837</u> ✓ | <u>\$ 325,464</u> ✓ |
| LIABILITIES AND FUND BALANCE | | | | |
| Liabilities | | | | |
| Accounts payable | \$ 179,097 ✓ | \$ - | \$ 16,056 ✓ | \$ (3,736) ✓ |
| Accrued liabilities | <u>7,336</u> ✓ | <u>-</u> | <u>-</u> | <u>-</u> |
| Total liabilities | <u>186,433</u> ✓ | <u>-</u> | <u>16,056</u> ✓ | <u>(3,736)</u> ✓ |
| Fund balance | | | | |
| Special Revenues | 1,439,522 ✓ | - | - | - |
| Capital Projects | <u>-</u> | <u>1,288,440</u> ✓ | <u>(5,219)</u> ✓ | <u>329,200</u> ✓ |
| | <u>1,439,522</u> ✓ | <u>1,288,440</u> ✓ | <u>(5,219)</u> ✓ | <u>329,200</u> ✓ |
| Total liabilities and fund balance | <u>\$ 1,625,955</u> ✓ | <u>\$ 1,288,440</u> ✓ | <u>\$ 10,837</u> ✓ | <u>\$ 325,464</u> ✓ |

| <u>2010 Joint Resolutions Fund</u> | <u>Joint Resolutions Fund</u> | <u>Total Capital Projects</u> | <u>Total Other Governmental Funds</u> |
|------------------------------------|-------------------------------|-------------------------------|---------------------------------------|
| \$ <u>891,218</u> ✓ | \$ <u>5,147,290</u> / | \$ <u>7,663,249</u> / | \$ <u>9,289,204</u> X |
| \$ - | \$ 107,385 / | \$ 119,705 / | \$ 298,802 / |
| - | - | - | 7,336 / |
| - | 107,385 / | 119,705 / | 306,138 X |
| - | - | - | 1,439,522 X |
| <u>891,218</u> ✓ | <u>5,039,905</u> / | <u>7,543,544</u> / | <u>7,543,544</u> , |
| <u>891,218</u> / | <u>5,039,905</u> / | <u>7,543,544</u> / | <u>8,983,066</u> X |
| \$ <u>891,218</u> / | \$ <u>5,147,290</u> / | \$ <u>7,663,249</u> / | \$ <u>9,289,204</u> X |

OFFICE FOR THE IMPROVEMENTS OF PUBLIC SCHOOLS
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COMBINING STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND
BALANCE
YEAR ENDED JUNE 30, 2011

Capital Project Funds

| | Capital Project Funds | | | | |
|--|-------------------------------|--|------------------------|---------------------|---------------------|
| | Various Special Revenue Funds | Extraordinary Improvements Interest Fund | School Renovation Fund | \$29 M Project Fund | \$7 M Project Fund |
| Revenues | | | | | |
| Appropriations | | \$ - | \$ - | \$ - | \$ - |
| Interest Income | 2,188 ✓ | 24 ✓ | - | - | 363 ✓ |
| Other Income | 164,545 ✓ | - | - | 25,422 ✓ | - |
| Total revenues | 166,733 ✓ | 24 ✓ | - | 25,422 ✓ | 363 ✓ |
| Expenditures | | | | | |
| Current | | | | | |
| Payroll and related costs | 25,774 ✓ | - | - | - | - |
| Purchased services | - | - | - | - | 470 ✓ |
| Professional services | 452,595 ✓ | - | - | - | - |
| Advertising | 2,884 ✓ | - | - | - | - |
| Others | 16 ✓ | - | - | - | - |
| Bad debt expense | - | - | - | - | - |
| Maintenance, construction and improvements of public schools | 785,733 ✓ | 94,261 ✓ | 234,917 ✓ | 16,055 ✓ | 23,107 ✓ |
| Total expenditures | 1,267,002 ✓ | 94,261 ✓ | 234,917 ✓ | 16,055 ✓ | 23,577 ✓ |
| Excess (deficit) of revenues over expenditures | (1,100,269) ✓ | (94,237) ✓ | (234,917) ✓ | 9,367 ✓ | (23,214) ✓ |
| Other financing uses: | | | | | |
| Transfer in | 4,500 ✓ | - | - | - | - |
| Transfer out | - | (12,101) ✓ | - | - | - |
| | 4,500 ✓ | (12,101) ✓ | - | - | - |
| Net changes in fund balance | (1,095,769) ✓ | (106,338) ✓ | (234,917) ✓ | 9,367 ✓ | (23,214) ✓ |
| Fund balance beginning | 2,535,292 ✓ | 106,339 ✓ | 1,523,357 ✓ | (14,586) ✓ | 352,415 ✓ |
| Fund balance ending | \$ 1,439,523 ✓ | \$ 1 ✓ | \$ 1,288,440 ✓ | \$ (5,219) ✓ | \$ 329,201 ✓ |

See notes to the financial statements.

Capital Project Funds

| <u>2010 Joint Resolutions Fund</u> | <u>Joint Resolutions Fund</u> | <u>Total Capital Projects Fund</u> | <u>Total Other Governmental Funds</u> |
|------------------------------------|-------------------------------|------------------------------------|---------------------------------------|
| \$ - | \$ 1,958,927 ✓ | \$ 1,958,927 ✓ | \$ 1,958,927 ✗ |
| 890 ✓ | 4,190 ✓ | 5,467 ✓ | 7,655 ✗ |
| - | - | 25,422 ✓ | 189,967 ✗ |
| <u>890</u> | <u>1,963,117</u> ✓ | <u>1,989,816</u> | <u>2,156,549</u> ✗ |
| - | - | - | 25,774 ✗ |
| - | - | 470 ✓ | 470 ✗ |
| - | - | - | 452,595 ✗ |
| - | - | - | 2,884 ✗ |
| - | 6 ✓ | 6 ✓ | 22 ✗ |
| - | - | - | - |
| - | <u>967,235</u> ✓ | <u>1,335,575</u> ✓ | <u>2,121,308</u> ✗ |
| - | <u>967,241</u> ✓ | <u>1,336,051</u> ✓ | <u>2,603,053</u> ✗ |
| 890 | <u>995,876</u> ✓ | <u>653,765</u> ✓ | <u>(446,504)</u> ✗ |
| - | 22,942 ✓ | 22,942 ✓ | 27,442 ✗ |
| - | - | (12,101) ✓ | (12,101) ✗ |
| - | <u>22,942</u> ✓ | <u>10,841</u> ✓ | <u>15,341</u> ✗ |
| 890 ✓ | <u>1,018,818</u> ✓ | <u>664,606</u> ✓ | <u>(431,163)</u> ✗ |
| <u>890,327</u> ✓ | <u>4,021,085</u> ✓ | <u>6,878,937</u> ✓ | <u>9,414,229</u> ✗ |
| <u>\$ 891,217</u> ✓ | <u>\$ 5,039,903</u> ✓ | <u>\$ 7,543,543</u> ✓ | <u>\$ 8,983,066</u> ✗ |

OFFICE FOR THE IMPROVEMENTS OF PUBLIC SCHOOLS
(A Component Unit of the Commonwealth of Puerto Rico's Department of Education)
SCHEDULE OF EXPENDITURES OF FEDERAL AWARD
FOR THE YEAR ENDED JUNE 30, 2011

| <u>Federal Grantor/Program Title</u> | <u>Federal CFDA Number</u> | <u>Federal Expenditures</u> |
|--|----------------------------|-----------------------------|
| Pass through from the Commonwealth of Puerto Rico Infrastructure Financing Authority (PRIFA) State Fiscal Stabilization Fund, Government Services, Recovery Act | 84.397 | \$ <u>1,671,459</u> ✓ |

See notes to Schedule of Expenditures of Federal Awards.

OFFICE FOR THE IMPROVEMENTS OF PUBLIC SCHOOLS
(A Component Unit of the Commonwealth of Puerto Rico's Department of Education)
NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARD
FOR THE YEAR ENDED JUNE 30, 2011

BASIS OF PRESENTATION

The accompanying schedule of expenditures of federal awards (Schedule) includes the federal grant activity of the Office for the Improvements of Public Schools (OMEP), and is presented in accordance with the requirements of OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements. OMEP's government-wide financial statements are reported using the *economic resources measurement focus* and the *accrual basis of accounting*, which conform to accounting principles generally accepted in the United States of America ("GAAP") as applicable to governmental units. The accounts of OMEP are presented on the basis of funds, each of which is considered a separate accounting entity. The operations of each fund are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues and expenditures. Government resources are allocated to and accounted for by individual funds based upon the purposes for which they are to be spent and the means by which spending activities are controlled.

FEDERAL CATALOG OF FEDERAL DOMESTIC ASSISTANCE (CFDA) NUMBER

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

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

Honorable Jesús Rivera
Office for the Improvements of Public Schools
San Juan, Puerto Rico

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the Office for the Improvements of Public Schools (OMEP) (a component unit of the Commonwealth of Puerto Rico's Department of Education) for the year ended June 30, 2011, which collectively comprise the OMEP's basic financial statements and have issued our report thereon dated _____. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies, or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying schedule of findings and questioned costs, we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses and other deficiencies that we consider to be significant deficiencies.

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. We consider the deficiencies described in items 11-01, 11-02, and 11-04 in the accompanying schedule of findings and questioned costs to be material weaknesses.

A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiency described in item 11-03 in the accompanying schedule of findings and questioned costs to be a significant deficiency.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether OMEP's financial statement are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

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

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to the original of this report

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

Honorable Jesús Rivera
Office for the Improvements of Public Schools
San Juan, Puerto Rico

Compliance

We have audited the compliance of the Office for the Improvements of Public Schools (OMEP) with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that could have a direct and material effect to each of its major federal programs for the year ended June 30, 2011. OMEP'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 OMEP's management. Our responsibility is to express an opinion on OMEP'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 OMEP'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 OMEP's compliance with those requirements.

In our opinion, OMEP complied, in all material respects, with the compliance requirement referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2011.

Internal Control Over Compliance

The management of OMEP 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 OMEP's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, and to test and report on 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 OMEP'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.

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

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

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OFFICE FOR THE IMPROVEMENTS OF PUBLIC SCHOOLS
(A Component Unit of the Commonwealth of Puerto Rico's Department of Education)
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
YEAR ENDED JUNE 30, 2011

Part I - Summary of Auditors' Results

Financial Statements

- Type of auditors' report issued: **Qualified**
- Internal control over financial reporting:
- Material weakness (es) identified? **X** Yes ___ No
- Significant deficiency (ies) identified that are not considered to be material weaknesses? **X** Yes ___ No
- Noncompliance material to financial statements noted? **X** Yes ___ No

Federal Awards

- Type of auditors' report issued on compliance for major programs: **Unqualified**
- Internal control over major programs:
- Material weakness (es) identified? ___ Yes **X** No
- Significant deficiency (ies) identified that are not considered to be material weaknesses? ___ Yes **X** No
- Any audit findings disclosed that are required to be reported in accordance with section 510(a) of OMB Circular A-133? ___ Yes **X** No
- Identification of major programs:

CFDA

Number (s) Federal Program Grantor and Program Name US Department of Education

84.397 State Fiscal Stabilization Fund, Government Services, Recovery Act

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

OFFICE FOR THE IMPROVEMENTS OF PUBLIC SCHOOLS
(A Component Unit of the Commonwealth of Puerto Rico's Department of Education)
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
YEAR ENDED JUNE 30, 2011

Part II - Financial Statement Findings Section

11-01 Accounting - Internal Control

Criteria

Act No. 230 of July 23, 1974, as amended, known as the "Commonwealth of Puerto Rico Accounting Law", establishes in Article 2b that the accounting should clearly reflect the results of the financial operations, provide the financial information necessary for the administration of the governmental operations and the budget management and constitute effective control over revenues, disbursements, funds, property and other assets of government.

Condition

There are no formal monthly closing procedures. Inactive and/or unnecessary funds and accounts are not closed. OMEP is maintaining funds and accounts that have been inactive for a long period. The accounting records include various funds and accounts, many of which have been inactive or had insignificant operations during the year ended June 30, 2011.

Cause

This situation occurs because OMEP has not properly analyzed and closed inactive funds as well as the related bank accounts when the funds' objectives have been achieved or are no longer of relevance.

Effects

The continued use of these funds and accounts exposes OMEP to the unauthorized use of funds from inactive accounts for activities not intended to be financed with these funds. The accounting department could not issue accurate and timely interim financial statements, in order for management to make adequately administrative and financial decisions.

Recommendation

OMEP should determine whether the intended objectives of these funds were met. OMEP should close all funds that have complied with the requirements. Remaining balances in those funds should be investigated and properly transferred in accordance with local and Federal regulations. OMEP should perform monthly closings in order from management to be able to perform adequate decision making.

OFFICE FOR THE IMPROVEMENTS OF PUBLIC SCHOOLS
(A Component Unit of the Commonwealth of Puerto Rico's Department of Education)
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
YEAR ENDED JUNE 30, 2011

11-01 Accounting - Internal Control - Continued

Views of Responsible Officials

Management agrees.

11-02 - Property management – Accounting records and financial reporting

Criteria

Act No. 230 of July 23, 1974, as amended, known as the "Commonwealth of Puerto Rico Accounting Law", establishes in Article 2b that the accounting should clearly reflect the results of the financial operations, provide the financial information necessary for the administration of the governmental operations and the budget management and constitute effective control over revenues, disbursements, funds, property and other assets of government.

Condition

OMEP's property records are not properly maintained and are not segregated by fund because it does not reconcile the vehicles inventory with the vehicle licenses records.

Cause

The Accounting Department has not enforced the requirement for the regions that property inventory performed should ensure the proper accountability of assets.

Effects

There is a significant risk of unauthorized use or disposition because there are no controls to ensure proper asset management by region. This inadequate property control may expose OMEP to misleading financial statement information and presentation.

Recommendation

A physical inventory of OMEP's property should be performed as soon as possible for all departments and all differences should be investigated, adjusted and reconciled with the property recorded on the subsidiary ledgers.

OFFICE FOR THE IMPROVEMENTS OF PUBLIC SCHOOLS
(A Component Unit of the Commonwealth of Puerto Rico's Department of Education)
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
YEAR ENDED JUNE 30, 2011

11-02 - Property management – Accounting records and financial reporting - Continued

Views of Responsible Officials

Management agrees.

11-03 Financial Management — Accounting System and Reporting Practices

Criteria

Act No. 230 of July 23, 1974, as amended, known as the "Commonwealth of Puerto Rico Accounting Law", establishes in Article 4e that the accounting system establish or authorized by the Secretary (Treasury Department) should be design in such way that they reflect and provide the following: (1) Complete information over the results of operations of the agencies or entities; (2) proper financial information, necessary for the administration of the agencies; (3) effectiveness over the controls and accounting of all funds, property, and assets pertaining to the agencies or entities; (4) reliable reports that serve as the basis for the preparation and justification of the budgetary needs of the agencies and entities to control the budget, and any other financial information required by the Bureau of Budget and Planning Board to the agencies or entities; and, (5) appropriate coordination between the accounts of each agency and the central accounting that the Secretary requires under this law.

Condition

The accounting records are kept in an accounting system but monthly financial statements are not prepared.

Cause

The Office for the Improvements of Public School accounting system does not properly disclose the financial records of assets and liabilities.

Effects

The Office for the Improvement of Public Schools does not have a complete monthly financial report that could affect the decision making process.

Recommendation

The Office for the Improvement of Public Schools needs to improve its accounting system in order to provide complete financial information and reporting.

OFFICE FOR THE IMPROVEMENTS OF PUBLIC SCHOOLS
(A Component Unit of the Commonwealth of Puerto Rico's Department of Education)
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
YEAR ENDED JUNE 30, 2011

11-03 Financial Management — Accounting System and Reporting Practices - Continued

Questioned costs

None

Views of Responsible Officials

Management agrees.

11-04 Internal control on inventory

Criteria

Act No. 230 of July 23, 1974, as amended, known as the "Commonwealth of Puerto Rico Accounting Law", establishes in Article 2b that the accounting should clearly reflect the results of the financial operations, provide the financial information necessary for the administration of the governmental operations and the budget management and constitute effective control over revenues, disbursements, funds, property and other assets of government.

Condition

The accounting records are kept in an accounting system, but perpetual inventory records over inventory are not maintained. The inventory is not verified and reconciled on a timely basis.

Cause

The Office for the Improvements of Public School accounting system does not properly disclose the financial records of assets and liabilities.

Effects

The Office for the Improvement of Public Schools does not have a proper internal control over inventory and monthly financial report does not reflect the usage over inventory. Incomplete accounting data could affect the decision making process.

Recommendation

The Office for the Improvement of Public Schools needs to improve its accounting system in order to provide complete financial information and reporting.

OFFICE FOR THE IMPROVEMENTS OF PUBLIC SCHOOLS
(A Component Unit of the Commonwealth of Puerto Rico's Department of Education)
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
YEAR ENDED JUNE 30, 2011

11-04 Internal control on inventory - Continued

Questioned costs

None

Views of Responsible Officials

Management agrees.

Part III – Findings on Compliance with requirements applicable to the major program and on internal control over compliance in accordance with OMB Circular A-133.

None